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SEC Reporting Skills Workshop

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Pay-versus-Performance Rule: Updates for Year 2

Roadmap

- Recap-Overview of Pay vs. Performance Rules
- 2023 Developments / Looking into 2024
  - 2023 disclosure trends
  - Proxy advisor policies
  - Compliance & Disclosure Interpretations (C&DIs)
  - SEC staff comments, ABA meeting and other potential 2024 focus items
- Frequently Asked Questions
- Key Takeaways

Recap-Overview

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PvP Disclosure Elements

- **Table** – disclose specified executive compensation and company financial performance measures for 5 most recently completed fiscal years (phased in – details on next slide)
  - Make prescribed adjustments to prior Summary Compensation Table total to determine "Compensation Actually Paid"
    - Adjusting for equity award value under PvP rules requires multi-step calculations
- **Relationship disclosures** – clear graphical and/or narrative description of:
  - Relationships between each financial performance measure included in table and executive compensation actually paid
  - Relationship between the company TSR and peer group TSR
- **Tabular list** – unranked list of most important 3 to 7 financial performance measures used to link executive compensation actually paid to NEOs during the last fiscal year to the company's performance
  - May, but need not, include non-financial measures in certain circumstances

May voluntarily provide supplemental disclosures so long as clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure

Table

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
					Value of Initial Fixed $100 Investment Based On:			
Year (1)	Summary Compensation Table Total for PEO	Compensation Actually Paid to PEO (2)	Average Summary Compensation Table Total for Non-PEO NEOs	Average Compensation Actually Paid to Non-PEO NEOs (2)	Total Shareholder Return (3)	Peer Group (4) Total Shareholder Return [Not required for SRC]	Net Income	[Company-Selected Measure] (5) [Not required for SRC]
Y1								
Y2								
Y3								
Y4								
Y5								

1) Disclosure will be phased in, with disclosure for year 2 covering the past four fiscal years and increasing each year until the past five fiscal years are covered (Three / three for SRCs)
2) Compensation actually paid is total compensation reported in the SCT, with adjustments to amounts disclosed for equity awards and pension benefits
3) TSR calculated on a cumulative basis, measured from the market close on the last trading day before the company's earliest fiscal year in the table through and including the end of the fiscal year for which TSR is being calculated (i.e., the TSR for the first year in the table will represent the TSR over that first year, the TSR for the second year will represent the cumulative TSR over the first and second years, and so on); same methodology used for performance graph
4) Must use same peer group or published industry or line-of-business index used for purposes of Item 201(e) of Reg. S-K or a peer group used in the CD&A for purposes of disclosing compensation benchmarking practices
5) The title of this column will be replaced with the name of the company-selected measure, and this column will include the numerically quantifiable performance of the company under such measure for each covered fiscal year (e.g., if the company-selected measure for the most recent fiscal year was total revenue, the column would be titled "Total Revenue" and the company would disclose its quantified total revenue performance in each covered fiscal year

Year 2 Reminders – Disclosure Considerations

- Companies should disclose material changes in assumptions when valuing equity awards to calculate ‘Compensation Actually Paid”
- Companies may limit reconciliation tables to the most recently completed fiscal year following their initial table
- Companies may specifically designate only one financial performance measure as the “company-selected measure”
- The date when a performance-based vesting condition is considered satisfied depends on specific facts and circumstances
- Covered in November 2023 C&DIs (discussed in later section below)
  - Guidance / clarification re: peer group changes
  - Multiple same-position NEOs in one FY
  - SRC/EGC status loss scenarios

Year 2 Reminders – Market & Regulatory Context

- **Transitional phase-in steps up**
  - Inaugural 2023 disclosure required to cover 3 past fiscal years (2 for SRCs)
  - **In 2024, this will increase to 4 years (3 for SRCs)**
  - In 2025, 5 years for non-SRCs and 3 years for SRCs
  - For newly public companies, phases in 1 year at a time
- **Keep an eye out for relevant developments**
  - November 21, 2023 C&DIs and SEC comments to 2023 PvP disclosure (covered in later section below) may be relevant to 2024 disclosure
  - ISS and Glass Lewis 2024 policy updates minimal (also covered later) but 2025 additions possible
- **Monitor macroeconomic & third party factors that could affect PvP disclosure / scrutiny**
  - Be aware of market movement effect on required disclosure and consider supplemental explanatory disclosure if appropriate
    - e.g. 2023 bull market may increase reportable CAP
  - Be prepared to address activist shareholder use of relationship disclosure that appears to show negative or no relationship between CAP and NI
- **Consider whether supplemental disclosure should be made in CD&A (expanded pay-for-performance discussion)**
  - Compensation Committee certification may be a factor based on proxy organization

2023 Disclosure Trends

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Lessons learned from Year 1

- Wide variation in disclosure format, substantive compliance in some areas
  - Many companies noted SEC-prescribed net income disclosure not pivotal in incentive compensation design
  - Many companies cross-referenced CD&A for pay-for-performance context
  - SEC Staff has been issuing some detailed comments on initial 2023 disclosures
- SEC Staff provided additional interpretive guidance in Sept. and Nov. 2023
- Proxy advisory firms & institutional shareholders' positions / policies on PvP disclosure remain minimal or unformulated

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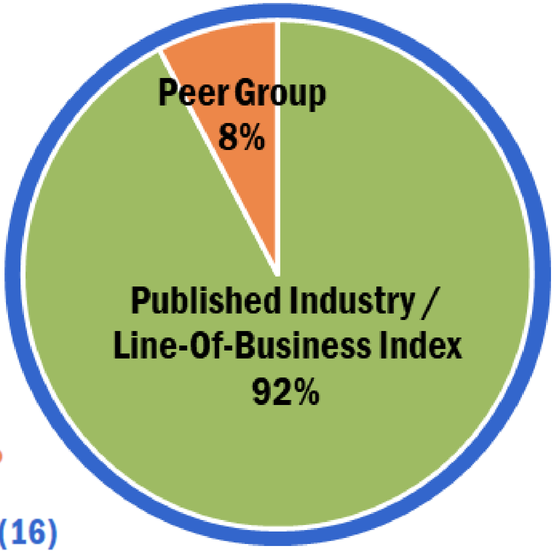
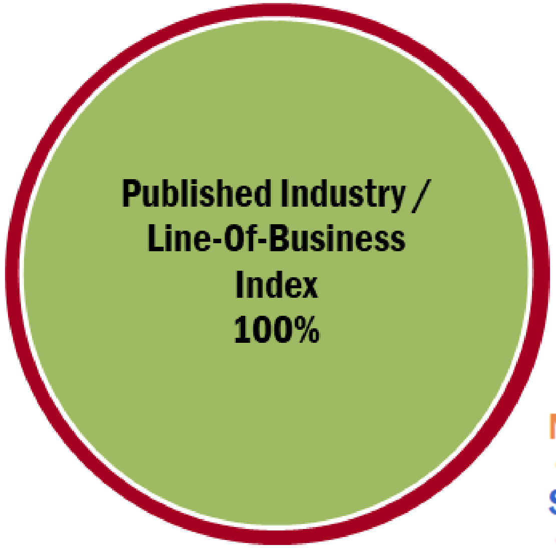
Pay Versus Performance
Peer Groups Selected for Total Shareholder Return Comparison*

*Results of Review of Compensia Client Disclosure through June 30, 2023

Peer Group TSR Comparison
Tech



Peer Group TSR Comparison
Life Sciences



Top 5 Tech Indices

- S&P 500 IT Index (31)
- Philadelphia Semiconductor Index (16)
- Nasdaq Telecommunications Index (7)
- Nasdaq Computer Index (5)
- S&P SW & Services Select Index (4)

Top 5 Life Sciences Indices

- Nasdaq Biotechnology Index (16)
- S&P Health Care Services Select Industry Index (3)
- NASDAQ Health Care Index (3)
- NASDAQ Medical Equipment Index (3)
- S&P Healthcare Equipment Select Industry Index (3)

Pay Versus Performance
Most Common Company-Selected Measure*

*Results of Review of Compensia Client Disclosure through June 30, 2023

Top 5 Tech CSMs

Revenue (58)

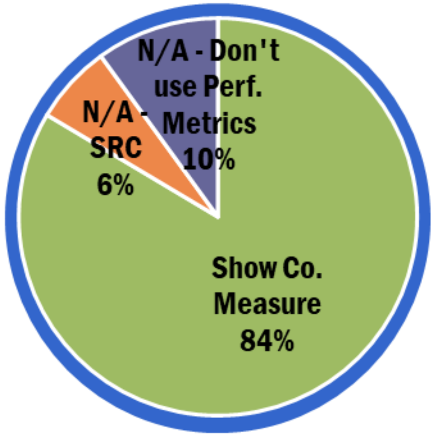
Adjusted EBITDA (18)

Income (5)

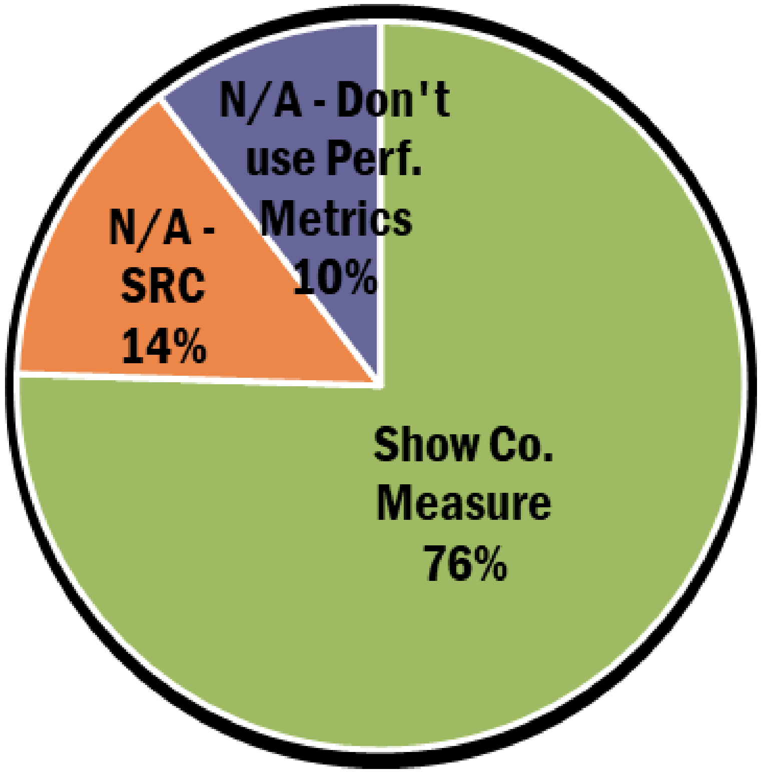
Profit (5)

Relative TSR (4)

Company Selected Measures
Tech



Company Selected Measures



Top 4 Life Sciences CSMs

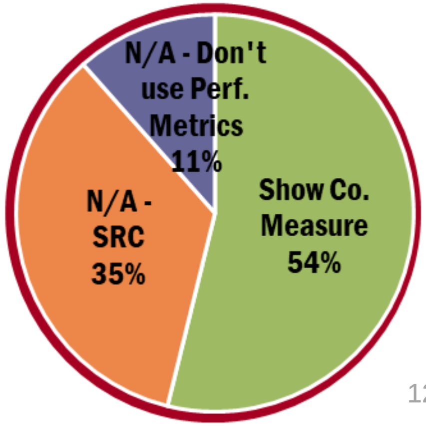
Revenue (15)

Adjusted EBITDA (2)

Income (2)

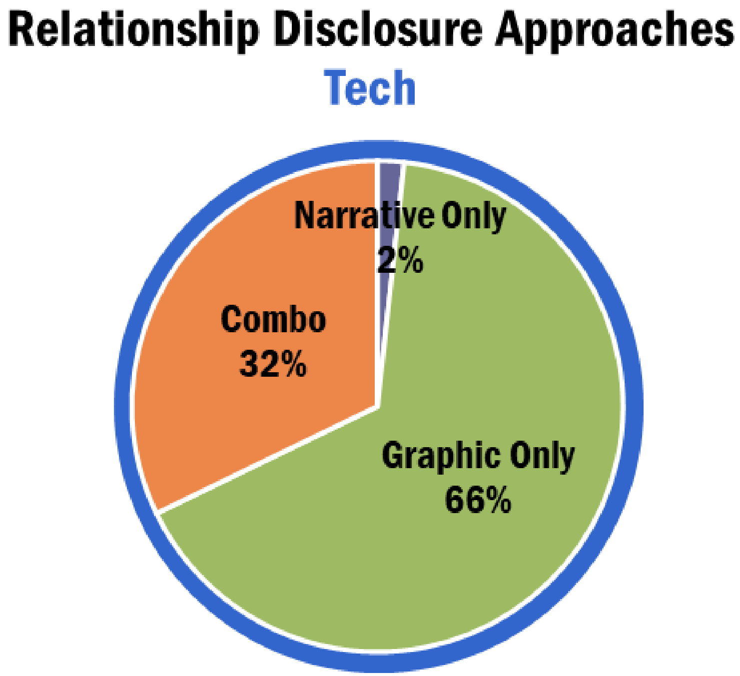
Earnings-per-share (2)

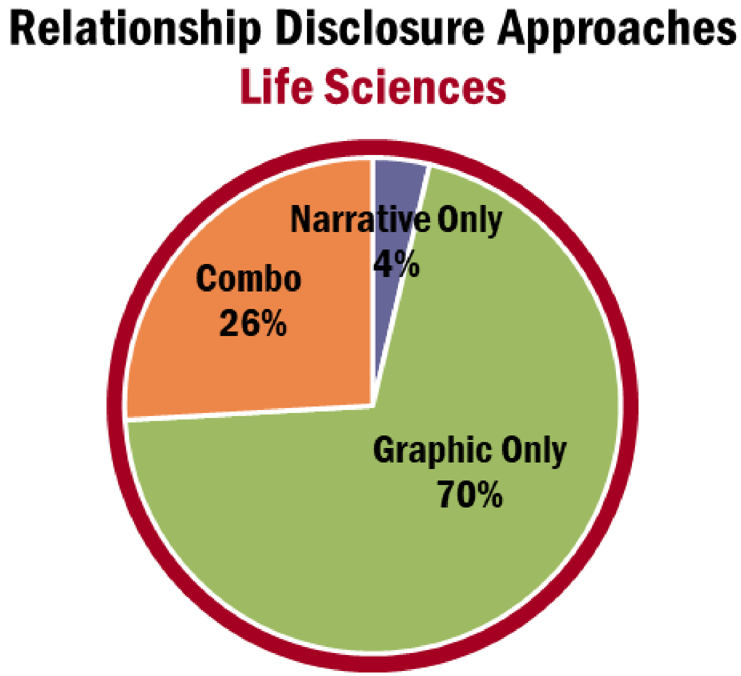
Company Selected Measures
Life Sciences



Pay Versus Performance
Form of Relationship Disclosure*

*Results of Review of Compensia Client Disclosure through June 30, 2023





Note: Clients whose only narrative disclosure is describing the contents of the graphic are considered as "Graphic Only" for purposes of these calculations.

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Proxy Advisor Policies

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ISS 2024 Policies (US)

- In a departure from prior years & 2024 expectations, ISS released only one compensation-related policy update relating to executive severance
- ISS policy on Pay vs. Performance disclosure remains unformulated but this may change in 2025

Glass Lewis 2024 Policies (US)

- Glass Lewis released several compensation-related policy updates
- In 2024, GL may use Pay vs Performance disclosures -- specifically, the “compensation actually paid” data -- as part of its supplemental quantitative assessments supporting its primary pay-for-performance grade
- Scope is very limited, but may be expanded / accompanied by additional PvP-related policy updates in future years

Compliance & Disclosure Interpretations

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Latest C&DI updates (Nov. 21, 2023)

- Peer group change requires disclosure of change and TSR should be reported using the peer group applicable to that disclosure year
- If retirement eligibility not sole vesting condition, other factors must be considered in determining whether award vested
- Dividends must be reported separately if not included in award fair value
- If more than one 10-K TSR index, can choose one for PvP reporting with footnote. If changed, must explain change rationale
- Broad-based equity index can only be used if used for 10-K or 402(b) disclosure

Latest C&DI updates (Nov. 21, 2023)

- Peer group component company change requires comparison of pre- and post-change comparative TSR unless:
  - Component company no longer in applicable line of business/industry or index/peer group based on the application of pre-established objective criteria, in which case no comparison is required but the change must be disclosed in a footnote
- Company that loses SRC status must file non-scaled disclosure if proxy filed more than 120 days after its 2023 fiscal year end
- Company that loses EGC status must file PvP disclosure with years covered based on transition phase-in rules
- If more than one individual served in a particular NEO position during a fiscal year, CAP must be calculated for each – can't aggregate to equal one FY NEO

Prior C&DI reminders

- Include awards granted in fiscal years prior to an equity restructuring (such as a spin-off)
- Equity award valuations for periods prior to date company required to provide Item 402(v) pay-vs-performance disclosures must be valued based on fair value of awards as of end of prior fiscal year for purposes of calculating compensation actually paid (not as of the IPO date)
- Need to consider whether certification is a substantive vesting condition for performance-based awards
  - Consider whether the employee must provide services through certification

SEC Staff Comments and Potential 2024 Focus Items

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SEC Comments on Initial PvP Disclosures

- **Company-Selected Measures**
  - More than one included
  - CSM not included in the Tabular List
  - Non-GAAP Company-Selected Measure and disclosure of how calculated from the financial statements
- **Reconciliation of SCT to CAP**
  - Do not show aggregate amount for equity/pension adjustments—must disclose each amount deducted/added
  - Do not describe change in value of equity awards granted in prior years that vested during the relevant fiscal year as "year-over-year" or "period-over-period" changes
- **Other Technical Compliance/Labeling Issues**
  - Wrong peer group index used from stock performance graph (e.g., broad equity index used)
  - Not naming the non-PEOs and the fiscal years included in the average non-PEO NEO compensation column
  - Not using Net Income as reported in GAAP financials (e.g., using net income attributable to the company or income (loss) from continuing operations)
  - No relationship disclosures or missing relationship disclosures

ABA Meeting Notes

- **Relationship Disclosure** – Room for improvement – graphs need to be understandable
  - Need to coordinate with information in Compensation Discussion and Analysis
- **Peer Group TSR** – Use of appropriate peer group; primarily selected index from stock performance graph
- **Non-GAAP Financial Measures** – No need to provide reconciliation, but do need to describe calculation methodology
- **Tabular List** – Must include Company-Selected Measure
- **Coordination with CD&A** – Company-Selected Measure and Tabular List should be consistent with discussion in Compensation Discussion and Analysis
- **XBRL** – Need to make sure tagging is accurate
- SEC Staff not (currently) planning to issue additional guidance and/or comment letters before 2024 proxy season

Frequently Asked Questions

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FAQs – Year 2 changes

- What disclosure if peer group changes?
  - See C&DI 128D.07 – disclose change, use new peer group for year in which used, keep prior peer group for years previously used
- What if we change our company-selected metric (CSM)?
  - CSM for most recently disclosed year must be applied to prior years (i.e. one column using newest CSM for all covered disclosure years)
- What if we become subject to PvP disclosure requirements for the first time this year?
  - Disclosure can be phased in based on Instructions 1 and 2 to S-K 402(v)
- Do we have to include footnotes for all years covered by the table?
  - Per C&DI 128D.03, required for most recent fiscal year

FAQs – Specific situations

- What if we have two PEOs?
  - CAP calculated for each per C&DI 128D.30 and presented separately per S-K 402(v)(2)(ii)
- We don’t have a CSM, what do we need to disclose?
  - Many 2023 disclosers without a CSM noted the basis (e.g. no FPMs used to determine compensation, only PvP table FPMs used, company is SRC)
- Do we need to provide supplemental narrative disclosure?
  - Carefully consider clarification value added vs. potential to obscure/confuse
- The company’s filing status has changed—will that impact our disclosure
  - Yes, and timing matters

Key Takeaways

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Appendix

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High-Level Overview

- **<u>Why</u> did the SEC adopt these rules?** The Dodd-Frank Act (adopted in 2010) required the SEC to adopt rules requiring issuers to show the relationship between executive compensation actually paid and the financial performance of the issuer
- **<u>What</u> is the disclosure?** Tabular <u>and</u> narrative/graphical disclosure focused on the relationship between compensation actually paid to NEOs and financial performance measures; must be tagged using Inline XBRL tagging requirements
- **<u>Who</u> is required to comply with the disclosure rules?** Public companies that are not emerging growth companies, foreign private issuers or registered investment companies (scaled disclosure for smaller reporting companies (SRCs))
- **<u>Where</u> is the new disclosure required?** Rule provides flexibility re where in proxy to include disclosure; not required in CD&A; likely to follow the executive compensation tables

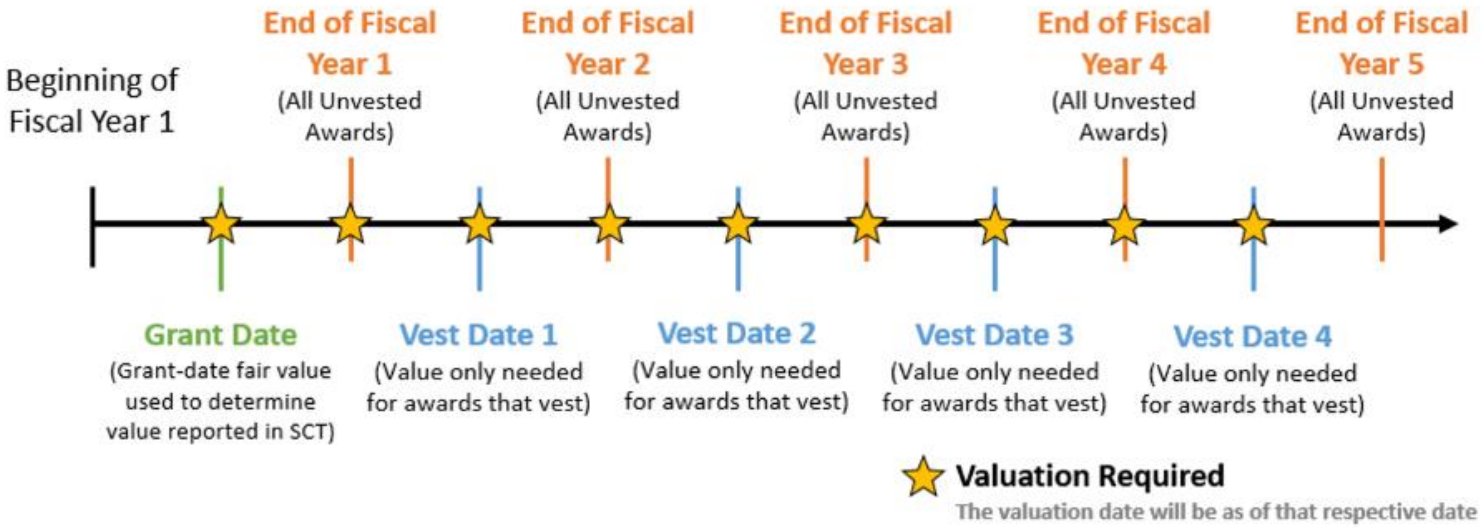
Key Terms & Definitions

- **Compensation actually paid (CAP)** – total compensation reported in the Summary Compensation Table, with adjustments to amounts disclosed for equity awards and pension benefits
- **Company-selected measure** – represents, in the company's own assessment, the most important financial performance measure (that is not otherwise required to be disclosed in the table) used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year
- **Financial performance measures** – measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return
- **Non-financial performance measures** – performance measures other than those that fall within the definition of financial performance measures
- **Performance graph** – the issuer's stock performance graph, which is required to be included in the annual report to security holders pursuant to Item 201(e) of Reg. S-K

Valuations Over the Life of an RSU Award to a Single PEO

(from Equity Methods blog entitled “Pay Versus Performance Is Here, Part 2: Understanding Compensation Actually Paid”)

- The graphic below is for a scenario with one PEO and no PEO turnover during the life of the award and pay-versus-performance table where one RSU vests in four annual installments
- RSU will be in the pay-versus-performance table for four years; will fluctuate in value each year until it vests or is forfeited
- Requires nine valuations over the life of the RSU



Latest C&DI Updates

Question 128D.07

Question: In each of 2020 and 2021, a registrant provided the same list of companies as a peer group in its Compensation Discussion & Analysis ("CD&A") under Item 402(b) but provided a different list of companies in its CD&A for 2022. With respect to a registrant providing initial Pay versus Performance disclosure in its 2023 proxy statement for three years (as permitted by Instruction 1 to Item 402(v) of Regulation S-K), may the registrant present the peer group total shareholder return for each of the three years using the 2022 peer group?

Answer: No. In this situation, the registrant should present the peer group total shareholder return for each year in the table using the peer group disclosed in its CD&A for such year. In the 2024 proxy statement, if the registrant uses the same peer group for 2023 as it used for 2022, the registrant should present its peer group total shareholder return for each of the years in the table using the 2023 peer group. If it changes the peer group in subsequent years, it must provide disclosure of the change in accordance with Regulation S-K Item 402(v)(2)(iv). [November 21, 2023]

Latest C&DI Updates

Question 128D.18

Question: Some stock and option awards allow for accelerated vesting if the holder of such awards becomes retirement eligible. If retirement eligibility was the sole vesting condition, would this condition be considered satisfied for purposes of the Item 402(v) of Regulation S-K disclosures and calculation of executive compensation actually paid in the year that the holder becomes retirement eligible?

Answer: Yes. However, if retirement eligibility is not the sole vesting condition, other substantive conditions must also be considered in determining when an award has vested. Such conditions would include, but not be limited to, a market condition as described in Question 128D.16 or a condition that results in vesting upon the earlier of the holder’s actual retirement or the satisfaction of the requisite service period. [November 21, 2023]

Latest C&DI Updates

Question 128D.23

Question: Some stock awards entitle the holder to receive dividends or dividend equivalents paid on the underlying shares prior to the vesting date. If the dollar value of dividends or dividend equivalents paid are not reflected in the fair value of such awards, should they be included in the calculation of executive compensation actually paid?

Answer: Yes. Item 402(v)(2)(iii)(C)(1)(vi) of Regulation S-K requires the calculation of executive compensation actually paid to include dividends or dividend equivalents paid that are not already reflected in the fair value of stock awards or included in another component of total compensation. [November 21, 2023]

Question 128D.24

Question: When identifying a total shareholder return peer group under Regulation S-K Item 402(v)(2)(iv), the registrant must use either the same index or issuers used by it to comply with Item 201(e)(1)(ii) or the companies it uses as a peer group under Regulation S-K Item 402(b). If a registrant uses more than one "published industry or line-of-business" index for purposes of Item 201(e)(1)(ii), may a registrant choose which index it uses for purposes of its pay versus performance disclosure?

Answer: Yes. In order to provide clarity to investors, the registrant should include a footnote disclosing the index chosen. If the registrant chooses to use a different published industry or line-of-business index from that used by it for the immediately preceding fiscal year, it is required under Item 402(v)(2)(iv) to explain, in a footnote, the reason(s) for this change and compare the registrant's cumulative total return with that of both the newly selected peer group and the peer group used in the immediately preceding fiscal year. [November 21, 2023]

Latest C&DI Updates

Question 128D.25

Question: For purposes of determining the total shareholder return of a registrant's peer group under Regulation S-K Item 402(v)(2)(iv), the registrant must use the same index or issuers used by it for purposes of Item 201(e)(1)(ii) or the companies it uses as a peer group for purposes of its disclosures under Item 402(b). If registrant discloses in its Compensation Discussion & Analysis that it determines the vesting of performance-based equity awards based on relative TSR compared to a broad-based equity index, can the registrant use that broad-based index as its peer group for purposes of Item 402(v)(2)(iv)?

Answer: No. Item 402(v)(2)(iv) does not contemplate the use of a broad-based equity index as a peer group for purposes of the pay versus performance disclosure. [November 21, 2023]

Question 128D.26

Question: Pursuant to Regulation S-K Item 402(v)(2)(iv), if the registrant's peer group is not a published industry or line-of-business index, the identity of the issuers composing the group must be disclosed in a footnote. The returns of each component issuer of the group must be weighted according to the respective issuers' stock market capitalization at the beginning of each period for which a return is indicated. In what circumstances is such market capitalization-based weighting required?

Answer: For purposes of Item 402(v)(2)(iv), the weighting requirement is applicable only if the registrant is not using a published industry or line-of-business index pursuant to Item 201(e)(1)(ii). [November 21, 2023]

Latest C&DI Updates

Question 128D.27

Question: If a registrant that uses a peer group other than a published industry or line-of-business index as its peer group under Regulation S-K Item 402(v)(2)(iv) adds or removes any of the companies in the peer group, is it required to footnote the change(s) and compare its cumulative total shareholder return with that of both the updated peer group and the peer group used in the immediately preceding fiscal year?

Answer: Yes. However, consistent with Regulation S-K Compliance and Disclosure Interpretations Question 206.05, comparison of the registrant's cumulative total return with that of both the newly selected peer group and the peer group used in the immediately preceding fiscal year is not required if (1) an entity is omitted solely because it is no longer in the line of business or industry, or (2) the changes in the composition of the index/peer group are the result of the application of pre-established objective criteria. In these two cases, a specific description of, and the bases for, the change must be disclosed, including the names of the companies deleted from the new index/peer group. [November 21, 2023]

Latest C&DI Updates

Question 128D.28

Question: A smaller reporting company (SRC) with a December 31 fiscal year end provided scaled pay versus performance disclosure covering fiscal years 2021 and 2022 in its proxy statement filed in April 2023. It subsequently loses its SRC status based on its public float as of June 30, 2023. The registrant proposes to rely on General Instruction G(3) of Form 10-K to incorporate by reference executive compensation and other disclosure required by Part III of Form 10-K into its 2023 Form 10-K from its definitive proxy or information statement to be filed not later than 120 days after its 2023 fiscal year end. What pay versus performance information is the registrant required to include in such proxy or information statement?

Answer: The staff will not object if a registrant that loses SRC status as of January 1, 2024, continues to include scaled disclosure under Regulation S-K Item 402(v)(8) in its definitive proxy or information statement filed not later than 120 days after its 2023 fiscal year end from which the registrant's Form 10-K will forward incorporate the disclosure required by Part III of Form 10-K. The pay versus performance disclosure in such filing must cover fiscal years 2021, 2022, and 2023.

Unless the registrant regains SRC status in subsequent years, any other proxy or information statement in which Item 402(v) disclosure is required and that is filed after January 1, 2024, must include non-scaled pay versus performance disclosure. For example, in the registrant's annual meeting proxy statement filed in 2025, it must include non-scaled pay versus performance disclosure for fiscal year 2024. A non-SRC is required to provide Item 402(v) disclosure covering five years; however, the staff will not object if the registrant does not add disclosure for a year prior to the years included in the first filing in which it provided Item 402(v) disclosure. The registrant generally is not required to revise the disclosure for prior years (in this example, 2021, 2022, and 2023) to conform to non-SRC status in such filings. However, because peer group TSR is calculated on a cumulative basis, the registrant should include peer group TSR for each year included in the pay versus performance table, measured from the market close on the last trading day before the registrant's earliest fiscal year in the table. In addition, the registrant should include its numerically quantifiable performance under the Company-Selected Measure for each fiscal year in the table. The entirety of the Item 402(v) disclosure provided for all fiscal years must be XBRL tagged in accordance with Item 402(v)(7). [November 21, 2023]

Latest C&DI Updates

Question 128D.29

Question: A registrant that previously qualified as an emerging growth company loses that status as of December 31, 2024. Is it required to provide pay versus performance disclosure in its proxy statement filed in 2025? How many years are required in the table?

Answer: The registrant is required to provide pay versus performance disclosure in any proxy or information statement filed after it loses its EGC status. It may apply the transitional relief in Instruction 1 to Item 402(v). [November 21, 2023]

Question 128D.30

Question: Two (or more) individuals served as a registrant's principal financial officer (PFO) during a single covered fiscal year included the pay versus performance table and related disclosure under Regulation S-K Item 402(v). Each such individual is included in the Summary Compensation table as a named executive officer (NEO) pursuant to Item 402(a)(3)(ii). For purposes of the calculation of average compensation amounts for the NEOs other than the principal executive officer reported pursuant to Items 402(v)(2)(ii) and (iii), may the registrant treat the PFOs as the equivalent of one NEO?

Answer: No. Each NEO must be included individually in the calculation of average compensation amounts. In such cases, the registrant should consider including additional disclosure on the impact of the inclusion of such individuals on the calculation in order to provide clarity to investors. [November 21, 2023]