Cahill

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SEC Reopens Comment Period on 2015 Pay Versus Performance Proposal

On January 27, 2022, the Securities and Exchange Commission (the "SEC") reopened the comment period on its proposed rules that would require disclosure by reporting companies describing how executive compensation relates to the company's financial performance over time (the "Proposed Rules").[1] The Proposed Rules were originally released in April of 2015 and are intended to implement the "pay versus performance" requirement of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act"). Our April 2015 firm memorandum discussing the original Proposed Rules can be found here. This memorandum summarizes the Reopening Release and the changes made to the Proposed Rules and highlights some of the additional questions raised for comment.

I. Section 14(i) and the 2015 Proposed Rules

Section 14(i) of the Securities and Exchange Act of 1934 (the "Exchange Act"), which was included in the Dodd Frank Act, provides that the SEC must adopt rules requiring "each issuer" to disclose in its proxy or consent solicitation materials for its annual stockholders' meeting a "clear description" of the compensation required to be disclosed under Regulation S-K Item 402, including (for companies other than emerging growth companies) "information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions."[2] Currently, Rule 402 of Regulation S-K does not require disclosure of specific information showing the relationship between compensation and financial performance.

The original Proposed Rules introduced a new Item 402(v) to Regulation S-K that would require companies to describe the relationship between the executive compensation "actually paid" to their named executive officers (the same named executive officers that appear on the company's Summary Compensation Table) and the cumulative total shareholder return ("TSR") of the company (the same TSR value disclosed in its Performance Graph), as well as the relationship between the company's TSR and the TSR of its peer group (the same peer group that appears in the company's Performance Graph or in its Compensation Disclosure and Analysis), in each case, over the last five years. The additional information would be required to be included in tabular form, as set forth in Part I of Appendix A to this memorandum. What an executive was "actually paid" would be determined by (1) deducting the change in the actuarial present value of all defined benefit pension plans while adding back the actuarially determined service cost

[1] See *Reopening of Comment Period for Pay Versus Performance*, Release No. 34-94074; File No. S7-07-15 (January 27, 2022), available at *https://www.sec.gov/rules/proposed/2022/34-94074.pdf* (the "Reopening Release"). Unless otherwise specified, all quotations in this memorandum are taken from the Reopening Release.

[2] 15 U.S.C. 78a *et seq*.

for services rendered by the executive during the applicable year, and (2) excluding the fair value of equity awards at the time they were granted while adding back the fair value of equity awards at vesting.

Registrants subject to the proxy rules under Section 14 of the Exchange Act generally would be subject to the Proposed Rules, but emerging growth companies, foreign private issuers and registered investment companies would be excluded from the Proposed Rules. Smaller reporting companies would be required to cover only a period of three years, as opposed to five, and would not be required to disclose peer group total shareholder return.

II. Reopening of Comment Period and Additional Disclosures Being Considered

The Reopening Release states that the comment period is being reopened to give "interested persons" "a further opportunity" to comment on the Proposed Rules in light of developments in compensation practices since 2015 and the additional matters the SEC is considering, as described below.

The SEC noted in the Reopening Release that, since the original Proposed Rules in 2015, executive compensation practices have changed, citing an increase in performance-contingent share plans and a decrease in the use of stock options in crafting executive compensation packages. COVID-19 has also affected executive compensation, with over 500 of the companies included in the Russell 3000 index having made adjustments to "CEO salary, bonus, or long-term incentive programs… or director fees."

The Reopening Release states that the SEC is considering requiring pre-tax net income (under U.S. generally accepted accounting principles ("GAAP")), net income (also under GAAP), and/or a measure "specific to a particular registrant, chosen by said registrant" to be used as additional performance measures, each of which (if adopted) would be required to be included in an additional column to the table described above, as set forth in Part II of Appendix A to this memorandum. The company-selected measure would allow companies to select, based on their own assessment, the "most important performance measure (that is not already included in the table) used by the registrant to link compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure." This measure may include, for example, earnings before interest, taxes, amortization, and depreciation, or EBITDA. The SEC believes that use of a company-selected measure "may elicit additional useful disclosure while reducing the risk…, of misrepresenting or providing an incomplete picture of how pay relates to performance." According to the Reopening Release, the SEC is also considering requiring companies to list the five most important performance measures they use (or, if lower, the number of measures the company actually uses) when linking compensation to performance.

The SEC acknowledged in the Reopening Release that certain of the additional requirements "should result in limited additional cost" and are expected to have "limited other effects on efficiency, competition and capital formation." The Reopening Release also indicates that the SEC is considering "whether and how the proposed rules and the potential disclosure of additional measures… would apply to smaller reporting companies."

III. Individual Commissioners' Comments and Dissent

SEC Commissioners Caroline A. Crenshaw and Hester M. Peirce each issued a separate statement regarding the Reopening Release.

Commissioner Crenshaw noted that "the world has changed significantly since 2015," including the increasing link between "executive pay to environmental, social, and governance measures."[3] Commissioner

[3] See *https://www.sec.gov/news/statement/crenshaw-statement-pvp-012722*.

Crenshaw encourages commenters to "provide insight into how ESG measures are utilized in executive pay packages" and feedback regarding whether to "scope in" smaller reporting companies under the Proposed Rules.

Commissioner Peirce noted in a dissenting statement that the Reopening Release does not fix "critical shortcomings" of the 2015 Proposal Rules but instead "doubles down" on a proposal that will lead to additional, burdensome disclosure requirements of "dubious use to investors."[4] Peirce does, however, "agree that we should move forward on this nearly twelve-year-old rulemaking mandate" but would have preferred soliciting comment specifically on whether to "permit companies greater flexibility to determine which financial performance measure is appropriate" in disclosing their pay-versus-performance practices.

IV. Additional 2022 Questions

The Reopening Release sets forth 22 separate groups of related questions, including:

- Would investors find the additional information in the tables regarding pre-tax net income and net income useful in evaluating the relationship between pay and performance?
- How should the company-selected measure be defined?
- Are there other measures of company performance that should be considered?
- Are there potential approaches to help mitigate the risk of possible misalignments during time periods to which pay is attributed and the time period in which the associated performance is reported?
- Are there any other developments (including with respect to executive compensation practices) since the original Proposed Rules that should affect the SEC's consideration of the Proposed Rules or their potential economic effects?

V. Conclusion

After nearly seven years, the pay versus performance rule changes are back on the SEC's near-term agenda. The final form of the rules will be of interest to all registrants covered by the rules. The comment period ends on March 4, 2022.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email authors Geoffrey E. Liebmann (Partner) at 212.701.3313 or gliebmann@cahill.com; or Keith Marantz (Associate) at 212.701.3570 or kmarantz@cahill.com; or email publications@cahill.com.

[4] See *https://www.sec.gov/news/statement/peirce-dissent-pvp-20220127*.