CompensationStandards.com

"Proxy Season Post-Mortem: The Latest Compensation Disclosures"

Tuesday, June 27, 2023

Course Materials

“Proxy Season Post-Mortem: The Latest Compensation Disclosures”

Tuesday, June 27, 2023

2 to 3:30 p.m. Eastern [archive and transcript to follow]

Our annual webcast focusing on the “lessons learned” that companies can start carrying forward into next proxy season. It's time to analyze what was disclosed and what was not in the 2023 proxy season!

Join these experts:

- **Mark Borges,** Principal, Compensia and Editor, CompensationStandards.com
- **Dave Lynn,** Partner, Morrison Foerster and Senior Editor, TheCorporateCounsel.net and CompensationStandards.com
- **Ron Mueller,** Partner, Gibson Dunn & Crutcher LLP

Among other timely topics, this webcast will cover:

- Say-on-Pay Results
- Key 2023 Lessons Learned
- Pay-versus-Performance Highlights
- Developments in CD&A
- ESG Metrics
- CEO Pay Ratio
- Perquisites Disclosure
- Equity Compensation Plan Proposals
- Pay-Related Shareholder Proposals
- Human Capital Management
- Proxy Advisors
- Recent & Expected SEC Rulemaking
- The Latest on Clawbacks

“Proxy Season Post-Mortem: The Latest Compensation Disclosures”

Course Outline/Notes

1. Say-on-Pay Results

2. Key 2023 Lessons Learned

3. Pay-versus-Performance Highlights

4. Developments in CD&A

5. ESG Metrics

6. CEO Pay Ratio

7. Perquisites Disclosure

8. Equity Compensation Plan Proposals

9. Pay-Related Shareholder Proposals

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April 18, 2023

CEO Pay Ratio—A Way to Assess Human Capital Management

This Glass Lewis blog highlights a potential use case for CEO pay ratio disclosure—to gauge a company's human capital management practices. Since it allows companies to use various methodologies to identify the median employee, the rule's flexibility has resulted in limited comparability of the data across companies, but Glass Lewis has identified helpful takeaways by considering year-over-year changes. As an example, the blog cites one company whose NEO base salaries increased by 50%—for which the company cited a challenging recruiting environment and inflationary pressures—while compensation for rank-and-file employees, which was evident in the pay ratio disclosure, only increased 6%.

This is a good reminder that CEO pay ratio can't be a fill-in-the-blanks exercise every year, even though it has largely failed to be the controversial, headline grabbing disclosure some expected years ago. Think about how your numbers have changed year-over-year and how investors will react to this year's data. If there are any anomalies or surprises, make sure to address them with contextual disclosure.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/04/ceo-pay-ratio-a-way-to-assess-human-capital-management.html

Checklist: Preparing Human Capital Management Disclosure

By TheCorporateCounsel.net

Item 101 of Regulation S-K requires companies to describe their business and that of their subsidiaries. To the extent material to an understanding of the company's business taken as a whole, Item 101(c) requires a description, and disclosure, of the company's human capital resources, including the company's number of employees. Item 101(c) also requires disclosure of any human capital measures or objectives that the company focuses on in managing the business—such as measures or objectives that address the development, recruitment and retention of employees. For human capital resources disclosure that's material to a particular segment, the company should identify the segment in its disclosures.

1. Human Capital Management Disclosure Topics & Metrics

– Disclose Number of Employees

Item 101(c) requires companies disclose the number of its employees. Investors use this metric as one way to assess the size and scale of a company's operations as well as how the company changes over time.

– Possible Disclosure Topics

In a memo following the SEC's adoption of human capital resources disclosure requirements, Compensia outlined the following broad categories of human capital resources disclosure for companies to consider – each company will need to evaluate its own particular circumstances to identify its human capital resources and determine their materiality to an understanding of its business:

- Workforce governance
    - Board or committee oversight of human capital resources
    - Role of chief human resources officer
    - Employee engagement
- Workforce composition
    - Talent acquisition and recruiting
    - Diversity and inclusion
    - Experience and education of workforce

- Workforce stability
    - Turnover (voluntary and involuntary)
    - Internal promotion initiatives
    - Employee satisfaction surveys

- Workforce skills and development
    - Educational opportunities
    - Formal and on-the-job training
    - Employee recognition programs

- Workforce culture
    - Work-life initiatives
    - Employee health, safety and well-being programs
    - Employee/manager feedback mechanisms

- Workforce compensation
    - Pay elements
    - Employee incentives and benefits
    - Pay equity

- Risk management
    - Ethics and compliance
    - Incentive risk management policies
    - Succession planning for key positions
    - Legal or regulatory proceedings related to employee management

– Disclose Human Capital Measures Material to Understanding Company's Business

Measures and objectives disclosed by companies will vary from one company to another based on the nature of a company's business and workforce. These could be things like:

- The number of part-time employees, independent contractors, seasonal workers and/or contingent workers

- Employee turnover rates, voluntary and involuntary

- Internal rates of hiring and promotion

- Opportunities for emerging talent in the organization
- Workforce diversity data
- Workforce compensation, pay equity
- Cultural initiatives to improve retention
- Workforce health & safety
- Continuing education and training, such as number of days or hours per year per employee
- Employee engagement scores

2. Drafting Considerations

– Don't Reinvent the Wheel

The human capital resource disclosure requirement, although new with the SEC's 2020 amendments to Regulation S-K, wasn't really all that new to companies. That's because many companies already track the type of information that should be disclosed. Some companies already disclose the information as part of a ESG or sustainability report, or other reports such as diversity and inclusion reports that are available on company websites.

– Consider Disclosing Information in Proxy Statement Too

Item 101(c) requires disclosure of human capital resources in a company's Form 10-K although we believe that many companies will include disclosure in both the Form 10-K and the proxy statement.

– Human Capital Resources Disclosure Should be Tailored

Each company's disclosure must be tailored to its unique business, workforce, and facts and circumstances. The SEC adopted a principles-based disclosure framework for human capital management recognizing that exact human capital measures and objectives may evolve over time and may depend, and

vary significantly, based on factors such as a company's industry, the various regions or jurisdictions in which a company operates, the general company strategy, including whether and to the extent a company is vertically integrated and other matters that affect human capital resources such as national or global health matters.

– Metrics Should Be Consistently Calculated

When the human capital disclosure requirements were adopted, SEC Chair Jay Clayton urged companies to provide meaningful qualitative—and quantitative—disclosure. In addition, he expressed an expectation that companies maintain metric definitions constant from period to period—or disclose prominently the changes to metrics or the definitions of metrics.

– Determining Materiality & Accuracy of Human Capital Management Information

When drafting human capital resources disclosure, you should remember to consider where human capital information is disclosed outside of SEC filings to ensure consistency with that disclosure. It's important confirm disclosures with unit leaders and senior management and to coordinate closely with HR to ensure that the Item 101(c) disclosure aligns with how the company manages talent and evaluates human capital matters. Factors that would indicate that a measure is material to running the business and should be disclosed would include being part of incentive agreements or programs or being reported to the board.

– Human Capital Disclosure Rule Doesn't Require Adoption of Metrics

The SEC's "human capital" rules are principles-based. They don't require companies to adopt particular measures—or any measures at all—to manage their business. What the SEC rules require is disclosure about existing human capital measures or objectives that the company focuses on in managing the business and that are material to an understanding of the business taken as a whole. Given that human capital is typically a focus of management and a driver of performance, most companies do employ some measures in this area.

3. Internal Controls

When preparing human capital resources disclosure, it's important to ensure the company has disclosure controls in place, particularly around any quantifiable

metrics that may be disclosed. Companies should also apply disclosure controls & procedures to data that they intend to measure and disclose to show progress in future periods. Companies should be cautious in disclosing specific metrics until they've established robust procedures to ensure the information is materially accurate, since it's better to wait to include information than to make inaccurate disclosure in the Form 10-K or elsewhere. We expect companies to gradually expand their human resource capital disclosure to cover additional topics and metrics as they develop adequate disclosure controls & procedures and shareholder expectations evolve.

For more information, see our "Human Capital Management" Practice Area on TheCorporateCounsel.net, along with our "Business Disclosure Handbook" – posted in our "Business Disclosure" Practice Area on TheCorporateCounsel.net.

← Compensation Considerations in a CEO Transition | Main |

June 8, 2023

Dodd-Frank Clawbacks: Exchanges Extend Effective Date!

As Liz blogged yesterday and today on TheCorporateCounsel.net, NYSE and Nasdaq have now filed amendments to their proposed listing standards, which set an October 2nd effective date. If the amendments are approved by the SEC as proposed, companies will have until Friday, December 1st to adopt a compliant Dodd-Frank clawback policy covering incentive-based compensation received by executives on or after October 2, 2023.

In addition, the NYSE Amendment changes the proposal to allow for a cure period when the Exchange believes that a company has failed to enforce the policy. It still requires NYSE companies to provide notice to the Exchange if they haven't adopted a compliant clawback policy before the compliance date (and the proposal continues to provide a cure period for late adoption scenarios). NYSE's changes to the delisting procedures align with comments on the proposal and the Nasdaq approach to delisting for lack of clawback policy enforcement. This Wilson Sonsini blog provides color here:

> Other than the change to the effective date, proposed Section 303A.14 of the NYSE Listed Company Manual is the same as proposed in the NYSE's initial filing and as noted above, closely follow the requirements outlined in Rule 10D-1. Notably, this means that, similar to Nasdaq's proposed listing standards, proposed Section 303A.14 does not include any guidance or factors that the NYSE will consider when making a determination as to whether the issuer has recovered "reasonably promptly" the amount of erroneously awarded incentive-based compensation.

However, the blog also highlights that in Amendment No. 1, the NYSE stated the following:

> "The issuer's obligation to recover erroneously awarded incentive based compensation reasonably promptly will be assessed on a holistic basis with respect to each such accounting restatement prepared by the issuer. In evaluating whether an issuer is recovering erroneously awarded incentive-based compensation reasonably promptly, the [NYSE] will consider whether the issuer is pursuing an appropriate balance of cost and speed in determining the appropriate means to seek recovery, and whether the issuer is securing recovery through means that are appropriate based on the particular facts and circumstances of each executive officer that owes a recoverable amount."

We've posted several very helpful sample policies on this site. In our "Proxy Season Post-Mortem: The Latest Compensation Disclosures" webcast coming up on June 27th, Morrison Foerster's Dave Lynn, Gibson Dunn's Ron Mueller and Compensia's Mark Borges will be sharing even more practical insights on how to finalize your policy. If you don't already have access to CompensationStandards.com, email sales@ccrcorp.com to start a no-risk membership or sign up online.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/06/dodd-frank-clawbacks-exchanges-extend-effective-date.html

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May 16, 2023

Equity Plans Facing Increased Scrutiny

Investors seem to be evaluating equity plan proposals with a more critical eye this year, based on early proxy season results. In its latest update on voting outcomes, Semler Brossy notes:

> Average vote support for equity proposals thus far in the proxy season (88.4%) is 300 basis points below the average vote support observed at this time last year, driven by two failed equity proposals early this proxy season. By comparison, no more than three proposals failed in a single year over the last five years.

A recent SGP write-up takes a closer look at why this might be happening – and suggests that companies may need to put extra effort into engagement if a plan proposal is currently on the ballot… or expected for next year. Here's an excerpt:

> Across the market, declining share prices over the past year created dilution and share availability issues, causing companies to rethink equity practices and potentially creatively manage equity burn rates (shift to cash? Lower grant sizes? Change mix of awards?). For many companies, creative considerations were not possible – which potentially has put more companies in a precarious situation: needing shares to replenish their equity plan, but bumping into the dilution and plan cost thresholds of proxy advisors and large investors. In the coming months, **many companies will need to strategically engage with their shareholders to win support for their equity plans.**
>
> **WHAT TO WATCH:** Although very few equity plans each year fail to receive majority support, there have already been two failures in the first three months of 2023. **Given the challenging market conditions of the past year, large grants to executives have been increasingly costly and highly dilutive.** Will this be the year that investors push back?

SGP's memo also touches on other executive pay-related trends that are coming to the fore this proxy season – lower director support due to executive pay concerns, importance of say-on-pay engagements, and whether pay vs. performance disclosures are creating more questions than answers.

– **Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/05/equity-plans-facing-increased-scrutiny.html

January 9, 2023

EVOLVING HUMAN CAPITAL DISCLOSURES

A Survey of Disclosures from the S&P 100 During the Two Years Following Adoption of the Securities and Exchange Commission Rule

To Our Clients and Friends:

Human capital resource disclosures by public companies have continued to be a focus since the U.S. Securities and Exchange Commission adopted the new rules in 2020; not only for companies making the disclosures, but employees, investors, and other stakeholders reading them. This alert serves as an update to the alert we issued in 2021, "*Discussing Human Capital: A Survey of the S&P 500's Compliance with the New SEC Disclosure Requirement One Year After Adoption*," and reviews disclosure trends among S&P 100 companies, each of which has now included human capital disclosure in their past two annual reports on Form 10-K. This alert also provides practical considerations for companies as we head into 2023.

The overall takeaway from our survey, which categorized disclosures into 17 topic areas, was that companies are generally expanding the length of their disclosures, covering more topics, and including slightly more quantitative information in some areas. We note the following trends regarding the S&P 100 companies' disclosures compared to the previous year:

- Seventy-nine companies increased the length of their disclosures, though the increases were generally modest.
- Sixty-six companies increased the number of topics covered.
- The prevalence of 16 topics increased and one remained the same.
  - The most significant year-over-year increases in frequency involved the following topics: talent attraction and retention (67% to 91%), employee compensation (68% to 85%), quantitative diversity statistics on race/ethnicity (43% to 59%) and gender (47% to 61%), workplace health and safety (51% to 65%), and pay equity (30% to 41%).
  - The only topic that did not see an increase in frequency was succession planning, which remained at 17%.
- Eight-five companies included more qualitative details in their disclosures compared to the previous year, including information relating to diversity, equity, and inclusion ("DEI") initiatives and programs and the board's role in overseeing human capital initiatives, although the depth of the additional detail provided varied greatly between companies.

  - In this most recent year, DEI was discussed by 96% of companies (89% in the previous year), and 37% of companies (22% in the previous year) went beyond qualitative DEI information and disclosed quantitative data regarding the breakdown of DEI statistics by job type or level (executive level, etc.).
  - Disclosure regarding the role of the board (or a human capital-focused committee) in overseeing human capital jumped to 44% of companies this most recent year from 26% the previous year.

- The topics most commonly discussed this most recent year generally remained consistent with the previous year. For example, DEI, talent development, talent attraction and retention, COVID-19, and employee compensation and benefits remained the five most frequently discussed topics, while succession planning, full-time/part-time employee split, quantitative pay gaps, culture initiatives, and quantitative workforce turnover rates continued to be the five least frequently covered topics.
- Within each industry, the trends that we saw in the previous year regarding the frequency of topics disclosed generally remained the same.

I. Background on the Requirements

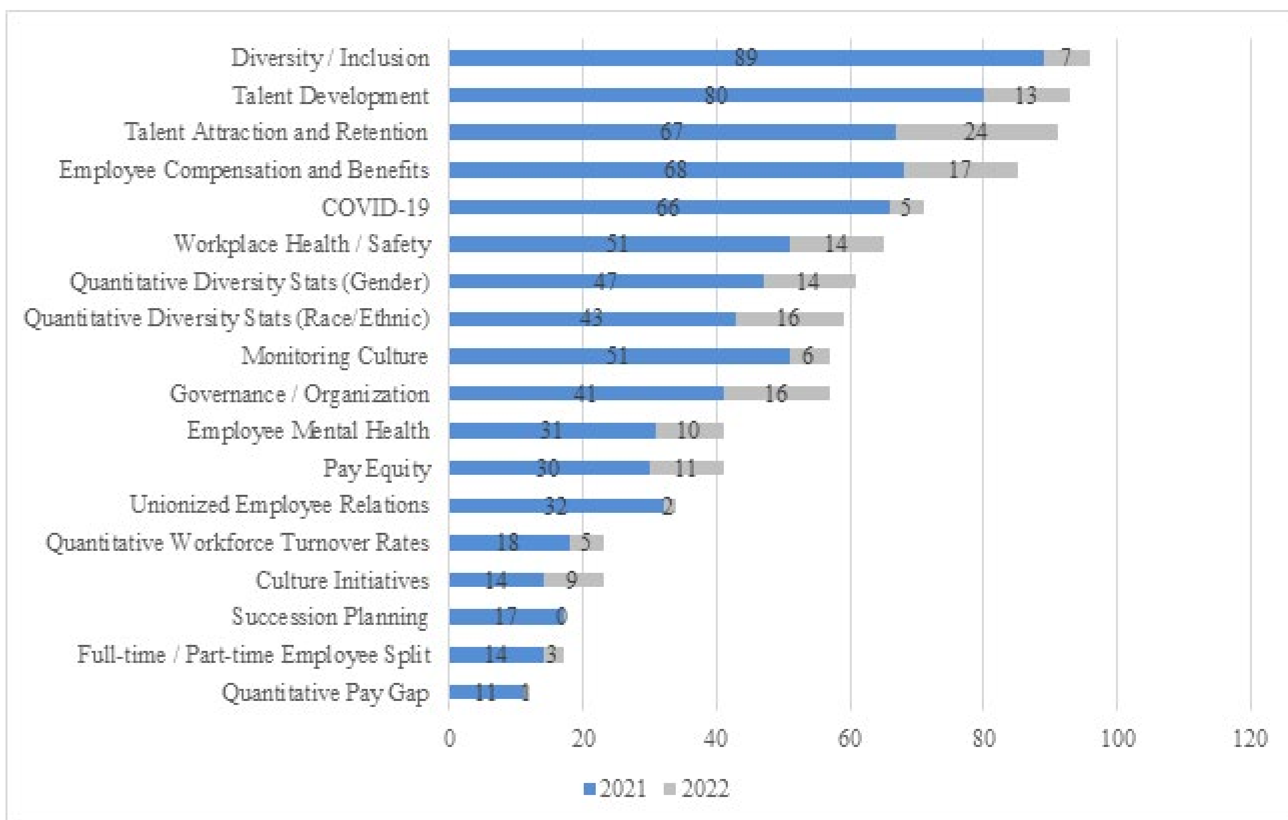
On August 26, 2020, the U.S. Securities and Exchange Commission (the "Commission") voted three to two to approve amendments to Items 101, 103, and 105 of Regulation S-K, including the principles-based requirement to discuss a registrant's human capital resources to the extent material to an understanding of the registrant's business taken as a whole.[1] Specifically, public companies' human capital disclosure must include "the number of persons employed by the registrant, and any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel)." One dissenting commissioner criticized the amendment for failing to even require disclosure of "commonly kept metrics such as part time vs. full time workers, workforce expenses, turnover, and diversity."[2]

As discussed below, following the change in presidential administration, the Commission has indicated that it plans to revisit the human capital disclosure requirements and potentially adopt more prescriptive rules in the future.[3]

While companies disclosures under the principles-based rules varied widely, our survey was able to introduce some comparability. The next two sections show the relevant data from our survey.[4]

II. Disclosure Topics

Our survey classifies human capital disclosures into 17 topics, each of which is listed in the following chart, along with the number of companies that discussed the topic in 2021 and the number of additional companies that discussed the topic in 2022. Each topic is described more fully in the sections following the chart.



A. Workforce Composition and Demographics

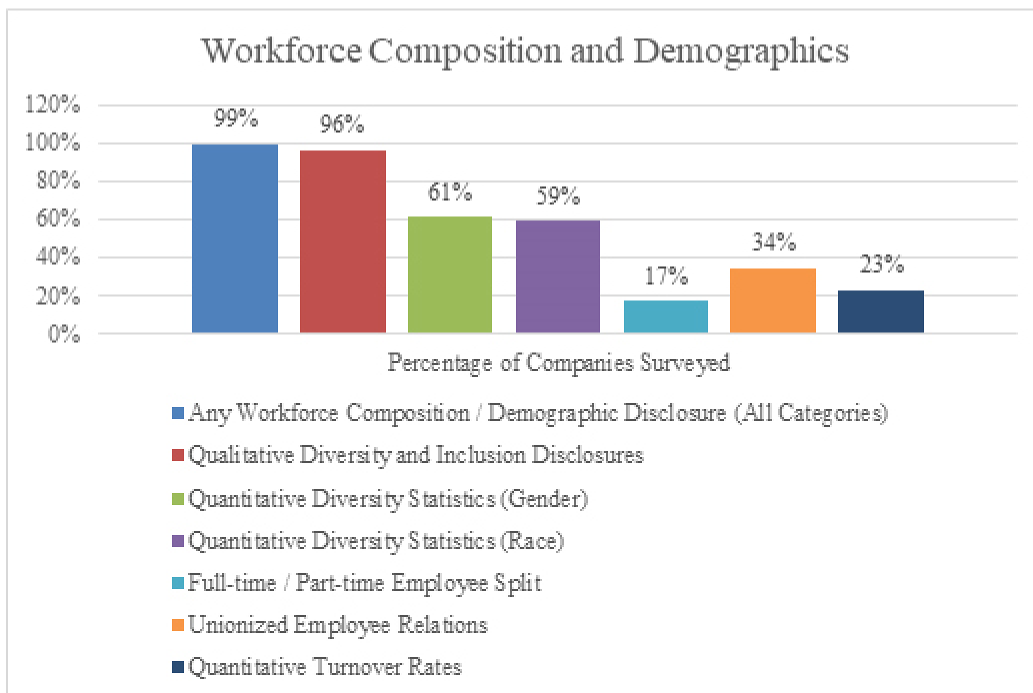
Of the 100 companies surveyed, 99 included disclosures relating to workforce composition and demographics in one or more of the following categories:

- ***Diversity and inclusion.*** This was the most common type of disclosure, with 96% of companies including a qualitative discussion regarding the company's commitment to diversity, equity, and inclusion, up slightly from 89% the previous year. The depth of these disclosures varied, ranging from generic statements expressing the company's support of diversity in the workforce to detailed examples of actions taken to support underrepresented groups and increase the diversity of the company's workforce. Many companies also included a quantitative breakdown of the gender or racial representation of the company's workforce: 61% included statistics on gender and 59% included statistics on race (compared to 47% and 43% in the previous year, respectively). Most companies provided these statistics in relation to their workforce as a whole; however, an increased subset (37% in the most recent year compared to 22% in the previous year) included separate statistics for different classes of employees (e.g., managerial, vice president and above, etc.) and/or for their boards of directors. Some companies also included numerical goals for gender or racial representation—either in terms of overall representation, promotions, or hiring—even if they did not provide current workforce diversity statistics.

- ***Full-time/part-time employee split.*** While most companies provided the total number of full-time employees, only 17% of the companies surveyed included a quantitative breakdown of the number of full-time versus part-time employees the company employed, up only slightly from 14% the previous year. Similarly, we saw a number of companies that provided statistics on the number of seasonal employees and/or independent contractors or a breakdown of employees by geographical location.

- ***Unionized employee relations.*** Of the companies surveyed, 34% stated that some portion of their workforce was part of a union, works council, or similar collective bargaining agreement, up slightly from 32% the previous year.[5] These disclosures generally included a statement providing the company's opinion on the quality of labor relations, and in many cases, disclosed the number of unionized employees.

- ***Quantitative workforce turnover rates.*** Although a majority of companies discussed employee turnover and the related topics of talent attraction and retention in a qualitative way (as discussed in Section II.B. below), only 23% of companies surveyed provided specific employee turnover rates (whether voluntary or involuntary), up slightly from 18% the previous year.



B. Recruiting, Training, Succession

Of the companies surveyed, 96% included disclosures relating to talent and succession planning in one or more of the following categories:

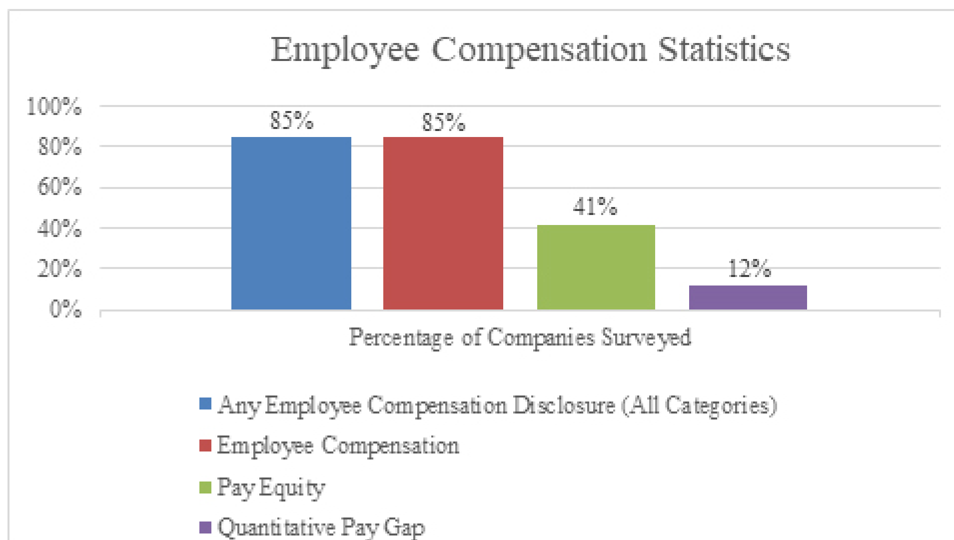
- ***Talent attraction and retention.*** These disclosures were generally qualitative and focused on efforts to recruit and retain qualified individuals. While providing general statements regarding recruiting and retaining talent were relatively common, with 91% of companies including this type of disclosure (compared to 67% in 2021), quantitative measures of retention, like workforce turnover rate, were uncommon, with less than 23% of companies disclosing such statistics (as noted above).

- ***Talent development.*** The most common type of disclosure in this area related to talent development, with 93% of companies including a qualitative discussion regarding employee training, learning, and development opportunities, up from 80% the previous year. This disclosure tended to focus on the workforce as a whole rather than specifically on senior management. Companies generally discussed training programs such as in-person and online courses, leadership development programs, mentoring opportunities, tuition assistance, and conferences, and a minority also disclosed the number of hours employees spent on learning and development.

- ***Succession planning.*** Only 17% of companies surveyed addressed their succession planning efforts (unchanged from 2021), which may be a function of succession being a focus area primarily for executives rather than the human capital resources of a company more broadly.

C. Employee Compensation

Of the companies surveyed, 85% included disclosures relating to employee compensation, up from 68% the previous year. All of those companies included a qualitative description of the compensation and benefits program offered to employees. Of the companies surveyed, 41% addressed pay equity practices or assessments (compared to 30% in 2021), and substantially fewer companies (12% of companies surveyed in 2022 and 11% in 2021) included quantitative measures of the pay gap between diverse and nondiverse employees or male and female employees.

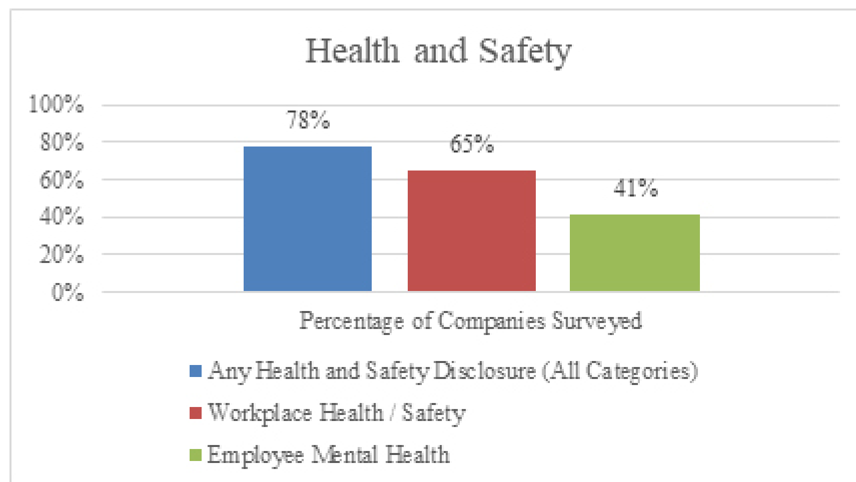


D. Health and Safety

Of the companies surveyed, 78% included disclosures relating to health and safety in one or both of the following categories:

- ***Workplace health and safety.*** Of the companies surveyed, 65% included qualitative disclosures relating to workplace health and safety, up from 51% in the previous year, typically with statements around the company's commitment to safety in the workplace generally and compliance with applicable regulatory and legal requirements. However, 10% of companies surveyed provided quantitative disclosures in this category, generally focusing on historical and/or target incident or safety rates or investments in safety programs. These disclosures tended to be more prevalent among industrial and manufacturing companies. Many companies also provided disclosures on safety initiatives undertaken in connection with COVID-19, which is discussed separately below.

- ***Employee mental health.*** In connection with disclosures about standard benefits provided to employees, or additional benefits provided as a result of the pandemic, 41% of companies disclosed initiatives taken to support employees' mental or emotional health and wellbeing, up from 31% the prior year.



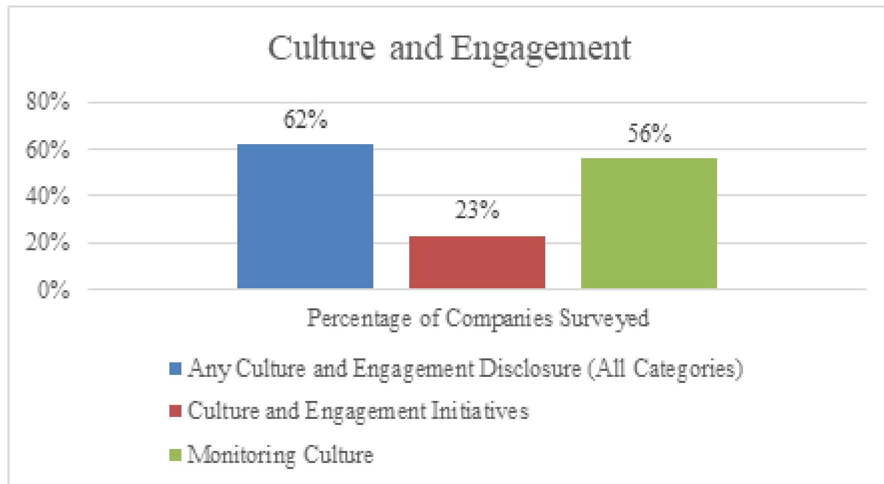
E. Culture and Engagement

In addition to the many instances where companies mentioned a general commitment to culture and values, 62% of the companies surveyed discussed specific initiatives they were taking related to culture and engagement in one or more of the following categories:

- ***Culture and engagement initiatives.*** Of the companies surveyed, 23% included specific disclosures relating to practices and initiatives undertaken to build and maintain their culture and values, up from 14% in the previous year. These companies most commonly discussed efforts to communicate with employees (e.g., through town halls, CEO outreach, trainings, or conferences and presentations) and to recognize employee contributions (e.g., awards programs

and individualized feedback). Many companies also discussed culture in the context of diversity-related initiatives to help foster an inclusive culture.

- ***Monitoring culture.*** Disclosures about the ways that companies monitor culture and employee engagement were much more common, with 56% of companies providing such disclosure, up from 51% the previous year. Companies generally disclosed the frequency of employee surveys used to track employee engagement and satisfaction, with some reporting on the results of these surveys, sometimes measured against prior year results or industry benchmarks.



F. COVID-19

A majority of companies (71% of those surveyed compared to 66% in 2021) included information regarding COVID-19 and its impact on company policies and procedures or on employees generally. COVID-19-related topics addressed ranged from work-from-home arrangements and safety protocols taken for employees who worked in person to additional benefits and compensation paid to employees as a result of the pandemic and contributions made to organizations supporting those affected by the pandemic.

G. Human Capital Management Governance and Organizational Practices

Over half of the companies (57% of those surveyed compared to 41% in 2021) addressed their governance and organizational practices (such as oversight by the board of directors or a committee and the organization of the human resources function).

III. Industry Trends

One of the main rationales underlying the adoption of principles-based—rather than prescriptive—requirements for human capital disclosures is that the relative significance of various human capital measures and objectives varies by industry. This is reflected in the following industry trends that we observed:[6]

- ***Technology Industries*** *(E-Commerce, Internet Media & Services, Hardware, Software & IT Services and Semiconductors).* For the 20 companies in the Technology Industries, 90% discussed talent development and training opportunities, talent attraction, recruitment and retention, employee compensation, and diversity. Relatively uncommon disclosures among this group included part-time and full-time employee statistics (10%), culture initiatives (15%), succession planning (10%), and quantitative pay gap (10%).

- ***Finance Industries*** *(Asset Management & Custody Activities, Consumer Finance, Commercial Banks and Investment Banking & Brokerage).* For the 13 companies in the Finance Industries, a large majority included quantitative diversity statistics regarding race (85%) and gender (85%). The same number of companies also included qualitative disclosures regarding employee compensation (85%), and, compared to other industries discussed below, a relatively higher number discussed pay equity (62%) and quantified their pay gap (38%). Relatively uncommon disclosures among this group included part-time and full-time employee statistics, unionized employee relations, quantitative workforce turnover rates, and succession planning (in each case less than 16%).

IV. Disclosure Format

The format of human capital disclosures in companies' annual reports continued to vary greatly.

Word Count. The length of the disclosures ranged from 109 to 1,995 words, with the average disclosure consisting of 960 words and the median disclosure consisting of 949 words. Compare this to 2021, which saw a range of 105 to 1,931 words, with an average of 823 words and median of 818 words.

Metrics. While the disclosure requirement specifically asks for a description of "any human capital *measures* or objectives that the registrant focuses on in managing the business" (emphasis added), our survey revealed that 25% of companies determined not to include disclosure in any of the quantitative categories we discuss above, and 10% did not include any type of quantitative metrics in their disclosure beyond headcount numbers (down from 36% and 14%, respectively, in 2021). Given the materiality threshold included in the requirement and the fact that it is focused on what is actually used to manage the business, this is not a surprising result. It was common to see companies identify important objectives they focus on, but omit quantitative metrics related to those objectives; however, that group has been shrinking as more companies include metrics. For example, while 96% of companies discussed their commitment to diversity, equity, and inclusion (compared to 89% in 2021), only 61% and 59% of companies disclosed quantitative metrics regarding gender and racial diversity, respectively (compared to 47% and 43%, respectively, in 2021).

Graphics. Although the minority practice, 24% of companies surveyed also included charts or other graphics, up from 21% the previous year, which were generally used to present statistical data, such as diversity statistics or breakdowns of the number of employees by geographic location.

Categories. Most companies organized their disclosures by categories similar to those discussed above and included headings to define the types of disclosures presented.

V. Comment Letter Correspondence

Comment letter correspondence from the staff of the Division of Corporation Finance (the "Staff"), which often helps put a finer point on principles-based disclosure requirements like this one, has shed relatively little light on how the Staff believes the new requirements should be interpreted. Consistent with what we found at this time last year, the comment letters, all of which involved reviews of registration statements, were generally issued to companies whose disclosures about employees were limited to the bare-bones items companies have discussed historically, such as the number of persons employed and the quality of employee relations. From these companies, the Staff simply sought a more detailed discussion of the company's human capital resources, including any human capital measures or objectives upon which the company focuses in managing its business. There were also a few comment letters where the Staff asked companies to clarify statements in their human capital disclosures. Based on our review of the responses to those comment letters, we have not seen a company take the position that a discussion of human capital resources was immaterial and therefore unnecessary.

VI. Conclusion

During the most recent year, we generally saw companies expanding the length of their human capital disclosures, covering more topics, and including slightly more quantitative information in some areas; however, the principles-based nature of the disclosure requirements has continued to result in companies providing a wide variety of disclosures, with significant differences in depth and breadth.

Given how high the Human Capital Management Disclosure rulemaking appears on the Fall 2022 Reg Flex Agenda (it appears as an action item for the first quarter of 2023), it seems unlikely we will see another year pass without more prescriptive rules being proposed and possibly adopted.

There has been no shortage of investors, politicians, and activists chiming in with input on the forthcoming rules. For example, earlier this year, several members of Congress wrote a letter asking the Commission to resist requests for more specific and quantitative disclosures on human capital, which expressed particular concerns about requiring metrics on full-time employees, part-time employees, independent contractors, subcontractors, or contingent employees.[7] In June 2022, the Working Group on Human Capital Accounting Disclosure, a group composed of academics and former SEC officials, submitted a rulemaking petition requesting the Commission to require more financial information about human capital in companies' disclosures.[8]

Until the Commission proposes and adopts new rules governing the disclosure of human capital management, however, we expect the wide variance in Form 10-K human capital disclosures to continue. As companies prepare for the upcoming Form 10-K reporting season, they should consider the following:

- Confirming (or reconfirming) that the company's disclosure controls and procedures support the statements made in human capital disclosures and that the human capital disclosures included in the Form 10-K remain appropriate and relevant. In this regard, companies may want to compare their own disclosures against what their industry peers did these past two years, including specifically any notable additional disclosures made in the past year.

- Setting expectations internally that these disclosures likely will evolve. As shown by the measurable increase in disclosure in the second year of reporting, companies should expect to develop their disclosure over the course of the next couple of annual reports in response to peer practices, regulatory changes, and investor expectations, as appropriate. The types of disclosures that are material to each company may also change in response to current events.

- Addressing in the upcoming disclosure, if not already disclosed, the progress that management has made with respect to any significant objectives it has set regarding its human capital resources as investors are likely to focus on year-over-year changes and the company's performance versus stated goals.

- Addressing significant areas of focus highlighted in engagement meetings with investors and other stakeholders. In a 2021 survey, 64% of institutional investors surveyed cited human capital management as a key issue when engaging with boards (second only to climate change at 85%).[9]

- Revalidating the methodology for calculating quantitative metrics and assessing consistency with the prior year. Former Chairman Clayton commented that he would expect companies to "maintain metric definitions constant from period to period or to disclose prominently any changes to the metrics."

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[1] *See* 17 C.F.R. § 229.101(c)(2)(ii).

[2] *See* Regulation S-K and ESG Disclosures: An Unsustainable Silence, *available at* https://www.sec.gov/news/public-statement/lee-regulation-s-k-2020-08-26.

[3] Commission Chair Gary Gensler's Fall 2022 Unified Agenda of Regulatory and Deregulatory Actions (the "Fall 2022 Reg Flex Agenda") shows "Human Capital Management Disclosure" as being in the proposed rule stage. *Available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST¤tPub=true&agencyCode&showStage=active&agencyCd=3235.

[4] Note that companies often include additional human capital management-related disclosures in their ESG/sustainability/social responsibility reports and websites and sometimes in the proxy statement, but these disclosures are outside the scope of the survey.

[5] While never expressly required by Regulation S-K, as a result of disclosure review comments issued by the Division of Corporation Finance over the years and a decades-old and since-deleted requirement in Form 1-A, it has been a relatively common practice to discuss collective bargaining and employee relations in the Form 10-K or in an IPO Form S-1, particularly since the threat of a workforce strike could be material.

[6] For purposes of our survey, we grouped companies in similar industries based on both their four-digit Standard Industrial Classification code and their designated industry within the Sustainable

Industry Classification System. The industry groups discussed in this section cover 33% of the companies included in our survey.

[7] *Available at* https://www.warner.senate.gov/public/index.cfm/2022/2/warner-brown-call-on-sec-to-update-human-capital-disclosures-so-that-companies-report-the-number-of-employees-who-are-not-full-time-workers.

[8] *Available at* https://www.sec.gov/rules/petitions/2022/petn4-787.pdf.

[9] *See* Morrow Sodali 2021 Institutional Investor Survey, *available at* https://morrowsodali.com/insights/institutional-investor-survey-2021.

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June 1, 2023

Negative Say-on-Pay Recommendations: Vetting Proxy Advisor Data

A week before its annual meeting this year, JPMorgan Chase posted this letter to its website and filed it with the SEC as additional soliciting material. The letter highlights that ISS had favorably changed its voting recommendation for the company's say-on-pay resolution.

> This can happen sometimes if the company agrees to resolve a problematic pay practice. But here, the proxy advisor didn't make the change because of any commitment by JPM. Instead, the company was somehow able to identify that ISS had used incorrect data for one of the ISS-selected peer companies, which caused a "technical error" in the proxy advisor's quantitative pay-for-performance screen. ISS agreed to re-run its analysis, and the data change caused JPM to move from "medium" concern to "low" concern. Three days after JPM first publicly communicated about the perceived error, ISS changed its voting recommendation from "against" to "for." JPM reported that 89% of voting shareholders ended up supporting the say-on-pay resolution.

This is a reminder that everyone makes mistakes – even proxy advisors. What's difficult for companies is identifying and communicating errors in pay-for-performance models in time to salvage the voting outcome. This blog from Ed Hauder offers verification steps that other companies should consider whenever they are faced with a negative say-on-pay recommendation:

> – Review your company's compensation data used in the report to ensure it is accurate.
>
> – Pull the compensation data for the proxy advisor's peer group to see if it conforms to the data presented in the report.
>
> – Have your staff or your compensation consultant analyze whether the compensation data used is the latest that should be used according to the proxy advisor policies.

JPM was also proactive in messaging its views about the ISS's original recommendation prior to ISS agreeing to change it, with its first public letter coming 10 days before the meeting. I can only imagine the effort and resources that went into identifying the error, correcting it, respectfully communicating, and soliciting proxies.

– **Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/06/negative-say-on-pay-recommendations-vetting-proxy-advisor-data.html

February 22, 2023

Pay-Versus-Performance Disclosure and Form 10-K

If you read to the very end of Item 402(v) of Regulation 402(v), you'll see that Instruction 3 says that "[t]he information required by paragraph (v) of this section will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference." Based on this Instruction (as well as the statement at the very beginning of the Adopting Release that "[t]he disclosure is required in proxy or information statements in which executive compensation disclosure is required"), I just assumed that the question of where the disclosure should be located was fairly straightforward.

However, one question kept popping up – did the "pay-versus-performance" disclosure also need to be included in the Annual Report on Form 10-K, particularly where a company wasn't taking advantage of the "forward incorporation by reference" technique permitted by General Instruction G(3) of Form 10-K. After checking with a colleague, who pointed me to the following statement in the Adopting Release (at Section 2.A.1.iii) that:

> We are not requiring the pay-versus-performance disclosure in other filings where disclosure under Item 402 of Regulation S-K is required, as we believe that, taken in context, the language of Section 14(i) calling for registrants to provide the disclosure "in any proxy or consent solicitation material for an annual meeting of the shareholders" suggests that the information was intended to be presented in conjunction with a shareholder vote.

I took comfort in that language, as well as Instruction 3, that it wasn't necessary to include the disclosure in a Form 10-K. Of course, that view was subsequently confirmed by the SEC Staff in its recent interpretive guidance on Item 402(v) in Question No. 128D.01:

> Question: Is the information required pursuant to Item 402(v) of Regulation S-K required to be included in Form 10-K, given that Item 11 of Form 10-K indicates that the registrant is required to furnish the information required under Item 402 of Regulation S-K?
>
> Answer: No. Item 402(v) of Regulation S-K provides that the information required thereunder must be provided in connection with any proxy or information statement for which the rules of the Commission require executive compensation disclosure pursuant to Item 402 of Regulation S-K, and Instruction 3 to Item 402(v) specifies that the information provided under Item 402(v) of Regulation S-K will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference. [February 10, 2023]

Nonetheless, in several Form 10-K filings in late January and early February, I noted that some companies had inadvertently included the disclosure in their Form 10-K in the language they used in Item 11 of Part III of the form. Typically, the Item 11 statement would read something like the following:

> The information in the sections of our 2023 Proxy Statement captioned "Compensation Discussion and Analysis," "Compensation Tables," "Director Compensation," "Corporate Governance – Compensation Committee Interlocks and Insider Participation," "Other Information

> – CEO Pay Ratio Disclosure" and "Other Information – Pay Versus Performance" is incorporated in this Item 11 by reference.

However, since the issuance of the SEC Staff guidance, I'm beginning to see fewer of these statements. Instead, the following language is becoming more common in Item 11:

> Information appearing in our Proxy Statement under the captions "2022 Director Compensation Table," "Compensation Discussion and Analysis," "Information Regarding Executive Compensation" (excluding the information under the subheading "Pay Versus Performance") and "Compensation Committee Report" is incorporated by reference herein.

It's just a small thing, but it's probably worth checking your customary Item 11 statement to make sure you've carved out the "pay-versus-performance" disclosure.

Posted by Mark Borges
Permalink: https://www.compensationstandards.com/member/blogs/compensationdisclosure/2023/02/pay-versus-performance-disclosure-and-form-10-k.html

← Tips for Using Relative TSR in a Tough Market | Main | The Pay & Proxy Podcast: Adopting a Dodd-Frank Compliant Clawback Policy →

May 24, 2023

Proxy Season Midpoint: Say-on-Pay Still Looking Bright…For Now

So far in 2023, say-on-pay results seem to be improving from 2022 despite decreases in TSR. WTW recently reported on updated say-on-pay results at Russell 3000 companies, and the data continues to confirm the early positive trends:

> On the one hand, 2023 say-on-pay outcomes appear to be holding fairly steady. Average say-on-pay support continues to trend around 90%, with negative recommendations from proxy adviser Institutional Shareholder Services (ISS) having a 20 to 30 percentage point downward impact on outcomes.
>
> However, as shown in Figure 1 below, the rate of ISS "no" recommendations for say-on-pay and the overall failure rate has dropped considerably so far in 2023. The 1% failure rate is derived from six failed votes observed to date, which is markedly below the 13 and 22 failed votes observed at a similar time in the proxy season in 2022 and 2021, respectively.
>
> . . . Pay-for-performance disconnects remain the primary issue most investors and their advisers cite when voting against say-on-pay resolutions and pay outcomes are likely driving some of the reduced opposition for say-on-pay this year.

That being said, WTW notes:

> It will be interesting to see if the early trend of less say-on-pay opposition continues to play out in the 2023 proxy season. Historically, WTW has tracked a reversion to the mean when all outcomes are ultimately tallied.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/05/proxy-season-midpoint-say-on-pay-still-looking-bright-for-now.html

GIBSON DUNN

October 27, 2022

SEC RELEASES FINAL CLAWBACK RULES

To Our Clients and Friends:

On October 26, 2022, the Securities and Exchange Commission ("SEC" or "Commission"), in a 3-to-2 vote, adopted final rules that will require listed companies to implement policies for recovery (*i.e.*, "clawback") of erroneously awarded incentive compensation, implementing Section 10D of the Securities Exchange Act, which was added by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[1] The SEC originally proposed clawback rules on July 14, 2015,[2] but the proposed rules remained dormant until October 14, 2021, when the SEC reopened the comment period[3] (and which was reopened for a second time on June 8, 2022).[4] The final rules add new Exchange Act Rule 10D-1 ("Rule 10D-1"), which largely tracks the long-pending proposed rules but also incorporate terms previewed in the 2021 release reopening the comment period.

Rule 10D-1 directs the national securities exchanges to establish listing standards that require issuers to adopt and comply with written clawback policies meeting strict conditions:

- The clawback policy must provide that, in the event the company is required to prepare an accounting restatement due to the material noncompliance of the company with any financial reporting requirement under the federal securities laws, the company will recover (on a pre-tax basis) the amount of incentive-based compensation received by its current and former executive officers in excess of the amount of incentive-based compensation that would have been received had it been determined based on the restated amount, subject to limited exceptions.
- Compensation recoupment is required regardless of whether the executive officer engaged in any misconduct and regardless of fault.
- The policy must apply to compensation "received"—which is defined as occurring when the financial reporting measure was attained regardless of when payment is actually made—during the three-year "recovery period" preceding the date the company is required to prepare the accounting restatement (the three-year period was mandated by the Dodd-Frank Act).
- The clawback policy must apply both to material accounting errors that require a restatement of prior years' financial results (commonly known as "Big R" restatements), *as well as* to errors that are corrected in the current year's results (commonly known as "little r" restatements).

In addition, the final rules require companies to file a copy of their policy as an exhibit to their Form 10-K, 20-F, 40-F or N-CSR, as applicable, and to publicly disclose how they have applied the policy whenever they experience a restatement. Rule 10D-1 also requires that issuers add two checkboxes to the cover page of their 10-Ks (or 20-Fs or 40-Fs): one checkbox to indicate whether the financial

statements included in the filing reflect the correction of an error to previously issued financial statements, and one to indicate whether any of the error corrections require a recovery analysis under the company's Rule 10D-1 clawback policy.

Almost all issuers are subject to the clawback rules, including those companies that are otherwise excluded from other SEC disclosure requirements related to executive compensation. A company would be subject to delisting if it does not adopt and comply with an exchange-compliant clawback policy.

The final rules release is available here and a Fact Sheet (*Recovery of Erroneously Awarded Compensation*) is available here. Set forth below is a summary of the final rules and considerations for companies.

When the Rules Take Effect

Each exchange will be required to propose rules or rule amendments consistent with Rule 10D-1 no later than 90 days following the date of the publication of the rules in the Federal Register. The listing standards must be effective no later than one year following the final rules publication date. Each company subject to such listing standards must adopt a compliant recovery policy no later than 60 days following the date on which the applicable listing standards become effective. The mandated clawback policies must apply to any incentive-based compensation that is received by current or former executive officers on or after the effective date of the applicable listing standard (which is a modification from the proposed rules). Compliance with the disclosure requirements is required in the first annual report or proxy or information statement required to be filed after the effective date of the new listing standards.

Summary of the Final Rules

All listed companies are covered by the rule, including foreign private issuers, emerging growth companies, smaller reporting companies, controlled companies and companies with only listed debt securities, but certain registered investment companies are excluded to the extent they have not provided incentive-based compensation to any current or former executive officer of the fund in the last three fiscal years.

There are five key components of the final rules:

1. *Covered individuals*. Current and former "executive officers" are subject to clawback of incentive-based compensation. "Executive officer" includes the company's president, principal financial officer, principal accounting officer, any vice president in charge of a principal business unit, division or function, and any other person who performs policymaking functions for the company and otherwise conforms to the full scope of the Exchange Act Section 16 definition. In a change from the proposed rules, the final rules will only require recovery of incentive-based compensation received by a person (i) after beginning service as an executive officer and (ii) if that person served as an executive officer at any time during the recovery period. Recovery of compensation received prior to becoming an executive officer will not be required, although compensation received during the recovery period by former executive officers is covered.

2. *Restatements that trigger application of clawback policy*. In a change from the proposed rules, the final rules require recoupment of erroneously awarded compensation (i) when the company is required to prepare an accounting restatement that corrects an error in previously issued financial statements that is material to the previously issued financial statements (commonly referred to as "Big R" restatement) and (ii) when the company is required to prepare an accounting restatement that corrects an error that is not material to previously issued financial statements, but that would result in a material misstatement if (A) the error was left uncorrected in the current report or (B) the error correction was recognized in the current period (commonly referred to as "little r" restatements). Application of the recovery policy would not be triggered by an "out-of-period adjustment" – a situation where the error is immaterial to the previously issued financial statements and the correction of the error is also immaterial to the current period. The recovery policy also would not be triggered by changes to prior period financial statements that do not arise due to error corrections, such as retrospective revisions to financial statements due to changes in accounting principles or segments.The Commission rejected a bright-light standard for determining when the recovery period begins, reasoning that doing so might incentivize companies to delay a restatement determination in order to manipulate the recovery date. Therefore, the final rules state that the recovery period runs from the earlier of: (i) the date the company's board of directors, committee of the board, or the officer or officers of the company authorized to take such action, concludes, or *reasonably should have concluded*, that the company is required to prepare an accounting statement due to the material noncompliance with any financial reporting requirement under the securities laws; or (ii) the date a court, regulator, or other legally authorized body directs the company to prepare an accounting restatement. The SEC stated in its October 14, 2021 Notice when it reopened the comment period: "For errors that are material to the previously issued financial statements, we generally expect the date . . . to coincide with the date disclosed in the Item 4.02(a) Form 8-K filed."

3. *Definition of incentive compensation and when it is "received."* "Incentive-based compensation" is any compensation (including cash and equity) granted, earned or vested based in whole or in part on the attainment of a "financial reporting measure." "Financial reporting measures" are measures that are determined and presented in accordance with the accounting principles used in preparing the company's financial statements, and any measures derived in whole or in part from such measures, as well as stock price and total shareholder return ("TSR"). A financial reporting measure is subject to the rule even if it is not actually presented in the company's financial statements or included in an SEC filing.

   Incentive-based compensation does not include compensation that is based *solely* on continued employment for a specified period of time (*e.g.*, time-vesting awards, including time-vesting stock options), unless such awards were granted or vested based in whole or in part on a financial reporting measure. Incentive-based compensation also does not include base salary (however, in the preamble to the proposed rule the SEC indicated that if the executive officer receives a salary increase earned wholly or in part based upon the attainment of a financial reporting measure, such increase would be subject to recovery), compensation awarded solely at the board's discretion, or compensation awarded upon the achievement of subjective, strategic or operational measures that are not financial reporting measures (such as the

achievement of ESG goals).The Dodd-Frank Act specified that the compensation subject to clawback is that which was received by the executive during a recovery period that is defined as "the three-year period preceding the date on which the issuer is required to prepare an accounting restatement." The final rules provide that incentive-based compensation is "received," and thus subject to clawback, in the fiscal period during which the applicable financial reporting measure is attained, even if the payment or grant occurs after the end of that period. In other words, the date of "receipt" of such compensation is tied to the satisfaction of the financial reporting measure goal, irrespective of applicable vesting, grant or payment dates. An award subject to both time- and performance-based vesting conditions is considered received upon satisfaction of the performance metric even if the award continues to be subject to time-based vesting criteria.

4. *Calculating the amount of clawback*. The amount required to be recouped is the amount of incentive-based compensation received by the executive in excess of what would have been received if the incentive-based compensation was determined based on the restated financial statements. To the extent the incentive-based compensation was based on stock price or TSR, such excess amount must be based on a reasonable estimate of the effect of the accounting restatement on the applicable measure. The company must maintain documentation of the determination of that reasonable estimate and provide it to the relevant exchange. In all cases, the calculation of erroneously awarded compensation would be calculated on a pre-tax basis. As discussed below, companies are required to disclose in their Form 10-K, 20-F, 40-F or N-CSR, as applicable, and proxy statement information on their calculation of the amount subject to clawback.

5. *Minimal discretion regarding recovery and its enforcement*. The rules require a company to recover erroneously awarded compensation in compliance with its recovery policy subject to limited exceptions. Recovery is not required only if the company's board or compensation committee has determined that recovery is impracticable for one of three reasons: (1) because the direct expenses paid to third parties to assist in enforcing the policy would exceed the amount to be recovered and the company has made a reasonable attempt to recover; (2) in the case of a foreign private issuer, because pursuing such recovery would violate home country law in effect prior to publication of the final rules in the Federal Register and where the company provides an opinion of counsel to that effect to the exchange; or (3) because recovery would likely cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code.[5] Clawback must be evaluated on a "no fault" basis – *e.*, without regard to whether any misconduct occurred or whether an executive bears responsibility. Executives may not be indemnified for the clawback, nor may companies pay premiums on an insurance policy that would cover an executive's potential clawback obligations. The rules require that companies pursue recovery "reasonably promptly," which suggests that boards may not allow covered executives to repay any clawed back amount in installments under a payment plan of any extended duration, barring any unreasonable economic hardship to the executive. In addition, under the new disclosure requirements (addressed further below), any amount subject to clawback from a current or former named executive officer but unpaid after 180 days must be disclosed.

New Disclosure Requirements

There are three key new disclosure requirements tied to the clawback rules:

1. *Clawback Policy Exhibit Requirement*. Each listed company must file its clawback policy as an exhibit to its annual report on Form 10-K, 20-F, 40-F or N-CSR, as applicable.

2. *New Item 402 disclosures*. Item 402 of Regulation S-K was amended to require companies to disclose how they have applied their recovery policies. If, during its last completed fiscal year, the company either completed a restatement that required recovery, or there was an outstanding balance of excess incentive-based compensation relating to a prior restatement, the company must disclose the following information for each restatement in any Form 10-K or proxy or information statements that includes executive compensation disclosure:

    (i) the date on which the company was required to prepare each accounting restatement and the aggregate dollar amount of excess incentive-based compensation attributable to the restatement, *including an analysis of how the recoverable amount was calculated* (an expansion of the proposed rules), or if the clawback amount has not been determined yet, an explanation of the reasons why it has not, and subsequent disclosure in the next filing that is subject to Item 402 of Regulation S-K;

    (ii) if the compensation is related to a stock price or TSR metric, the estimates used to determine the amount of erroneously awarded compensation attributable to such accounting restatement and an explanation of the methodology used for such estimates;

    (iii) the aggregate dollar amount of excess incentive-based compensation that remained outstanding at the end of the company's last completed fiscal year;

    (iv) where a company is invoking an impracticability exception, for each current and former named executive officer and for all other current and former executive officers as a group, the amount of recovery forgone and a brief description of the reason the listed registrant decided in each case not to pursue recovery, as well as (to the extent applicable to the invoked impracticability exception) a brief explanation of the types of direct expenses paid to a third party to assist in enforcing the recovery policy, identification of the provision of foreign law the recovery policy would violate, or how the recovery policy would cause an otherwise tax-qualified retirement plan to fail to meet the requirements of the Internal Revenue Code; and

    (iv) for each current and former named executive officer, the amounts of incentive-based compensation that are subject to a clawback but remain outstanding for more than 180 days since the date the company determined the amount owed.

The final rules also add a new instruction to the Summary Compensation Table to require that any amounts recovered pursuant to a company's compensation recovery policy reduce the amount reported

in the applicable column, as well as the "total" column" for the fiscal year in which the amount recovered initially was reported, with the clawback identified by footnote.

The final rules require information mirroring the above Item 402 disclosures to be included in annual reports on Form N-CSR and in proxy statements and information statements relating to the election of directors; on Form 20-F or, if the foreign private issuer elects to use the registration and reporting forms that U.S. issuers use, on Form 10-K; and on Form 40-F.

3. *New check boxes on cover pages of Forms 10-K, 20-F and 40-F*. In addition, and according to the SEC, "to assure that issuers listed on different exchanges are subject to the same disclosure requirements regarding erroneously awarded compensation recovery policies," companies must indicate by check boxes on their annual reports whether the financial statements included in the filings reflect a correction of an error to previously issued financial statements and whether any such corrections are restatements that required a recovery analysis.

Observations and Considerations for Companies

Companies do not need to adopt a Rule 10D-1 clawback policy until after the stock exchanges' listing standards implementing Rule 10D-1 are proposed, adopted and become effective. Nevertheless, there are important steps that companies should be taking before that time to prepare for the new rules:

1. *Prepare for Implementation*. The new listing standards will require companies to adopt "and comply" with their Rule 10D-1 clawback policies. In addition, the clawback policy needs to apply to any incentive compensation "received" on or after the effective date of the new listing standards, even if that compensation was received pursuant to an award granted before adoption of the company's Rule 10D-1 clawback policy. Therefore, to the extent they have not done so already, companies should be adding a term to their existing incentive compensation plans or award agreements and taking any other appropriate measures to enhance the enforceability of their Rule 10D-1 clawback policy once it is adopted.

2. *Evaluate Incentive Compensation Arrangements*. Companies should evaluate their existing compensation arrangements to assess which have any element that relates to a "financial performance measure" as defined under the SEC rules. At the same time, companies may wish to evaluate whether to modify or clarify the operation of arrangements that have financial performance measure elements. For example, companies with a legacy Section 162(m) bonus pool that is based on a financial performance measure, but under which actual payments are discretionary or based on other criteria, may wish to eliminate the performance-based funding of the bonus pool component. The clawback rules may also accelerate the trend toward the use of non-financial, strategic and ESG-related performance criteria in incentive compensation arrangements.

3. *Interaction with Existing Clawback Policies*. Companies will need to determine whether to integrate the Rule 10D-1 clawback policy with their existing policies, replace their existing policies, or adopt the Rule 10D-1 policy on a stand-alone basis. Various aspects of the Rule 10D-1 clawback requirements go beyond what companies typically have adopted to date, including

the mandatory nature of the clawback, the timing and length of the recovery period and the no-fault standard. At the same time, many company policies cover triggering events beyond financial restatements, may cover a larger population, and may apply to broader categories of compensation. Given the differences, companies may find it easier to adopt a stand-alone Rule 10D-1 clawback policy, and simply modify their existing clawback policies to clarify that they apply only to the extent that the Rule 10D-1 clawback policy does not. As noted above, the new rules require attaching the clawback policy as an exhibit to the annual report, so it is advisable to review the policy in light of that anticipated public disclosure.

4. *Enhance Documentation Around Compensation Committee Determinations*. Going forward, it will be more important than ever to have clear documentation around the extent to which financial performance measures affect decisions regarding granting, vesting and settlement/payout of each element of executives' compensation. To the extent that a compensation committee is exercising discretion, particularly if awarding compensation without regard to financial results, those decisions should be documented. Finally, it will be important to enhance internal and disclosure controls so that the implications of any restatement, including a "little r" restatement, can be taken into account.

The Rule 10D-1 clawback rules are designed to enhance an environment promoting compliance with applicable accounting rules. However, their application on a no-fault basis means that executives could be subject to compensation clawbacks based on inadvertent failures to satisfy complex accounting standards. It will be important to assess whether that possibility will lead to inadvertent consequences, such as a move away from financial performance measures in compensation arrangements or the loss of talented executives who feel unfairly penalized under a clawback claim that they intend to contest.

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[1] Pub. L. No. 111-203, 124 Stat. 1900 (2010).

[2] Listing Standards for Recovery of Erroneously Awarded Compensation, Exchange Act Release No. 34-75432 (July 14, 2015), available here.

[3] Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Exchange Act Release No. 34-93311 (Oct. 14, 2021), available here.

[4] Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Exchange Act Release No. 34-95057 (June 8, 2022), available here, which sought review and comment on the memo prepared by the staff of the SEC's Division of Economic and Risk Analysis, available here.

[5] With respect to this exception, Rule 10D-1(b)(1)(iv)(C) provides: "Recovery would likely cause an otherwise tax-qualified retirement plan, under which benefits are broadly available to employees of the registrant, to fail to meet the requirements of 26 U.S.C. 401(a)(13) or 26 U.S.C. 411(a) and regulations thereunder."

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SEC Staff Provides Guidance on Pay Versus Performance Disclosure

15 Feb 2023

Capital Markets and **Public Company Advisory & Governance**

Client Alert

On February 10, 2023, the staff of the Division of Corporation Finance (Staff) of the U.S. Securities and Exchange Commission (SEC) published new Regulation S-K Compliance and Disclosure Interpretations (C&DIs) regarding the pay versus performance disclosure requirements specified in Item 402(v) of Regulation S-K.**[1]**

The Staff's guidance on the pay versus performance disclosure requirements comes at a time when many companies are preparing their pay versus performance disclosure for the first time. While preparing the new disclosure, a number of interpretive issues have come up as companies and their advisors have encountered a number of interpretive issues as they consider how to apply the new rules to their own particular circumstances. The new C&DIs published by the Staff provide guidance on some of these interpretive questions.

Background of the Pay Versus Performance Disclosure Requirement

On August 25, 2022, the SEC adopted the pay versus performance disclosure requirements that the agency was directed to promulgate by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.**[2]** The pay versus performance disclosure requirements specified in paragraph (v) of Item 402 of Regulation S-K became effective on October 11, 2022.

Item 402(v) of Regulation S-K requires that companies provide a new table disclosing specified executive compensation and financial performance measures for the company's five most recently completed fiscal years.**[3]** This table includes, for the principal executive officer (PEO) and, as an average, for the other named executive officers (NEOs), the Summary Compensation Table measure of total compensation and a measure reflecting "executive compensation actually paid," as specified by the rule. The financial performance measures to be included in the table are:

- Cumulative total shareholder return (TSR) for the company;
- TSR for the company's self-selected peer group;
- The company's net income; and
- A financial performance measure chosen by the company and specific to the company that, in the company's assessment, represents the most important financial performance measure the company uses to link compensation actually paid to the company's NEOs to company performance for the most recently completed fiscal year (Company-Selected Measure).

In addition, Item 402(v) of Regulation S-K also requires a clear description of the relationships between each of the financial performance measures included in the table and the executive compensation actually paid to its PEO and, on average, to its other NEOs over the company's five most recently completed fiscal years. The company is also required to include a description of the relationship between the company's TSR and its peer group TSR.

Item 402(v) of Regulation S-K requires a list of three to seven financial performance measures that the company determines are its most important measures. Companies are permitted, but not required, to include non-financial measures in the list if they considered such measures to be among their three to seven "most important" measures.

Location of the Pay Versus Performance Disclosure

In Regulation S-K C&DIs Question 128D.01, the Staff indicates that the information required pursuant to Item 402(v) of Regulation S-K is not required to be included in an annual report on Form 10-K. The information required by Item 402(v) of Regulation S-K must be provided in connection with any proxy or information statement for which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required. Furthermore, the Staff notes that

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Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.

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information provided under Item 402(v) of Regulation S-K will not be deemed to be incorporated by reference into any filing under the Securities Act or Exchange Act, unless an issuer specifically incorporates it by reference.

Calculating and Presenting Compensation Actually Paid

In Regulation S-K C&DIs Question 128D.02, the Staff notes that the change in the value of equity awards that are granted to a company's NEO prior to that individual being appointed as an NEO is required to be included in the calculation of compensation actually paid under Item 402(v) of Regulation S-K.

In Regulation S-K C&DIs Question 128D.03, the Staff notes that, in a company's first Pay Versus Performance table, the company should provide footnote disclosure of each amount deducted and added to calculate the compensation actually paid to the PEO and the average of the compensation actually paid to the other NEOs for each of the periods presented in the table. After the first Pay Versus Performance table, companies are required to provide footnote disclosure for years other than the most recent fiscal year only if it is material to an investor's understanding of the information reported in the Pay Versus Performance table or the relationship disclosure provided under Item 402(v)(5) of Regulation S-K.

In Regulation S-K C&DIs Question 128D.04, the Staff notes that Item 402(v)(3) of Regulation S-K requires footnote disclosure of each of the amounts deducted or added in calculating compensation actually paid. The Staff indicates that disclosing only the aggregate amount calculated for pension value adjustments and equity award adjustments does not satisfy the footnote disclosure requirement. The footnote disclosure must include each of the amounts deducted and added pursuant to Item 402(v)(2)(iii)(B) and Item 402(v)(2)(iii)(C) to calculate the compensation actually paid to the PEO and the average of the compensation actually paid to the other NEOs.

Issuer and Peer Group TSR

In Regulation S-K C&DIs Question 128D.05, the Staff notes that for purposes of calculating the peer group TSR under Item 402(v)(2)(iv) of Regulation S-K, a company may use a peer group that is disclosed in its Compensation Discussion & Analysis (CD&A), even if such peer group is not used for "benchmarking" purposes under Item 402(b)(2)(xiv) of Regulation S-K, as that term is explained in Regulation S-K C&DIs Question 118.05. In Regulation S-K C&DIs Question 128D.07, the Staff indicates that a company electing to use the peer group from its CD&A should present the peer group TSR for each year in the Pay Versus Performance table using the peer group as disclosed in its CD&A for the respective period.

In Regulation S-K C&DIs Question 128D.06, the Staff notes that a company that went public during the earliest year included in the Pay Versus Performance table should calculate the TSR and peer group TSR beginning with the date that the company's class of securities was registered under Section 12 of the Securities Exchange Act of 1934, as amended (Exchange Act) during the earliest year included in the table, consistent with the calculation of TSR under Item 201(e) of Regulation S-K.

Net Income

In Regulation S-K C&DIs Question 128D.08, the Staff notes that a company is required to present in the Pay Versus Performance table its net income or loss as required by Regulation S-X in the company's audited GAAP financial statements. Other net income amounts, such as net income attributable to a controlling interest or income from continuing operations, cannot be reported in the Pay Versus Performance table for this purpose.

Company-Selected Measure

In Regulation S-K C&DIs Question 128D.09, the Staff notes that the Company-Selected Measure must be a financial performance measure that is not otherwise required to be disclosed in the Pay Versus Performance table, and the financial measures required to be reported in the Pay Versus Performance table include net income and the cumulative TSR of the company. The Staff notes that the Company-Selected Measure can be any financial performance measure that differs from the financial performance measures otherwise required to be disclosed in the table, including a measure that is derived from, is a component of, or is similar to, net income or cumulative TSR, such as earnings per share, gross profit, income or loss from continuing operations, or relative TSR.

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Further, in Regulation S-K C&DIs Question 128D.10, the Staff indicates that a company's stock price can be disclosed as a Company-Selected Measure only if the company uses its stock price to link the compensation actually paid to its NEOs to company performance, even if stock price has a significant impact on the amounts reported in the Pay Versus Performance table. Therefore, if the only impact of stock price on an NEO's compensation is through changes in the value of share-based awards, the company could not include its stock price as the Company Selected Measure. By contrast, if the company's stock price is used as a market condition applicable to an incentive plan award or is used to determine the size of the bonus pool, the stock price may be included as the company's Company-Selected Measure.

In C&DIs Question 128D.11, the Staff notes that the Company-Selected Measure included in the Pay Versus Performance table cannot be measured over a multi-year period that includes the relevant fiscal year as the final year, because the Company-Selected Measure is a measure which, in the company's assessment, represents the most important financial performance measure (that is not otherwise disclosed in the Pay Versus Performance table) used by the company to link compensation actually paid to the company's NEOs, for the most recently completed fiscal year, to the issuer's performance.

Tabular List of Financial Performance Measures

In Regulation S-K C&DIs Question 128D.12, the Staff addresses a situation where the only financial performance measure used by a company is in a "pool plan," where a bonus pool is available for payout only upon achievement of a financial performance measure or the size of the pool is determined based upon the extent such measure is achieved, but where the compensation committee may allocate bonus payouts to participants in its discretion, based on criteria independent of the achievement of any financial performance measure(s). The Staff indicates that the company may not omit the Tabular List required under Item 402(v)(6) of Regulation S-K and the Company-Selected Measure required under Item 402(v)(2)(vi) of Regulation S-K and the related relationship disclosure required under Item 402(v)(5)(iii) of Regulation S-K from its disclosure under Item 402(v) of Regulation S-K, because the size of the bonuses paid from the "bonus pool" is determined based wholly or in part on satisfying the financial performance measure, therefore the company is using the financial performance measure to link the executive compensation actually paid to company performance within the meaning of Item 402(v)(2)(vi) and Item 402(v)(6) of Regulation S-K.

Relationship Disclosure

In Regulation S-K C&DIs Question 128D.13, the Staff states that if a company has multiple PEOs in a fiscal year, the Staff will not object to the aggregation of the PEOs' compensation for purposes of the narrative, graphical, or combined comparison between compensation actually paid and TSR, net income, and the Company-Selected Measure.

Time Periods Presented in the Pay Versus Performance Table

In Regulation S-K C&DIs Interpretation 228D.01, the Staff indicates that if a company changes its fiscal year during the time period covered by the Pay Versus Performance table, the issuer must provide the disclosure required by Item 402(v) of Regulation S-K for the "stub period," and the company may not annualize or restate compensation. For example, in late 2022, a company that is not a smaller reporting company changed its fiscal year end from June 30 to December 31. In the company's first Pay Versus Performance table, the company must provide disclosure for each of the following four periods: July 1, 2022 to December 31, 2022; July 1, 2021 to June 30, 2022; July 1, 2020 to June 30, 2021; and July 1, 2019 to June 30, 2020. The company would continue providing such disclosure including the stub period until there is disclosure for five full fiscal years after the stub period. The Staff notes that this approach is consistent with the approach applicable to reflecting changes in fiscal year end in the Summary Compensation Table, as addressed in Regulation S-K C&DIs Interpretation 217.05.

In Regulation S-K C&DIs Interpretation 228D.02, the Staff addresses a situation where a company emerged from bankruptcy, and a new class of stock that was issued under the bankruptcy plan started trading in September 2020. The Staff notes that, consistent with Regulation S-K C&DIs Interpretation 206.14, the company will be presenting less than five full years of data in its stock performance graph under Item 201(e) using a measurement period for the graph from September 2020 through December 2022. For purposes of the requirement in Item 402(v)(2)(iv) of Regulation S-K, the Staff indicates that the company may provide its cumulative TSR and peer

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group cumulative TSR in the same manner. The Staff states that the company should provide footnote disclosure to explain the approach and its effect on the Pay Versus Performance table.

Next Steps

The Staff's new guidance addresses some of the questions that have arisen regarding the new pay versus performance disclosure requirement, so this guidance should be factored into the disclosure that companies provide under these new requirements. We expect that further guidance may be coming once the Staff has had an opportunity to review the new disclosures provided during the 2023 proxy season and identify potential areas for improvement or clarification.

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[1] ***Regulation S-K Compliance and Disclosure Interpretations***

[2] ***Release No. 34-95607, Pay Versus Performance*** (Aug. 25, 2022)

[3] Companies (except for smaller reporting companies) will be required to provide the information for three years in the first proxy or information statement in which they provide the disclosure, adding another year of disclosure in each of the two subsequent annual proxy filings that require the Item 402(v) disclosure.

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← Here Soon: Meredith Ervine's Blogging Debut! | Main | Pay Versus Performance: Some Large-Cap Disclosures! →

March 6, 2023

The Same Old Story—Another Perks Enforcement Action

I searched this blog for entries about perks, and no fewer than 29 had "perk" and 11 had "enforcement" in the title. In my book, that's already 29 reasons to beef up your perks disclosure controls and procedures. But the SEC keeps focusing on them, so we keep blogging about them!

It should surprise no one that the latest enforcement action involves a private plane, personal security and travel expenses for the spouses of executives. This time, the private plane was owned by the executive, and there's a related-party transaction element.

> Specifically, the SEC announced it settled charges against a global transportation company and its former CEO for failing to disclose $320,000 in perks. Further, with respect to the related-party transaction, the proxy disclosed that the company chartered the former CEO's plane from an independent management company and that it paid $3 million for those charters. However, the company failed to include that the CEO received $1.6 million of that amount, and therefore did not disclose the approximate dollar value of the CEO's interest in the transaction.

To settle the charges, the company and CEO agreed to pay $1 million and $100,000, respectively, in civil penalties.

As a perks refresher this proxy season, check out our "Perks" Practice Area and our chapter on Perks & Other Personal Benefits as part of Lynn & Borges's "Executive Compensation Disclosure Treatise" posted on this site.

– **Meredith Ervine**

Posted by Meredith Ervine
Permalink: https://www.compensationstandards.com/member/blogs/consultant/2023/03/the-same-old-story-another-perks-enforcement-action.html