



# Executive Compensation and Benefits Alert

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## SEC Staff Issues Additional Pay-Versus-Performance Compliance & Disclosure Interpretations

On September 27, 2023, the staff of the Securities and Exchange Commission's (SEC's) Division of Corporation Finance issued 10 new Compliance & Disclosure Interpretations (C&DIs) relating to the pay-versus-performance (PVP) disclosure rules adopted last year. This new set of C&DIs supplements the 15 C&DIs regarding the PVP disclosure rules issued by the staff on February 10, 2023, and provides answers to some of the questions that companies encountered in complying with the PVP disclosure rules for the first time during the 2023 proxy season. The new C&DIs are included below.<sup>1</sup>

For more information about the PVP rules and related disclosure requirements, see our previous client alerts: "[SEC Guidance Clarifies Some Issues Regarding Pay-Versus-Performance Disclosure, but Leaves Questions Unanswered](#)" (February 28, 2023) and "[SEC Adopts Long-Awaited Final Pay Versus Performance Disclosure Rules](#)" (August 31, 2022).

### Question 118.08

**Question:** Instruction 5 to Item 402(b) provides that "[d]isclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G and Item 10(e); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements." Does this instruction extend to non-GAAP financial information that does not relate to the disclosure of target levels, but is nevertheless included in Compensation Discussion & Analysis (CD&A) or other parts of the proxy statement — for example, to explain how pay is structured and implemented to reflect the registrant's or a named executive officer's performance?

**Answer:** No. Instruction 5 to Item 402(b) is limited to CD&A disclosure of target levels that are non-GAAP financial measures. If non-GAAP financial measures are presented in CD&A or in any other part of the proxy statement for any other purpose, such as to explain how pay is structured or implemented to reflect the registrant's or a named executive officer's performance or to justify certain levels or amounts of pay, then those non-GAAP financial measures are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K (except with regards to the Company-Selected Measure or additional financial performance measures disclosed pursuant to Item 402(v)(2)(vi) of Regulation S-K).

<sup>1</sup> The C&DIs covering the PVP disclosure rules, including the 10 new C&DIs and the 15 C&DI issued in February 2023, are contained in a larger set of C&DIs for Regulation S-K. The August 2022 adopting [release](#) includes the final PVP rules.

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In these pay-related circumstances only, the staff will not object if a registrant includes the required GAAP reconciliation and other information in an annex to the proxy statement, provided the registrant includes a prominent cross-reference to such annex. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, the staff will not object if the registrant complies with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information. [September 27, 2023]

## Question 128D.14

**Question:** Should awards granted in fiscal years prior to an equity restructuring, such as a spin-off, that are retained by the holder be included in the calculation of executive compensation actually paid?

**Answer:** Yes. All stock awards and option awards that are outstanding and unvested at the beginning of the covered fiscal year or are granted to the principal executive officer and the remaining named executive officers during the covered fiscal year, including those awards modified in connection with an equity restructuring or retained following such a transaction, and for which compensation cost will be recognized under FASB ASC Topic 718 should be included in the table required by Item 402(v)(1) of Regulation S-K. [September 27, 2023]

## Question 128D.15

**Question:** In periods prior to pursuing an initial public offering, a private company may grant stock awards or option awards. Once that company is required to provide Item 402(v) disclosures, should the change in fair value of awards granted prior to the date of a registrant's initial public offering be based on the fair value of those awards as of the end of the prior fiscal year for purposes of determining executive compensation actually paid?

**Answer:** Yes. For outstanding stock awards and option awards, the calculations required by Item 402(v)(2)(iii)(C)(1) of Regulation S-K should be determined based on the change in fair value from the end of the prior fiscal year. The fair value of these awards should not be determined based on other dates, such as the date of the registrant's initial public offering. [September 27, 2023]

## Question 128D.16

**Question:** Market conditions under U.S. GAAP are certain conditions related to the price of the issuer's shares that affect the exercise price, exercisability, or other pertinent factors used in determining the fair value of the award. Market conditions are not considered vesting conditions under U.S. GAAP even though the executive

is not entitled to the compensation until the market condition is satisfied. How should awards with a market condition consider that condition in determining whether the applicable vesting conditions have been met in performing the calculation required by Item 402(v)(2)(iii)(C)(1) of Regulation S-K?

**Answer:** In accordance with FASB ASC Topic 718, the effect of a market condition should be reflected in the fair value of share-based awards with such a condition. In addition, for purposes of the table required by Item 402(v)(1) of Regulation S-K, market conditions should also be considered in determining whether the vesting conditions of share-based awards have been met. That is, until the market condition is satisfied, registrants must include in executive compensation actually paid any change in fair value of any awards subject to market conditions. Similarly, registrants must deduct the amount of the fair value at the end of the prior fiscal year for awards that fail to meet the market condition during the covered fiscal year if it results in forfeiture of the award. [September 27, 2023]

## Question 128D.17

**Question:** An award did not meet vesting conditions during the year because the performance or market conditions were not met. However, there is still potential for the award to vest in the future. Should the award fair value be subtracted under Item 402(v)(2)(iii)(C)(1)(v) of Regulation S-K because it failed to vest in the current year?

**Answer:** No. Item 402(v)(2)(iii)(C)(1)(v) is referring to awards that were forfeited and the cumulative reported value of that award is \$0. Awards that remain outstanding and have not yet vested, because, for example, performance or market conditions were not met in an eligible year, are not considered to have failed to meet the applicable vesting conditions for the purpose of Item 402(v). [September 27, 2023]

## Question 128D.18

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

**Answer:** Yes. However, for awards with additional substantive conditions, in addition to retirement eligibility, such as a market condition as described in Question 128D.16, those other conditions must also be considered in determining when an award has vested. [September 27, 2023]

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## Question 128D.19

**Question:** Some stock and option awards with a performance condition require certification by others, such as the compensation committee, that the level of performance was attained. If the performance condition was met by fiscal year-end, however, the certification occurs after year-end, would the award be considered vested for purposes of the Item 402(v) of Regulation S-K disclosures at the end of the fiscal year-end?

**Answer:** If certification is an additional substantive vesting condition, then the award would not be considered vested. A performance-based vesting condition is considered satisfied when the applicable condition is achieved. However, a provision which requires the compensation committee to certify the level of performance attained should be analyzed to determine if it creates an additional substantive vesting condition, such as an employee does not vest in the award unless and until they remain employed through the date such certification occurs. [September 27, 2023]

## Question 128D.20

**Question:** Item 402(v)(2)(iii)(C)(3) of Regulation S-K requires the fair value of all stock awards, and all option awards, with or without tandem stock appreciation rights (SARs) to be computed in a manner consistent with the methodology used to account for share-based payments under GAAP. May a registrant satisfy this requirement by using a valuation technique that differs from the one used to determine the grant date fair value of option or other equity-based awards that are classified as equity in the financial statements?

**Answer:** Yes, as long as the valuation technique would be permitted under FASB ASC Topic 718, including that it meets the criteria for a valuation technique and the fair value measurement objective. For example, if another valuation technique provides a better estimate of fair value subsequent to the grant date, which would meet the measurement objective in U.S. GAAP, then a registrant may use it to calculate executive compensation actually paid under Item 402(v) instead of the technique used to determine the grant-date fair value of share-based payments in the registrant's GAAP financial statements. Item 402(v)(4) of Regulation S-K requires disclosure about the assumptions made in the valuation that differ materially from those disclosed as of the grant date of such equity awards. A change in valuation technique from the technique used at the grant date of such equity awards in the registrant's financial statements would require disclosure of the change if such technique differs materially. We would expect a registrant to disclose under Item 402(v)(4) both the change in valuation technique from the grant date and the reason for the change. [September 27, 2023]

## Question 128D.21

**Question:** To comply with Item 402(v)(2)(iii)(C)(3) of Regulation S-K, the methodology used to compute the fair value amounts of all stock awards, and all option awards, with or without tandem SARs, must be consistent with the methodology used to account for share-based payments in the financial statements under GAAP. Is it ever acceptable to value these awards as of the end of a covered fiscal year based on methods not prescribed by GAAP?

**Answer:** No. The fair value of stock awards and option awards must be computed using a methodology and assumptions consistent with FASB ASC Topic 718. For example, the expected term assumption to value options should not be determined using a method that is not acceptable under GAAP, such as a "shortcut approach" that simply subtracts the elapsed actual life from the expected term assumption at the grant date. This approach would not be acceptable because it does not consider whether there were changes in the factors that a registrant considers in determining the expected term assumption at grant date, such as volatility and/or exercise behavior. U.S. GAAP fair value measurement objectives require that assumptions and measurement techniques be consistent with those that marketplace participants would likely use in determining an exchange price for the share options. Similarly, the expected term for options referred to as "plain vanilla" in Staff Accounting Bulletin 14.D.2 should not be determined using the "simplified" method described in that Staff Accounting Bulletin if those options do not meet the "plain vanilla" criteria at the re-measurement date, such as when the option is now out-of-the-money. [September 27, 2023]

## Question 128D.22

**Question:** Instruction 4 to Item 402(b) of Regulation S-K provides that "registrants are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant." Item 402(v)(2)(iii)(C)(3) of Regulation S-K provides that "for any awards that are subject to performance conditions, calculate the change in fair value as of the end of the covered fiscal year based upon the probable outcome of such conditions as of the last day of the fiscal year." In addition, Item 402(v)(4) of Regulation S-K provides that "for the value of equity awards added pursuant to paragraph (v)(2)(iii)(C) of this section, disclose in a footnote to the table required by paragraph (v)(1) of this section any assumption made in the valuation that differs materially from those disclosed as of the grant date of such equity awards." If the disclosure required by Item 402(v)(4) would involve confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant, may the registrant omit such information?

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**Answer:** Yes. A registrant is not required to disclose detailed quantitative or qualitative performance condition for its awards under Item 402(v)(4) to the extent such information would be subject to the confidentiality protections of Instruction 4 to Item 402(b) of Regulation S-K. However, the registrant must provide as much information responsive to the Item 402(v)(4) requirement as possible without disclosing the confidential information, such as a

range of outcomes or a discussion of how a performance condition impacted the fair value. In addition, consistent with Instruction 4 to Item 402(b), the registrant should also discuss how the material difference in the assumption affects how difficult it will be for the executive or how likely it will be for the registrant to achieve undisclosed target levels or other factors. [September 27, 2023]

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