

AGENDA

SEC's Comp Guidance Raises New Questions for Boards

The SEC has pulled an Uno Reverse card on certain PVP decisions

By **Amanda Gerut** | October 23, 2023

Compensation committees will face new considerations raised by recent SEC guidance on the pay-versus-performance disclosure rule. None of them will lack for complexity, sources said.

The SEC in September issued nine compliance and disclosure interpretations. One C&DI, which relates to whether an equity award is considered vested when the executive who was granted the award hits retirement eligibility, could be particularly challenging to navigate.

Under the SEC's interpretation, if that is the only vesting condition on the equity award, the award is considered vested — and thus is to be factored into the compensation actually paid calculation required by the PVP rule — once the executive reaches retirement eligibility (RE). If there are other conditions, the award isn't to be considered vested and would be scooped out in calculating CAP.

While retirement eligibility provisions vary by company — and some don't have retirement provisions in equity awards at all — a common RE provision is that executives are eligible once they reach age 55 and have 10 years of experience.

Many companies with such RE provisions took a different approach from the SEC's guidance in complying with the PVP rule in the first year, sources said. Accordingly, those companies will have to decide whether to change the way they calculate CAP.

From there, companies will have to decide whether to amend figures from the first year of the PVP table and whether and how to explain the difference to investors. If companies with retirement provisions in their awards don't treat them as vested, boards should understand the rationale, sources said.

"This is a meaningful piece of guidance for many companies," said **Gillian Emmett Moldowan**, global governance and advisory practice group leader and partner at **Shearman & Sterling**.

Whatever decisions are made won't exclusively impact the PVP disclosure either, she said.

Whether or not an award is considered vested could impact other required compensation disclosures such as the table on outstanding equity awards at fiscal year-end, the option exercises and stock vested table, and the nonqualified deferred compensation table, explained Moldowan. The SEC requires those table disclosures in Item 402 of Regulation S-K, and they appear annually in proxy statement compensation disclosure.

"It's my view that companies should have a consistent concept of what vesting means across these tables," she added. "If a company has been treating something as unvested and based on this guidance you are going to change course and treat it as vested, then you're going to have to look at all of your Item 402 tables

and reassess what changes might be needed.”

New Complications

There are several factors to consider about the SEC’s approach, said **Takis Makridis**, president and CEO of equity valuation consulting firm **Equity Methods**.

First, the CEO’s CAP and the named executive officers whose CAP figures are averaged can now all have different vesting dates, given their individual retirement eligibility dates, said Makridis. The change introduces new potential for errors in the calculations and could also lead to new swings in the CAP figures from company to company. Those variations might lead to confusion for investors or possibly board members who look at their PVP tables in relation to peers’ tables, said Makridis.

“What it will do is lead to much more lumpiness in the CAP calculations,” he said.

“At company A, where all or most executives are retirement eligible at grant, you could solidify the amount hitting CAP on the date of grant and have no subsequent remeasurement...At another company, where there aren’t retirement provisions or the executives aren’t yet retirement eligible, CAP will swing in response to valuation changes. The comparison might suggest that one company is paying much more or less but only because they’re measuring the value at a different point in time.”

For boards and compensation committees that want to look at PVP tables and CAP figures in relation to peer companies, the comparisons could be apples to oranges, he said.

In addition to optics, implementation is another thorny matter, said Makridis.

Given that many companies took a different approach to what the SEC put forward in its recent C&DI, those companies will now need to decide if they need to redo the first-year PVP table.

The questions about retirement eligibility have lingered since the rule first came out, noted **David Lynn**, chair of **Morrison Foerster**’s public company advisory and governance practice.

“If you didn’t approach it in this way in the prior initial filing, then you would have to make some adjustments now that you have the benefit of the staff’s thinking,” said Lynn, who previously served as chief counsel in the division of corporation finance at the SEC. “That happens all the time with new disclosure requirements.”

Indeed, Makridis had more than one client that hadn’t filed its first PVP disclosure by the time the C&DIs were issued in September but had already finished the core legwork, and the company counsel concluded that they would recalculate the historical figures in the table based on the guidance.

“Their attitude was, ‘We don’t need a comment letter, and we don’t need drama,’” said Makridis.

The SEC’s clarifications to the PVP rule were silent on whether companies are required to make changes to the first-year table or adopt the new methodologies on a prospective basis, said Makridis.

“Not every clarification merits redoing three years’ worth of calculations,” he said. “It’s really going to come down to how you interpret their silence on retrospection.”

For many companies, that decision will largely turn on materiality, said **Kate Napalkova**, partner at law firm **Proskauer**. Assuming that the CAP figures are smaller based on applying the SEC's guidance, adding a footnote explaining to shareholders that the difference reflects adjustments made based on SEC guidance could preempt questions from investors about why the numbers look different, she said.

A future revision and footnote would be consistent with what companies seem to have done so far in response to SEC comments on PvP tables.

Comp committees should understand the implications of any changes, Napalkova noted, and the impact of the awards on CAP.

“At the end of the day, it's about telling shareholders a clear story.”

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