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SEC Reopens Comment Period for Proposed Pay Versus Performance Rule

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On January 27, 2022, the Securities and Exchange Commission (the “SEC”) announced the reopening of the comment period for its proposed pay versus performance rule, which was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and which the SEC first proposed in 2015. The original proposal would have required registrants to describe how compensation actually paid to the registrant’s named executive officers relates to the registrant’s financial performance and disclose the following, in tabular format, for the preceding five years:

- the compensation for the registrant’s chief executive officer and the average compensation for the registrant’s other named executive officers, as reported in the Summary Compensation Table;
- the compensation actually paid to the registrant’s chief executive officer and the average compensation actually paid to the registrant’s other named executive officers; and
- the total shareholder return for the registrant and for the registrant’s peer group.

In reopening the proposal, the SEC has also suggested broadening the required disclosure:

- to include in the tabular disclosure the registrant’s pre-tax net income, net income and an additional measure, selected by the registrant, which the registrant believes represents “the most important performance measure” to link compensation actually paid to the registrant’s performance; and
- to require a registrant to list the five most important performance measures used by the registrant to link compensation actually paid to the registrant’s performance.

The SEC has noted that the proposed regulations would not apply to foreign private issuers, registered investment companies and Emerging Growth Companies. Smaller reporting companies would be subject to the proposed regulations, if adopted, but would be able to provide reduced disclosure.

The proposed regulations leave many details to be determined, as acknowledged by the questions raised by the SEC in its request for comment, including:

- whether the registrant should be required to disclose the methodology behind determining the registrant-selected performance measure;
- what should be the criteria for determining “the most important performance measure”;
- should the performance measures disclosed by the registrant be limited to financial measures or should ESG, diversity or similar non-financial measures also be permitted (particularly relevant given the heightened focus on ESG matters in 2022 compared with 2015);
- should registrants be permitted to disclose a different “most important performance measure” for each of the five years covered by the table; and

- how should “compensation actually paid” be determined, including how should the value of stock options or pension benefits be reflected.

The new comment period is open until March 4, 2022 after which time we would expect the SEC to adopt final rules fairly quickly.

While implementation of the rule itself would not require companies to change their executive compensation programs and practices, the required disclosure may result in increased attention from investors and proxy advisory firms as to how companies structure their incentive compensation and the metrics they use to incentivize and compensate their executives. As a result, we recommend that companies consider informing their boards and/or compensation committees of the SEC’s renewed focus on these rules, including the updates reflected in the reopened proposal.

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