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OBSERVATIONS FROM S&P 500 PAY VERSUS PERFORMANCE DISCLOSURES

FW Cook reviewed the S&P 500 companies that filed 2023 proxy statements as of June 1, 2023 (n=403 companies) to analyze the new SEC Pay Versus Performance (PVP) requirements. Key findings include:

- The top three most common financial performance measures that companies chose as their Company Selected Measure (CSM) were profit (56%), revenue (17%), and returns (12%)
- Majority of companies included profit (88%), TSR (55%), and revenue (51%) in their Tabular List and only 21% of companies included non-financial performance measures
- Most companies (76%) used their 10-K published industry or line-of-business index as their total shareholder return (TSR) peer group
- Despite three financial performance measures being the minimum requirement, most companies included additional financial performance measures
- Most companies (91%) used graphs/charts as the clear description requirement, and the remaining 9% used a narrative only description

Background

In August 2022, the SEC released the long-awaited final rule implementing the requirement in the Dodd-Frank Act that proxy statements contain a “clear description” of “information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the stock.”

This ALERT is a follow-up to FW Cook’s [“Observations from Initial Pay Versus Performance Disclosures”](#) published in March 2023.

For detailed information on the new PVP rule, please see our prior postings [here](#) and [here](#).

S&P 500 Sample

Our findings cover the 403 companies in the S&P 500 Index that filed proxy statements covering the PVP requirements as of June 1, 2023. Following is the profile of companies covered:

Industry Sector # of companies (n=403)	Percent of Companies Reviewed	(\$Bil)		Median		
		Total Revenue	Net Income	Market Cap	TSR ⁽¹⁾	
					1-Year	3-Year Cumulative
Financials (67)	17%	\$12.5	\$2.2	\$31.6	-12%	18%
Industrials (62)	15%	\$14.0	\$1.0	\$24.5	-12%	32%
Health Care (52)	13%	\$13.0	\$1.3	\$45.1	-8%	38%
Consumer Discretionary (42)	10%	\$11.7	\$1.0	\$20.0	-24%	4%
Information Technology (34)	8%	\$5.4	\$0.8	\$29.8	-23%	34%
Real Estate (30)	7%	\$2.9	\$0.6	\$20.8	-27%	3%
Utilities (29)	7%	\$13.8	\$1.1	\$25.5	2%	12%
Materials (26)	6%	\$13.6	\$1.3	\$24.0	-14%	25%
Energy (23)	6%	\$21.2	\$4.1	\$36.4	58%	72%
Consumer Staples (22)	5%	\$27.4	\$2.1	\$46.0	5%	30%
Communication Services (16)	4%	\$32.7	\$1.9	\$54.9	-40%	-17%
Total Sample	—	\$12.6	\$1.3	\$28.8	-9%	25%

Source: S&P Capital IQ (total revenue and net income represents 10-K results; market capitalization measured as of 6/1/2023).

⁽¹⁾ TSR = Total Shareholder Return, a measure of stock price and dividend performance; calculated through 12/31/2022.

Company Selected Measure

Included in the PVP Table is the company's CSM, which represents the most important financial performance measure (not otherwise required to be disclosed in the PVP Table) used by the registrant to link CAP for the most recently completed fiscal year to company performance. Companies may use non-GAAP measures as their CSM as long as there is disclosure as to how the CSM value is computed from the audited financial statements. Among the 403 companies, the following financial performance measures were most common: profit (56%), revenue (17%), and returns (12%).¹ Three companies noted that they do not use any financial performance measures in their executive compensation programs and thus did not provide a CSM.

Company Selected Measure	Prevalence
Profit	56%
Revenue	17%
Returns	12%
Cash Flow	5%
Relative TSR	3%
Margin	2%
Other Financial Performance	2%
Stock Price	1%
No CSM	1%

Numbers do not add up to 100% due to rounding.

¹ Examples of profit measures include EPS, EBIT, EBITDA, and operating/pre-tax profit; examples of returns measures include return on equity, return on assets, and return on capital.

A review of the companies' CSMs shows that common practice is to use the financial performance measure with the highest weighting in either the company's annual and/or long-term incentive program, that is not otherwise required to be disclosed in the PVP table (i.e., Absolute TSR and GAAP Net Income). The majority practice among companies is to use a non-GAAP CSM. This was expected because many companies use non-GAAP measures in their incentive plans.

CSM: GAAP vs. Non-GAAP	Prevalence
GAAP	16%
Non-GAAP	84%

Of the sample reviewed, the CSM was used in the annual incentive plan at 71% of companies and in the long-term incentive plan at 54% of companies (the percentages add to more than 100% because of situations where the same financial performance measure is used in both plans). Seven companies used a metric as its CSM that is in neither its annual nor long-term incentive plan.

CSM: Incentive Plan	Prevalence
Annual Incentive Plan Only	45%
Long-Term Incentive Plan Only	28%
Both (Annual and Long-Term Incentive Plans)	26%
None	2%

Numbers do not add up to 100% due to rounding.

It was uncommon for companies to provide a supplemental measure in addition to the CSM in the PVP table. Only eight companies (2% of the sample) used this approach.

The Tabular List of Financial Performance Measures

Another disclosure requirement is the list of at least three (and no more than seven) financial performance measures that represent the most important financial performance measures used by the registrant to link CAP for the most recently completed fiscal year to company performance (the Tabular List). There is no requirement that the measures be ranked and, as long as the list includes three financial performance measures, companies can also include non-financial metrics.² The rule notes that separate Tabular Lists can be provided for (1) the principal executive officer (PEO) and the other named executive officers (Non-PEO NEOs) as a group or (2) as separate tabular lists for each named executive officer (NEO).

Almost all companies provided a single list. Companies that chose to use an individual list for each NEO typically did so because a business unit head was among their NEO group.

² Companies may include less than three financial performance measures if they use fewer than three financial performance measures to link CAP to financial performance. If fewer than three financial performance measures were used, the Tabular List must include all the measures that were used.

Tabular List: Type	Prevalence
One List for all NEOs	98%
Individual List for Each NEO	1%
No List (No Financial Performance Measures)	1%
One List for CEO and Another for Other NEOs	0%

The majority of companies included more than three measures.

Tabular List: # of Measures	Prevalence
<3	6%
3	34%
4	25%
5	20%
6	7%
7	8%

Most companies did not include a non-financial performance measure.

Tabular List: Non-Financial Performance Measures	Prevalence
Does Not Include Non-Financial Performance Measures	79%
Includes Non-Financial Performance Measures	21%

This finding is interesting given that FW Cook's 2022 Top 250 Annual Incentive Plan Report, which can be found [here](#), indicates that 78% of the 250 largest companies use non-financial components in their annual incentive plan. Among companies that included non-financial performance measures in the Tabular List, environmental, social, governance-related, and safety goals were prevalent.

When reviewing the measures in companies' Tabular Lists, a majority of companies included the following measures: profit (88%), TSR (55%), and revenue (51%). While many companies included multiple measures from the same category (e.g., relative TSR and absolute TSR), prevalence counted only once for each company.

Tabular List Measure	Prevalence
Profit	88%
TSR	55%
Revenue	51%
Returns	38%
Cash Flow	30%
Other Financial	19%
Margin	17%
Non-Financial (Non-ESG)	13%
Environmental, Social & Governance (ESG)	12%
Stock Price	7%

TSR Peer Group

Companies must select a specific peer group for presentation of relative TSR values in the PVP table. Permitted choices include a compensation peer group disclosed in the Compensation Discussion and Analysis (CD&A) or the published industry or line-of-business index used in the Form 10-K performance graph. Most companies chose to use the published industry or line-of-business index in the Form 10-K.

One of the primary reasons for selecting an index used in the Form 10-K is it avoids the need for additional calculations when changes are made year-over-year to a custom peer group.

Peer Group	Prevalence
10-K Performance Graph – Published Industry or Line-of-Business Index	76%
10-K Performance Graph – Custom Peers	10%
CD&A Compensation Peer Group	8%
10-K Performance – Broad-Based Index	3%
CD&A Performance Award Peer Group	2%

Numbers do not add up to 100% due to rounding.

Clear Description Requirement

The rule requires companies to provide a “clear description” of the relationships between CAP of the PEO and NEOs with the company’s TSR, the company’s net income (GAAP), and the CSM. Companies must also include a comparison of the company’s TSR to the peer group TSR. The rule provides no guidance on what constitutes a “clear description,” other than noting that graphs may be used. Most companies used graphs or charts in their narrative. For this review, if a graph or chart is used to show a clear description, the prevalence is captured as such, even if additional narrative was provided.

Clear Description Requirement	Prevalence
Includes Graphs / Charts	91%
Narrative Only	9%

PVP Disclosure Location within the Proxy

An additional consideration is where to place the PVP disclosure in the proxy statement. Among the 403 companies reviewed, the most prevalent practice is to include the PVP disclosure near the end of the proxy statement, typically following the CEO Pay Ratio disclosure (i.e., after the CD&A compensation tables). This was the general expectation after the PVP rule was first announced. Only four companies chose to include the disclosure before its SCT.

Proxy Location	Prevalence
Near the End of Proxy Statement (After Termination Tables and CEO Pay Ratio)	80%
Between Termination Tables and CEO Pay Ratio	16%
Between SCT and Termination Tables	3%
Before SCT	1%

Compensation Actually Paid Compared to Summary Compensation Table

What can one learn from a company's CAP value? The key take-away is that the CAP values will differ from SCT-disclosed amounts based on short-term stock price performance. The degree of difference, however, depends on many factors including leverage in the overall program (e.g., use of stock options versus other equity awards), correlation between metrics used in the incentive structure and changes in shareholder value, and overall pay mix (e.g., cash versus equity).

We examined the relationship between CAP and SCT by dividing CAP by SCT (CAP/SCT) over the three reported fiscal years, both annually and cumulatively, to evaluate patterns relative to companies' TSR over the same timeframe.

In 2020, even with many companies severely impacted by COVID-19, CAP values for most companies were above reported SCT amounts. The median PEO CAP/SCT ratio was 112% and the median other NEO ratio was 111%, while median TSR for these companies was 8%.

In 2021, when many companies experienced rebounding share prices, median CAP/SCT ratios were 163% and 147% for PEOs and other NEOs, respectively, while median TSR for these companies was 29%.

In 2022, due to a difficult financial year and share price declines for many companies, median CAP/SCT ratios for PEOs and Non-PEO NEOs were below 100% and median TSR (at median) was also negative.

Over the cumulative three years, primarily due to a very strong 2021, the NEOs' CAP/SCT ratios were above 100% and companies' TSR at median were positive. The companies' median 3-year cumulative TSR was 25%, while the PEOs' and Non-PEO NEOs' CAP/SCT ratios, at median, were 125% and 117%, respectively.

CAP / SCT	PEO	Non-PEO NEOs	TSR ⁽¹⁾
2020			
75th Percentile	188%	166%	27%
Median	112%	111%	8%
25th Percentile	68%	74%	-7%
2021			
75th Percentile	244%	209%	47%
Median	163%	147%	29%
25th Percentile	113%	107%	11%
2022			
75th Percentile	131%	125%	8%
Median	85%	87%	-9%
25th Percentile	25%	37%	-27%
Cumulative (2020 – 2022)			
75th Percentile	165%	150%	54%
Median	125%	117%	25%
25th Percentile	96%	98%	0%

⁽¹⁾ For Cumulative (2020 – 2022), TSR is measured cumulatively over three years.

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