

## **“Pay Versus Performance” Disclosures in the Technology and Life Sciences Sectors – Year Two**

As we did last year, we have taken a close look at the required “pay-versus-performance” disclosure during the recent 2024 proxy season – the second year of the disclosure mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act. As you may recall, this disclosure, required of all reporting companies (other than foreign private issuers, registered investment companies, and emerging growth companies), consists of:

- a table containing specified compensation information about the reporting company’s named executive officers (“NEOs”) and financial performance for its four (and eventually five) most recently completed fiscal years (although companies subject to the requirement for the first time in 2024 need only provide three years of information);
- a clear description of the relationships between each of the financial performance measures included in the required table and the executive compensation actually paid (“CAP”) to the company’s Principal Executive Officer (“PEO”) and, on average, its other NEOs, along with a description of the relationship between its total shareholder return (“TSR”) and its peer group’s TSR; and
- a list of three to seven financial performance measures that the company determines are its most important measures used to link the compensation actually paid to its NEOs, for the most recently completed fiscal year, to company performance.

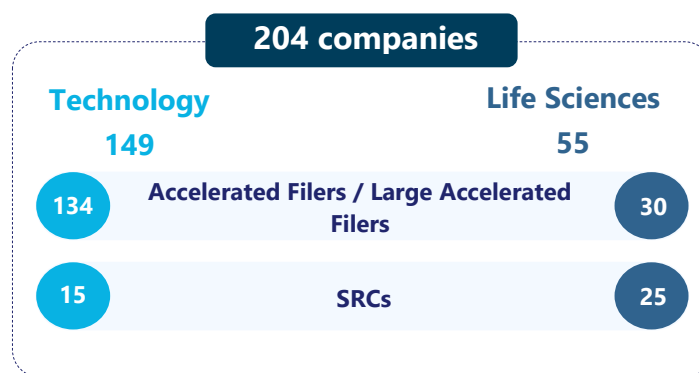
Smaller reporting companies (“SRCs”) are eligible to comply with scaled disclosure requirements, including providing the tabular disclosure for only their three most recently completed fiscal years (two years in the initial year of compliance).

For a detailed discussion and analysis of the “pay-versus-performance” disclosure rules, please see our Thoughtful Pay Alert, [SEC Adopts New Rules for “Pay Versus Performance” Disclosure Requirement \(Sept. 9, 2022\)](#). For last year’s review of the initial round of “pay-versus-performance” disclosure, please see our Thoughtful Disclosure Alert, [“Pay Versus Performance” Disclosures in the Technology and Life Sciences Sectors \(Oct. 24, 2023\)](#).

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## COMPANIES REVIEWED

We conducted an analysis of 204 technology and life sciences companies that filed their proxy statements between March 1, 2024 and July 31, 2024. These consisted of 149 companies in the technology sector and 55 companies in the life sciences sector. All of these companies were accelerated filers or large accelerated filers, except for 40 companies (19.6%) that self-reported as SRCs. Of these SRCs, 15 were in the technology sector and 25 were in the life sciences sector.



Of the companies that were not SRCs, 19 companies disclosed that they did not use any financial performance measures in their short-term incentive compensation plan and granted only time-based equity awards (or only used financial performance measures that were already included in the "Pay-Versus-Performance" table). Consequently, these companies did not include a Company-Selected Measure ("CSM") in their "Pay-Versus-Performance" table or describe the relationship between the CAP to their NEOs and their CSM (11 of which were technology companies and eight of which were life sciences companies).

Finally, 192 of the companies we reviewed were filing the "pay-versus-performance" disclosure for the second time (consisting of 142 technology companies and 50 life sciences companies), while for 12 companies (consisting of seven technology companies and five life sciences companies), their 2024 disclosure was their initial "pay-versus-performance" disclosure.

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## TABULAR DISCLOSURE

As was true during the 2023 proxy season, for most companies the greatest effort involved the computation of CAP for each covered fiscal year, which as we know, principally involved the recalculation of the fair values of the equity awards granted or vested during each covered fiscal year as of each vesting date and outstanding at the end of each covered fiscal year, as well as any equity awards granted in prior fiscal years that vested during and/or were outstanding at the end of each covered fiscal year. This requirement was markedly easier for companies presenting their second year of disclosure as they needed only to recalculate and add one additional year of compensation information to their previous "Pay-Versus-Performance" table. In 2025, these companies will add the fifth – and final – fiscal year of information to the table and thereafter will be able to rotate the earliest year out of the table as each new fiscal year is added.

## Reconciliation of CAP

Virtually every company used so-called "reconciliation" tables to satisfy the requirement that they provide, by means of a footnote, a reconciliation between the reported Summary Compensation Table amounts and the CAP amounts disclosed in the "Pay-Versus-Performance" table. This included both companies providing the disclosure for the second time and companies providing the disclosure for the first time. Apparently, one company did not address this particular requirement in its disclosure.

## Disclosure of Reconciliation Tables

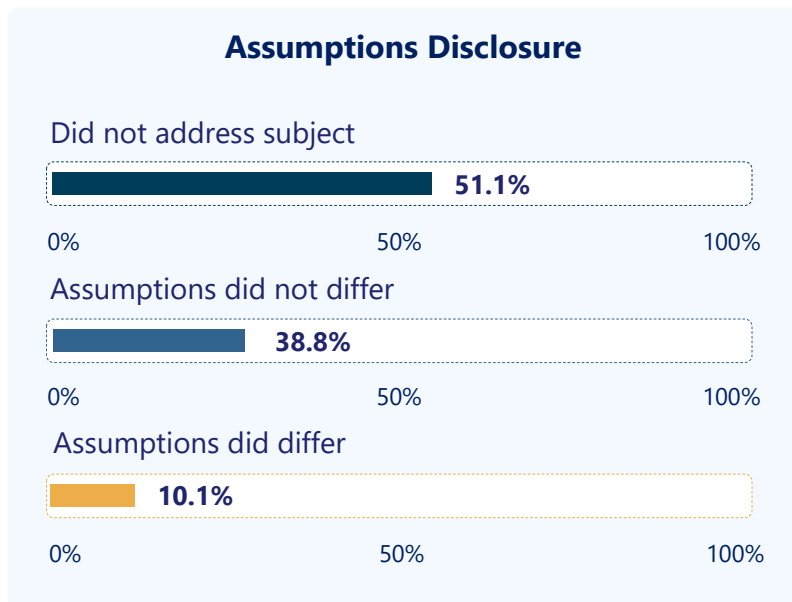
The SEC Staff has indicated that following a company's initial "Pay-Versus-Performance" table, in subsequent years footnote disclosure of the amounts deducted and added to calculate CAP for purposes of the "Pay-Versus-Performance" table for years other than the most recently completed fiscal year is required only if it is material to an investor's understanding of the information reported in the "Pay-Versus-Performance" table for the most recently completed fiscal year. We found that the majority of the companies providing their second year of disclosure (79.2%) (consisting of 112 technology companies and 40 life sciences companies) continued to provide the full four years (three years in the case of SRCs) of information in their reconciliation tables, while 39 companies (20.8%) opted to streamline their disclosure by providing the reconciliation only for the most recently completed fiscal year (consisting of 29 technology companies and 10 life sciences companies).

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## Valuation Assumptions

There appears to be some ongoing uncertainty as to how the requirement to disclose the assumptions used to recalculate the fair value of equity awards for purposes of computing CAP that materially differed from those disclosed at the time of grant of such equity awards should be addressed. Once again this year, we found that companies used a number of different approaches to present this information. As was the case in 2023, 70 companies (38.8%), including 51 technology companies and 19 life sciences companies, expressly disclosed that the assumptions used to compute CAP did not materially differ from their grant date fair value assumptions. Among this group, three companies specifically disclosed that their “methodology” used to develop the valuation assumptions for each CAP computation did not materially differ from the disclosure in their audited financial statements for the period in which the equity awards were granted; a statement which may be problematic given the plain language of the disclosure requirement.

An additional 20 companies (10.1%), including 11 technology companies and 9 life sciences companies, disclosed that different assumptions were used to compute CAP, with 18 companies providing the revised assumptions in the footnote itself, while two companies simply cross-referenced the footnote in their Annual Report on Form 10-K which disclosed their equity award assumptions. Finally, a significant number (94) of the reviewed companies (51.1%), including 73 technology companies and 21 life sciences companies, did not address the subject in their disclosure.



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## Peer Group TSR

For purposes of disclosing the cumulative TSR of their peer group for each covered fiscal year, companies were permitted to use either (i) the published industry or line-of-business index that they used for purposes of preparing the stock performance graph to be included in their Annual Report to Shareholders (“ARS”) or, more commonly, their Annual Report on Form 10-K or (ii) the companies that they used as a compensation peer group for purposes of their Compensation Discussion and Analysis (“CD&A”).

In 2023, we noted that most companies opted to use the published industry or line-of-business index in their stock performance graph to satisfy this requirement. For the 2024 proxy season, 150 of the companies we reviewed (88.2%), including 119 technology companies (78.7%) and 31 life sciences companies (21.3%), chose to use a published industry or line-of-business index. Twenty companies (11.8%) (all in the technology sector) used a compensation peer group, including two companies which used separately constructed groups of peer companies. Curiously, we continued to see a number of companies (15 companies or 8.8%) using what appears to be a broad equity market index, rather than the narrower published industry or line-of-business index, for purposes of reporting their peer group TSR.

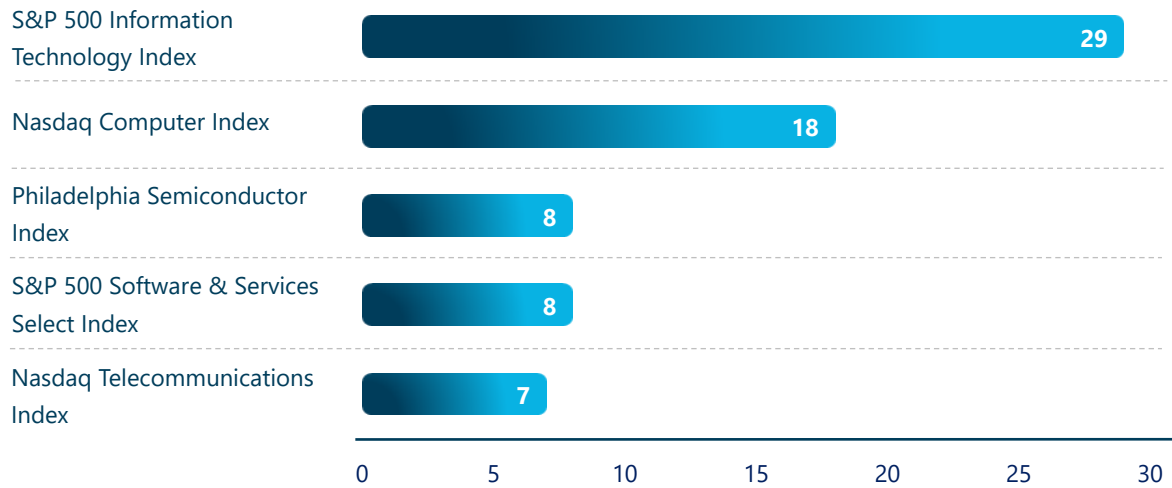
While they were not required to do so, six of the 40 SRCs disclosed their peer group TSR. We have included these SRCs in the following graphic.



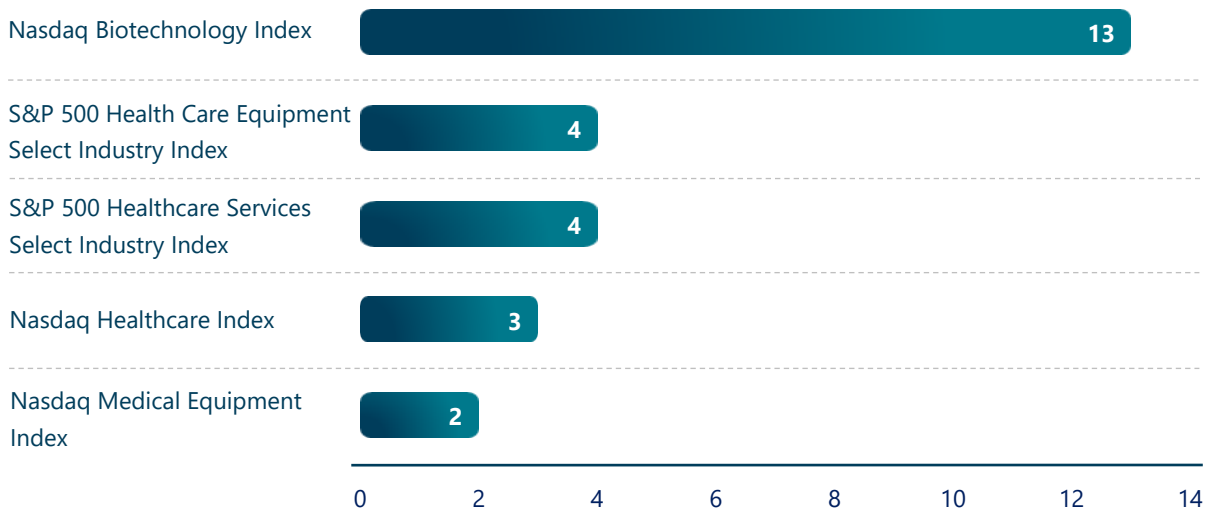
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The most commonly used indices in each sector were:

### Top 5 Technology Indices



### Top 5 Life Sciences Indices



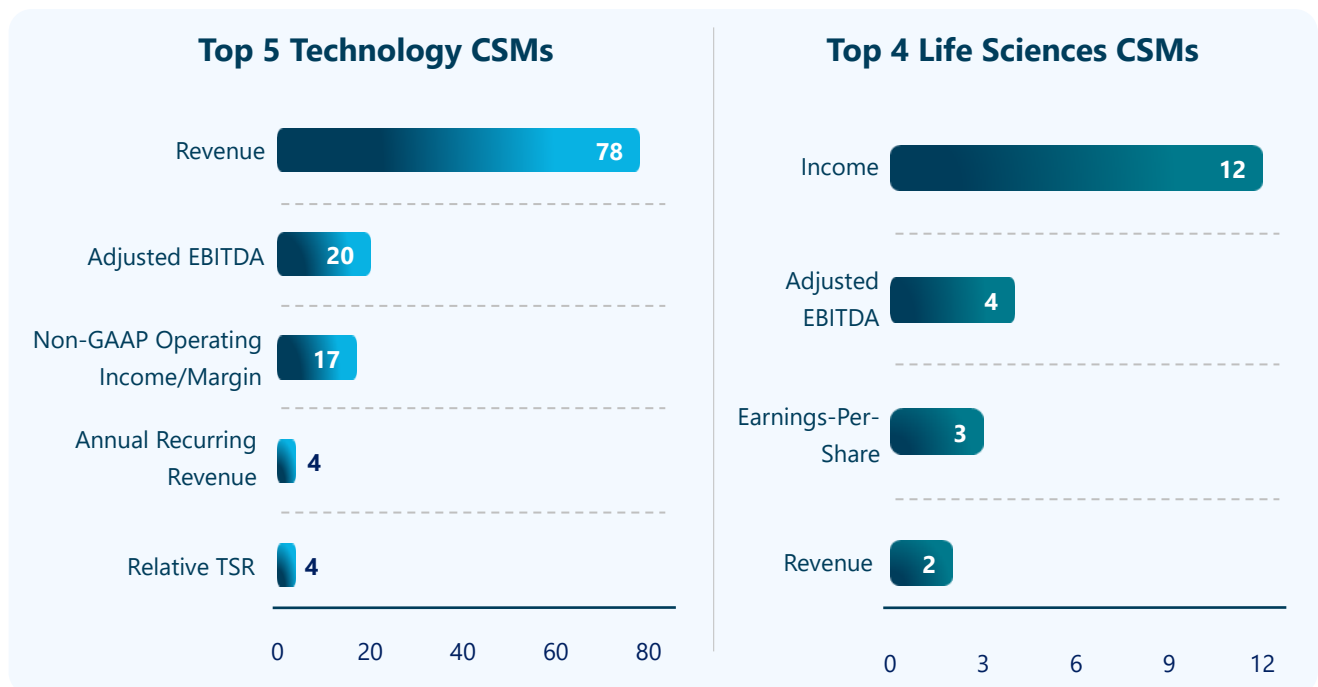
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## Company-Selected Measure

In addition to including their cumulative TSR and net income (or loss) for each covered fiscal year in the “Pay-Versus-Performance” table, companies (other than SRCs and companies that did not use any such measures in their executive compensation program) were required to select a single financial performance measure from their Tabular List (as discussed below) which, in their assessment, represented the most important financial performance measure (that was not otherwise required to be disclosed in the table) used to link CAP to their NEOs, for the most recently completed fiscal year, to their performance.

We noted 12 companies that changed their CSM from their 2023 disclosure to their 2024 disclosure. In most cases, the change constituted only a variation on the financial performance measure used in the initial disclosure (for example, a switch from “ARR” to “net ARR increase”). We did not encounter any material discussion of the reason for the change from one fiscal year to the next.

The most commonly disclosed CSMs for each sector were:



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## Use of Non-GAAP Performance Measures

The “pay-versus-performance” disclosure rules permit the use of a non-GAAP performance measure as a CSM. Of the companies that we reviewed which disclosed a CSM, 46 companies (28.0%), including 41 technology companies and five life sciences companies, indicated that they had selected a non-GAAP performance measure as their CSM.

## “Supplemental” Performance Measures

As in 2023, in 2024 we did not come across very many companies that provided more than one CSM in their “Pay-Versus-Performance” table (six companies). These “supplemental” CSMs consisted of EBITDA or adjusted EBITDA (four companies) and revenue or some variant of revenue (two companies).

Under the “pay-versus-performance” disclosure rules, to the extent additional financial performance measures are included in the “Pay-Versus-Performance” table, they must also be accompanied by a clear description of their relationship to CAP. We note that each of the companies providing a supplemental financial performance measure included the measure as part of its relationship disclosure.

**Observations:** Technology and life sciences companies (other than SRCs) providing their second round of “pay versus performance” disclosure were required to expand their tabular disclosure to cover four – rather than three – fiscal years (unless the company completed its IPO in fiscal 2021). Nonetheless, we noted four companies that included three fiscal years’ disclosure (2020, 2021, and 2022) in their initial “Pay-Versus-Performance” table and only three fiscal years’ disclosure (2021, 2022, and 2023) in their second “Pay-Versus-Performance” table, with the 2020 information entirely omitted from the table. It is important to note that the “pay-versus-performance” disclosure rules ultimately require five years of information (except in the case of SRCs) in the “Pay-Versus-Performance” table – three years in the initial year of compliance, then four years’ information in the second year of compliance, and, finally, five years’ information in the third year. If these companies are subject to SEC Staff review of their Exchange Act reports in 2024, they are likely to be reminded of this requirement.

## RELATIONSHIP DISCLOSURE

Most of the companies providing their second round of disclosure during the 2024 proxy season continued to use the same approach and format in describing the relationship between each of the financial performance measures included in the “Pay-Versus-Performance” table and the CAP to their CEO and, on average, to their other NEOs. The companies providing their initial “relationship” disclosure took the same approach.



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## Form of Relationship Disclosure

Almost every description provided to satisfy the relationship disclosure requirement, for both technology and life sciences companies, was presented graphically. While a handful of the companies used a combination of narrative and graphical disclosure to discuss this relationship, that approach does not appear to have gained traction in 2024. Only three companies (two technology companies and one life sciences company) provided this information entirely in narrative form. We noted only one company that switched from a narrative to a graphic presentation of the relationship disclosure.

**Observation:** It appears that the use of a single graphic to disclose both the required relationship description of CAP and a company's cumulative TSR and the relationship description of its cumulative TSR and peer group cumulative TSR has become the approach used by the vast majority of technology and life sciences companies. While some companies expressly noted that this graphic was being presented to satisfy two separate disclosure requirements – explaining the relationship between CAP and the company's cumulative TSR over the fiscal years covered in the "Pay-Versus-Performance" table and the relationship between the company's cumulative TSR and the selected peer group's cumulative TSR, most of the disclosures we reviewed did not highlight or otherwise address this distinction.

## TABULAR LIST OF IMPORTANT FINANCIAL PERFORMANCE MEASURES

To date, the requirement under the "pay-versus-performance" disclosure rules to provide a "Tabular List" of the most important financial performance measures used by the company in designing its short-term and long-term incentives compensation for the most recently completed fiscal year has continued to be noncontroversial.

## Number of Performance Measures in Tabular List

While companies are permitted to disclose up to seven financial performance measures in their Tabular List, we found that, during the 2024 proxy season, 103 of the companies we reviewed (60.5%) disclosed three or fewer measures, with seven companies disclosing only one or two measures. Among the companies providing the disclosure for the first time, nearly one-half (three technology companies and two life sciences companies) provided three or fewer measures.

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**Observations:** While we did not see the practice very often, we continue to believe that it may be helpful to stakeholders to describe how any unusual financial performance measure is calculated and/or to describe the methodology used to track a non-financial performance measure (although we recognize that such information is not required). We also note the increased emphasis in the CD&A on describing how any non-GAAP financial measures are calculated and why they are used and believe that companies may want to consider coordinating their related “pay-versus-performance” disclosure with their CD&A disclosure.

### **SMALLER REPORTING COMPANIES**

As during the 2023 proxy season, each of the companies maintaining SRC status took full advantage of this status and provided a “Pay-Versus-Performance” table for the three most recently completed fiscal years (and in the case of the one SRC presenting its initial disclosure, only two years’ information), omitted from the “Pay-Versus-Performance” table peer group cumulative TSR (except in two instances, as noted above) and a CSM, and omitted the Tabular List of important financial performance measures.

**Observations:** While we are aware that many SRCs were advised to include a statement at the beginning of their “pay-versus-performance” disclosure to indicate their SRC status, thereby explaining why their disclosure was abbreviated from that of accelerated filers, we did not identify many companies that provided such a statement in their 2024 disclosure.

We also are aware that companies which did not use any financial performance measures during the last completed fiscal year were advised to explain why they were not providing a CSM or a description of the “pay-versus-performance” relationship for that financial performance measure. Again, we did not come across many of these statements. We continue to believe that such statements are helpful to remind investors, their advisors, and regulators as to why a company ostensibly has provided only partial disclosure.

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## GENERAL OBSERVATIONS

While the second year of compliance with the “pay-versus-performance” disclosure rules has been relatively easier than in 2023, the disclosure continues to raise several issues as companies encounter factual situations (particularly in calculating CAP) that are not specifically addressed in the rules. Nonetheless, the SEC Staff’s Compliance and Disclosure Interpretations issued in February, September, and November 2023 proved to be extremely helpful in resolving a number of the interpretive issues that companies and their advisors encountered during the initial year of compliance. Still, new questions are likely to continue to arise (albeit not as frequently) and companies complying with the disclosure for the first time will need to expend significant time and effort as they familiarize themselves with the requirements. Further, we believe that there has been and will continue to be more attention paid to the coordination of the “pay-versus-performance” disclosure with the “pay-for-performance” analyses included in companies’ CD&As.

The SEC Staff has indicated that it will be closely reviewing the 2024 disclosures in view of the additional guidance that was issued last year. Consequently, companies may get a more detailed review than in 2023. We also expect that larger institutional shareholders and the major proxy advisory firms will be more comfortable with the disclosure as they and other stakeholders begin to synthesize this information with their existing analyses.

To date, we have not seen a dramatic shift in the design of performance-based equity awards largely in response to the “pay-versus-performance” disclosure. While the computations required to determine CAP continue to be onerous, particularly where stock options with monthly or quarterly vesting schedules are part of a company’s executive compensation program, most companies have either identified an external resource or developed the internal capability to handle this work. We continue to believe that the final chapter has yet to be written about the utility of the additional information now available to shareholders as a result of the “pay-versus-performance” disclosure and that the next few disclosure cycles should go a long way in determining how companies and investors evaluate executive compensation programs in light of the data now being presented for review and analysis.

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## NEED ASSISTANCE?

Compensia has extensive experience in helping companies analyze the requirements of the SEC's "pay-versus-performance" disclosure rules, as well as drafting the required disclosure. If you would like assistance in preparing your "pay-versus-performance" disclosure, or if you have any questions on the subjects addressed in this Thoughtful Disclosure Alert, please feel free to contact the authors of this Alert:

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**ABOUT COMPENSIA**

Compensia is the leading independent compensation advisor to technology and life sciences companies. For more than two decades, Compensation Committees and C-Suites have looked to us to develop customized solutions that balance the interests of a company, its shareholders and its executives.

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