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Corporate, Securities And Financial Institutions Law Alert - New Executive Compensation Disclosure Rules Proposed By SEC: Pay Vs. Performance

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On April 29, the Securities and Exchange Commission (SEC) proposed new rules to require public companies to disclose in their annual proxy statements the relationship between compensation actually paid to their executives and the financial performance of the company. The proposed rules were adopted under Section 953(a) of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. The SEC stated the proposed rules are intended to provide greater transparency and allow shareholders to be better informed when they vote in director elections or on public companies' non-binding executive compensation "say-on-pay" proposals.

If adopted, the new rules will result in additional data gathering and drafting responsibilities for public companies, but the rules also may present new shareholder outreach opportunities to explain the alignment of executive compensation and company performance. Following is a summary of the proposed rules.

Proposed New Disclosure

The proposed rules would require every SEC-reporting company to provide a new table in its proxy statements or information statements in which the company is required to provide executive compensation disclosures. For most companies, this means the new table will be required in the company's proxy statement relating to its annual meeting of shareholders. The new table will be required to contain the following information:

- Disclosure of the executive compensation actually paid to the company's principal executive officer, which would be the total compensation as disclosed in the summary compensation table already required in the proxy statement, with adjustments to the amounts included for pensions and equity awards. The amount disclosed for the remaining named executive officers identified in the summary compensation table would be the average compensation actually paid to those executives.
- The total executive compensation reported in the summary compensation table for the principal executive officer and an average of the reported amounts for the remaining named executive officers of the company.
- The company's total shareholder return on an annual basis, using the definition of total shareholder return (TSR) included in Item

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201(e) of SEC Regulation S-K, which sets forth the existing requirement for a company's stock performance graph.

- The TSR on an annual basis of the companies in a peer group, using the peer group identified by the company in its stock performance graph or in its compensation discussion and analysis section of the proxy statement.

The new table will need to include the above-referenced information for the last five fiscal years of the company, except that "smaller reporting companies" (generally, those SEC-reporting companies with public floats of less than \$75 million) would only be required to provide disclosure for the last three fiscal years. Additionally, smaller reporting companies would not be required to present a peer group TSR.

Companies would also be required to tag the table disclosures in XBRL (eXtensible Business Reporting Language) format. This requirement would be phased-in for smaller reporting companies, so they would not be required to comply with the tagging requirement until the third annual filing in which the pay-versus-performance disclosure is provided.

Using the information presented in the table, companies would be required to describe the relationship between the executive compensation actually paid and the company's TSR, and the relationship between the company's TSR and the TSR of its selected peer group. This disclosure could be described in narrative format, in a graph, or through a combination of the two.

Companies Covered

The new rules would apply to all SEC-reporting companies regardless of size, with the exception of foreign private issuers, registered investment companies, and emerging growth companies. As indicated above, this means that even smaller reporting companies will be required to provide the new disclosures. That being said, smaller reporting companies will be able to take advantage of scaled disclosure requirements, as explained above.

Executives Covered

The proposed rules would require disclosure for each company's "named executive officers" for whom disclosure is currently required in the summary compensation table – generally the company's CEO, CFO, and three most highly compensated executive officers other than the CEO and CFO who were serving as executive officers of the company as of the end of the fiscal year. For each year in which disclosure would be required, companies would present the information separately for the CEO, and as an average for the remaining named executive officers identified in the table.

Determination of Executive Compensation Actually Paid

Under the proposal, executive compensation actually paid would be calculated using the compensation a company reports in the summary compensation table already required in the proxy statement, with adjustments relating to pension amounts and equity awards. Companies would be required to disclose these adjustments. Pension amounts would be adjusted by deducting the change in pension value reflected in the summary compensation table, and adding back the actuarially determined



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service cost for services rendered by the executive during the applicable year. Smaller reporting companies would not be required to make adjustments in pension amounts. Also, equity awards would be considered actually paid on the date of vesting and at fair value on that date, rather than at fair value on the grant date as required in the summary compensation table. The fair values on both the vesting and grant dates would be required to be disclosed in the new table.

Phase-In Period

The proposed rules would be phased-in for all companies. Accelerated and large accelerated filers would be required to provide the new disclosures for three years in the first proxy statement in which they provide the disclosure, adding another year of disclosure in each of the two subsequent annual proxy filings. Smaller reporting companies would initially provide the information for two years, adding an additional year in their subsequent annual proxy statement.

Comment Period

The proposed rules are subject to a comment period lasting until July 6, 2015. At that time, the SEC may adopt final rules, extend the comment period further, or decline to take action on the rules. If the SEC finalizes the rules this summer, this likely means the new disclosures will be required as soon as the 2016 proxy season.

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