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# SEC Proposes "Pay for Performance" Disclosure Rule

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Securities

On April 29, 2015, the Securities and Exchange Commission (the "SEC") proposed a new rule that would require public companies to provide new disclosures annually regarding the relationship, over a five-year period, between executive compensation actually paid and a measure of financial performance of the company. The purpose of the rule, according to the SEC, is to elicit disclosure to provide greater transparency and allow shareholders to be better informed when they vote to elect directors and in connection with advisory votes on executive compensation. The proposed rule would implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

## Highlights

Under the proposed rule, new Item 402(v) of Regulation S-K would require many public companies[1] to provide, in proxy statements and information statements in which executive compensation disclosure is required, new tabular disclosure showing the following information for each year covered by the table:[2]

- Total compensation reported in the Summary Compensation Table ("SCT") for the principal executive officer ("PEO") and the average of the reported amounts of total compensation for the remaining named executive officers identified in the SCT.[3]
- Compensation *actually paid* to the PEO and the average of the compensation *actually* paid to the remaining named executive officers. For this purpose, compensation *actually* paid is determined by adjusting the total compensation as disclosed in the SCT to reflect (i) for pension benefits, only the annual pension service cost for services provided in the year, and (ii) for equity awards, only the fair value of awards that vested during the year. These calculations are described in more detail below.
- The company's cumulative total shareholder return ("TSR"), determined in accordance with the definition of TSR in Item 201(e) of Regulation S-K (which addresses the requirements for an annual stock performance graph).

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[1] As proposed, the new rule would not apply to foreign private issuers, registered investment companies, or emerging growth companies (as defined in the Jumpstart Our Business Startups Act of 2012).
[2] Although the pay-for-performance disclosure would be included as a new Item 402 requirement, the SEC's proposing release states that this disclosure would not be required in a company's annual report on Form 10-K or in Securities Act registration statements that otherwise require Item 402 disclosure.
[3] The proposed disclosure would relate to the named executive officers for whom disclosure is required in the current year's SCT.

- The TSR 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 ("CD&A").[4]

Below is an example of the tabular disclosure called for by proposed Item 402(v), as provided in the SEC's proposing release:

**Pay Versus Performance**

| Year (a) | Summary Compensation Table Total For PEO (b) | Compensation Actually Paid to PEO (c) | Average Summary Compensation Table Total for non-PEO Named Executive Officers (d) | Average Compensation Actually Paid to non-PEO Named Executive Officers (e) | Total Shareholder Return (f) | Peer Group Total Shareholder Return (g) |
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Using the information presented in the table, companies would also be required to describe, for the period covered by the table, (i) the relationship between the executive compensation actually paid to the PEO and other named executive officers and the company's TSR, and (ii) the relationship between the company's TSR and the TSR of the company's identified peer group. The proposed rule would afford companies flexibility to decide how best to show these relationships. The proposing release states that such information could be presented in narrative form, graphically (such as, for example, with plotted lines showing the change in compensation and TSR over the relevant period), in a table, or through a combination of methods.

### Calculation of Compensation Actually Paid

Compensation actually paid will be determined by adjusting the amount of total compensation, as reported in the SCT, to better reflect pension benefits and equity awards actually paid during the year. The proposed rule would require disclosure of the amount of such adjustments for each year, in a footnote to the table shown above.

[4] Smaller reporting companies, which are not required under current rules to prepare a stock performance graph under Item 201(e) or a CD&A, would not be required to disclose peer group TSR under the proposed rule. A smaller reporting company is defined in Rule 12b-2 under the Securities Exchange Act of 1934 and generally means a company with a public float below $75 million, or no public float and less than $50 million in annual revenues.

Pension amounts will be adjusted by deducting from total compensation the change in pension value and adding back the actuarially determined service cost for services rendered during the applicable year.[5]

Equity awards will be adjusted by deducting from total compensation the amounts reported in the SCT for grant date fair value of stock awards and option awards, and adding back the fair value, on the vesting date, of awards that vested during the year. To the extent that assumptions used to determine the fair value of awards on their vesting date differ materially from assumptions used in determining grant date fair value as disclosed in the company's financial statements, the company would be required to disclose such different assumptions with the pay for performance disclosures.

**Periods Covered and Phase-in**

Under the proposed rule, the new tabular disclosures would cover the last five fiscal years.

Companies other than smaller reporting companies would be required to phase in the new pay-for-performance disclosures over the course of three years. In their first year of being subject to the rule, such companies would have to provide the disclosures for the three-year period ending in the most recent fiscal year. In the second year, the disclosure would have to cover the preceding four-year period. In the third year of providing these disclosures companies would be required to provide the required disclosure for the full five-year period contemplated by the rule.

Smaller reporting companies would only be required to provide the proposed disclosures for a three-year period and would phase in their disclosures over the course of two years. In the first year of being subject to the rule, smaller reporting companies would be required to provide the information for the two-year period ending in the current fiscal year. In the second year such companies would be required to provide disclosure for a three-year period.

**XBRL Tagging**

Companies would be required to include an exhibit in which the required pay-for-performance information has been tagged in an interactive data format using XBRL. This requirement would be phased-in for smaller reporting companies, so that they would not be required to comply with the tagging requirement until the third annual filing in which the pay-for-performance disclosure is provided. This aspect of the proposed rule represents the first time the SEC will have mandated XBRL tagging for information contained in proxy statements.

**Next Steps and Observations**

The comment period for the proposed rule will run for 60 days after publication in the *Federal Register*. Although the SEC will need to consider the comments and meet again to finalize the new disclosure rules, it is possible that these rules could be in place for the 2016 proxy season.

The proposed rule would represent a significant new disclosure obligation for many public companies. The requirement to provide five years of data is not mandated by the Dodd-Frank Act, and, as proposed, the rule would require companies to come up with new compensation

[5] Smaller reporting companies, however, will not be required to make this adjustment when calculating compensation actually paid.

data points that the SEC's already-extensive executive compensation disclosure regime does not call for today.

Further, the proposal endorses a "one size fits all" approach of measuring a company's financial performance using TSR. While this may be useful for purposes of comparison with other companies, there will undoubtedly be many companies for which TSR is not the optimal measure of financial performance, and for which the relationship between TSR data and compensation paid may not tell the full story.

If you have any questions concerning the material discussed in this advisory, please contact the following members of our Securities and Capital Markets practice group:


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