SEC Proposes Pay Versus Performance Disclosure Rules

On Wednesday, April 29, 2015, the SEC proposed rules on the disclosure of executive pay versus company performance. The proposed rules implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which directs the SEC to adopt rules requiring public companies to disclose the relationship between executive compensation actually paid and the financial performance of the company.

New Tabular Disclosure

The proposed rules would add a new Item 402(v) to Regulation S-K, which would require in proxy and information statements in which executive compensation disclosure is required, a new "Pay Versus Performance" table that sets forth the following information for each of the last five fiscal years:

- total compensation from the Summary Compensation Table for the CEO,
- average total compensation from the Summary Compensation Table for the named executive officers (NEOs) other than the CEO,
- compensation actually paid to the CEO,
- average compensation actually paid to the NEOs other than the CEO,
- cumulative total shareholder return (TSR) of the company, and
- cumulative TSR of the company's peer group.

Compensation Actually Paid

Although the SEC acknowledged that a number of companies use the concepts of "realizable pay" and "realized pay" in proxy statements as a means of comparing pay and performance and that there has been an effort to develop a consistent methodology for computing them, it decided that "compensation actually paid" would be calculated using amounts disclosed in the Summary Compensation as a starting point.

Under the proposed rule, "compensation actually paid" represents the total compensation reported in the Summary Compensation Table with adjustments to the amounts included for pension benefits and equity awards. Specifically, changes in the actuarial present value of all defined benefit and pension plans would not be included (in order to exclude changes in value resulting from changes in interest rates, the executive's age and other actuarial inputs and assumptions), but the actuarially determined service cost for services rendered by the executive during the applicable year would be added back. In addition, the proposed rule would treat equity awards as actually paid on the date of vesting (regardless, in the case of options, of whether they are exercised) and would value them at their fair value as of the vesting date. Accordingly, "compensation actually paid" would not include amounts reported in the "Stock awards" and "Option awards" columns of the Summary Compensation Table and would instead include the fair value on the vesting date of all equity awards that vested during the applicable year, computed in accordance with FASB ASC Topic 718.

Companies would be required to disclose in footnotes to the Pay Versus Performance table amounts deducted and added to total compensation as well as any assumptions in the valuation of equity awards that differ materially from those disclosed in the Summary Compensation Table.

Total Shareholder Return

The SEC proposed that TSR be used as the measure of financial performance for purposes of the "performance" component of the new pay disclosure. It chose TSR in part because companies are already required to determine and disclose TSR in the stock performance graph included in the company's annual

ATTORNEY ADVERTISING

report. In the Pay Versus Performance table, the cumulative TSR would be reported as of the end of the applicable year, calculated in the same manner and over the same measurement period as under Item 201(e) of Regulation S-K.

Total Shareholder Return of the Company's Peer Group

The proposed rule would permit companies to use either the same peer group used for purposes of the stock performance graph or the peer group used in connection with the company's compensation benchmarking practices disclosed in the Compensation Discussion and Analysis. For purposes of the Pay Versus Performance table, the cumulative TSR of the company's peer group would be calculated in the same manner and over the same measurement period as under Item 201(e) of Regulation S-K.

Additional Disclosure

The proposed rule requires additional disclosure following the Pay Versus Performance table on 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 peer group. Companies would be permitted to describe these relationships in a narrative disclosure, graphic disclosure or a combination of the two. Examples provided by the SEC of acceptable forms of this disclosure include a graph providing executive compensation actually paid and change in TSR on parallel axes and plotting compensation and TSR over the required time period. The SEC also suggested that companies could disclose the percentage change over each year of the required time period in both executive compensation actually paid and TSR together with a brief discussion of that relationship.

Location and Format of Disclosures

The proposed rule provides companies with the flexibility to determine where in the proxy or information statement the new disclosure should be included, but the SEC noted that it expected the disclosure to appear together with the executive compensation disclosure required under Item 402 of Regulation S-K. In addition, the new disclosures would be required to be electronically formatted using XBRL.

Transition and Phase-In

In the first filing following the effectiveness of the proposed rule, companies would be required to provide the new disclosure for the last three fiscal years, instead of five. An additional year of disclosure would then be required in each of the two subsequent annual filings in which the disclosure is required. Pay-versus-performance disclosure would only be required for years in which a company was a reporting company pursuant to Section 13(a) or 15(d) of the Securities Exchange Act. Accordingly, a newly-reporting company would be required to provide the pay-versus-performance disclosure only for the last fiscal year in the first year as a reporting company and for the last two fiscal years in its second year as a reporting company. Emerging growth companies and foreign private issuers would be exempt from these new disclosure requirements.

Public comments are due within 60 days following the publication of the proposed rule in the Federal Register.

* * *

Please feel free to contact any member of Ropes & Gray's securities & public companies or executive compensation & employee benefits practice group or your usual Ropes & Gray contact with any questions about this Alert.

ropesgray.com

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2015 Ropes & Gray LLP

ATTORNEY ADVERTISING