

SEC Proposes Rules For Expanded Pay Versus Performance Disclosures

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The Securities and Exchange Commission (SEC) recently proposed new and amended disclosure rules to require that reporting companies enhance their executive compensation disclosure by including interactive tables and narrative examining the relationship between executive compensation and financial performance. The SEC's current rules require that prior to any shareholder meeting, shareholders receive a proxy or information statement disclosing the important facts about the issues on which the shareholders are being asked to vote. The new rules (proposed in response to provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act) are designed to provide shareholders with meaningful new information and metrics to aid in making informed decisions.

Pay Versus Performance Table

Under the proposed rules, any proxy or information statement which requires inclusions of executive compensation disclosure under Item 402 of Regulation S-K would also include a new Pay Versus Performance Table, setting forth:

- Total compensation (appearing in the Summary Compensation Table) for the principal executive officer (PEO);
- Average total compensation (appearing in the Summary Compensation Table) for the named executive officers (NEOs) other than the PEO;
- Compensation actually paid to the PEO;
- Average compensation actually paid to the NEOs, other than the PEO; Cumulative annual total shareholder return (TSR) of the reporting company; and
- Cumulative annual TSR of the reporting company's peer group.

Compensation "Actually Paid"

For purposes of the Pay Versus Performance Table, compensation "actually paid" would be defined as the total compensation for the covered fiscal year for the PEO and average total compensation for the NEOs, as disclosed in the Summary Compensation Table, but adjusted:

- (1) by deducting the change in pension value and adding back the actuarially determined pension service cost for services rendered during the applicable year; and
- (2) by deducting the fair value of equity awards granted during the year and adding back the fair value on the vesting date of equity awards that vested during the year.

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.

Total Shareholder Return of the Reporting Company’s Peer Group

The SEC proposed that TSR be the metric for measuring the “performance” component of the new Pay Versus Performance disclosure, noting that TSR was already a required disclosure in the stock performance graph included in the reporting company’s annual report. The proposed rules allow reporting companies to rely on either the same peer group used for the stock performance graph or the peer group used in connection with the reporting company’s compensation benchmarking practices disclosed in the Compensation Discussion and Analysis disclosure.

Location and Form of Disclosures

The proposed rules allow reporting companies to individually determine where in the proxy or information statement the new Pay Versus Performance disclosures would appear, although the SEC expects such disclosure will appear with the executive compensation disclosure currently required under Item 402 of Regulation S-K. Additionally, the new disclosure would need to be electronically formatted using the interactive eXtensible Business Reporting Language (XBRL), making this the first time the SEC requires XBRL outside the financial statements.

Also under the proposed rules, each reporting company would supplement the Pay Versus Performance Table with narrative and/or graphic disclosure if it believes doing so would provide useful information about the relationship between the compensation paid and the reporting company’s financial performance.

Transition and Phase-In

This new disclosure would be required to include each of the five (or, for smaller reporting companies, three) most recently completed fiscal years, or the number of years in which it was a reporting company if less than five years. To accommodate a transition period, in the first filing following the proposed rule becoming effective, companies would only be required to provide the new disclosure for the prior three fiscal years (or, for smaller reporting companies, two years), phasing-in the additional year(s) in subsequent annual filings.

Implications

Be aware that, like many recent SEC rulemaking efforts, the proposed Pay Versus Performance disclosure requirements were only passed by a 3-2 vote (along strict party lines). Depending which commissioner is speaking, this proposal either “improves transparency for executive pay practices” allowing for enhanced comparative disclosure across companies, or represents a waste of SEC time and funds “thrusting ourselves into corporate governance matters best left to state law.” With such differences, it is currently unclear when final rules will be adopted and what changes will be included, but reporting companies should prepare for the possibility that the new reporting requirements will go into effect as early as the 2016 proxy season. Comments on the proposed rules are due 60 days after their publication in the Federal Register. A copy of the proposed rules can be found [here](#), and for additional information on the proposed rules, please refer to the [press release](#) issued by the SEC.

We will follow the comments and final rulemaking process. Please contact one of the attorneys listed below or any of the attorneys in the Corporate & Securities Practice Group at Benesch to discuss the implications and effective strategies for your company of this proposed rule change.

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