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Securities Law ALERT ■

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SEC Proposes New Rules for Executive Pay Versus Performance Disclosure

On April 29, 2015, the Securities and Exchange Commission (SEC) voted 3-2 to approve proposed rules that would require companies to disclose the relationship between the compensation actually paid to their named executive officers and the financial performance of the company and the companies in their selected peer group. The new disclosure would be required in a table format in proxy statements and information statements in which executive compensation disclosure is required. Adding a new Item 402(v) to Regulation S-K, the proposed rules would implement Section 953(a) of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which added a new Section 14(i) to the Securities Exchange Act of 1934, as amended. The proposed rules are aimed at providing additional information to investors relevant to their casting advisory votes on executive compensation by giving an additional metric to assess a company's executive compensation relative to its financial performance.

The proposed rules failed to receive unanimous support from the five SEC commissioners. Along with Commissioners Luis Aguilar and Kara Stein, Chair Mary Jo White voted in favor of the rules and said the new disclosures could help inform and guide investors in say-on-pay votes and director elections. Commissioners Daniel Gallagher and Michael Piwowar dissented and voiced concerns with the rules' timing—the SEC has unfinished Dodd-Frank mandates that they believe are more closely tied to the causes of the financial crisis on which the SEC should be focused.

What new executive compensation disclosure would be required?

If adopted as proposed, companies would be required to disclose in a new table in their proxy statements the following information:

- the total compensation for the principal executive officer (PEO), as disclosed in the Summary Compensation Table;
- the total compensation "actually paid" to the PEO;
- the average total compensation for the named executive officers other than the PEO, as disclosed in the Summary Compensation Table;

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- the average compensation "actually paid" to the named executive officers other than the PEO;
- the company's total shareholder return (TSR); and
- the peer group's TSR.

In addition to the tabular disclosure, companies would be required to describe, in narrative or graphic form: (1) the relationship between the executive compensation actually paid and the company's TSR, and (2) the relationship between the company's TSR and the peer group's TSR.

The proposed rules would require companies to tag the disclosure in an interactive data format using XBRL format (eXtensible Business Reporting Language) to facilitate analysis of the data. As proposed, the tagging requirement would be phased in over time for smaller reporting companies so that they would not be required to comply with this requirement until the third annual filing in which the pay-versus-performance disclosure is provided.

What is compensation "actually paid"?

Executive compensation "actually paid" would be total compensation as disclosed in the Summary Compensation Table, with certain adjustments to the amounts included for pension benefits and equity awards.

- Changes in the actuarial present value of all defined benefit and pension plans would be deducted from the Summary Compensation Table total, and the actuarially determined service cost for services rendered by the executive during the applicable year would be added back.
- Equity awards would be considered actually paid on the vesting date and valued at fair value on that date, rather than fair value on the date of grant as required in the Summary Compensation Table.

The adjustments made to calculate executive compensation actually paid would be set forth in footnotes to the table.

How will TSR be calculated and what peer group will companies be required to use?

The proposed rules would require companies to use the definition of TSR provided by Item 201(e) of Regulation S-K, which sets forth an existing requirement for a stock performance graph. The peer group would either be the same group used for preparing the stock performance graph pursuant to Item 201(e) or the peer group disclosed in the compensation discussion and analysis (CD&A) with respect to the company's compensation benchmarking practices.

How many years must the disclosure cover?

All companies, other than smaller reporting companies, would be required to disclose the information for the five most recently completed fiscal years. Companies would only provide disclosure for the years in which it was a reporting company. The proposed rules provide phase-in periods for these requirements.

Would the rules affect all companies?

The proposed rules would apply to all reporting companies except foreign private issuers, registered investment companies and emerging growth companies, which are exempt from the statutory requirement. Smaller reporting companies would be subject to scaled disclosure requirements.

What are the scaled disclosure requirements for smaller reporting companies?

- Smaller reporting companies would be required to disclose the information for the last three fiscal years.
- Smaller reporting companies would not be required to disclose amounts related to pensions because current disclosure requirements do not require them to disclose information related to pension plans.
- Smaller reporting companies do not have to provide the peer group TSR.

Are there phase-in periods?

Yes. In the first proxy or information statement in which reporting companies are required to provide the disclosure, they would only need to do so for the last three fiscal years and would add an additional year in each of the two subsequent proxy or information statements that require this disclosure. Smaller reporting companies would initially provide the information for just two years and add an additional year in their subsequent proxy or information statement that requires the disclosure.

What's next?

The SEC will collect public comment on the proposed rules for 60 days following their publication in the *Federal Register* and will hold a second vote before the rules go into effect. Companies should proactively contact their counsel to evaluate how the proposed rules may impact their disclosure regarding executive pay.

If you have any questions or would like additional information on how to best prepare for these new standards, please contact your Alston & Bird attorney.

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