

# Finally! SEC Proposes New Pay for Performance Disclosure Regulations

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On April 29, 2015, in accordance with Section 953(a) of the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#) (the “Reform Act”), the Securities and Exchange Commission (the “SEC”) issued a [press release](#) and published proposed regulations ([Release No. 34-74835](#)) (the “Proposed Rules”) to require certain publicly-held companies to disclose the relationship between their financial performance and the compensation that is actually paid to their named executive officers.

The Reform Act implemented numerous new laws affecting executive compensation and corporate governance at publicly-held companies. Section 953(a) of the Reform Act directs the SEC to establish a rule which requires disclosure in any proxy or consent solicitation material for an annual meeting of shareholders of the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions (the “Pay for Performance Disclosure”).

After receiving thousands of comment letters from the public ([see posts of public comment letters here](#)) on the various aspects of the Reform Act over the past several years, the SEC Commissioners in a divided 3-2 vote adopted the Proposed Rules. The magnitude of public comments, the duration of time it took for the SEC to finally propose Pay for Performance Disclosure rules, and the divided SEC vote indicate the degree of difficulty in implementing Pay for Performance Disclosure.

The Proposed Rules provide some interesting details regarding the implementation of the Pay for Performance Disclosure. Of course, the Proposed Rules are yet not effective and could change before final approval and in this regard, the SEC has solicited the public for comments in numerous areas of the Proposed Rules in order to help them in their process of adopting final regulations.

The below provides a brief overview of the Proposed Rules in question and answer format.

## What Generally Will The Proposed Rules Do?

If approved as proposed, the Proposed Rules will add a new section (v) to [Item 402 of Regulation S-K](#) that would require certain publicly-held companies to disclose each of the following in a prescribed tabular format for each of the issuer’s last five completed fiscal years:

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A. the Summary Compensation Table ("SCT") total compensation, along with the compensation actually paid, for the issuer's principal executive officer ("PEO");

B. the average SCT total compensation, along with the average compensation actually paid, for the issuer's other non-PEO named executive officers;

C. the issuer's cumulative total shareholder return ("TSR"), as determined in accordance with [Regulation S-K Item 201\(e\)](#); and

D. the issuer's peer group of companies' cumulative TSR, as determined in accordance with [Regulation S-K Item 201\(e\)](#).

In determining the compensation that was actually paid to the named executive officer for each fiscal year, the starting point would be the officer's SCT total compensation amount. The following adjustments would then be made to this total compensation amount in order to derive the compensation that was actually paid to the officer for the applicable fiscal year and these adjustment amounts would also be reported as footnotes to the Pay for Performance Disclosure table. The amounts shown as being deducted below essentially reflect the removal of those values that were included in the SCT compensation total.

- The aggregate change in actuarial present value of the officer's accumulated benefit under defined benefit and actuarial pension plans would be deducted;
- The actuarial present value of the officer's benefit under defined benefit and actuarial pension plans which is attributable to services would be added (in other words, the portion of the change in actuarial pension value that results solely from changes in interest rates, the officer's age and other actuarial inputs and assumptions regarding benefits accrued in previous years would be excluded);
- The grant date fair market value estimates for equity compensation awards (e.g., stock options, stock appreciation rights, restricted stock units, and restricted stock) would be deducted; and
- The fair market values (measured in accordance with FASB ASC Topic 718) for equity compensation awards measured as of their applicable dates of vesting in the applicable fiscal year would be added. If the exercise price of a stock option or stock appreciation right was reduced or otherwise repriced, then the excess fair value of the modified award over the fair value of the original award (determined as of the modified award's vesting dates) will be added.

Utilizing the information in the foregoing table, the issuer would also need to include a narrative that provides a clear description of the relationship between the compensation actually paid to the PEO and other named executive officers and the cumulative TSR. This narrative would also need to include a comparison of the cumulative TSR to the peer group TSR. The disclosures would need to be electronically formatted using XBRL and the numerical amounts in the table would need to be tagged separately and the various textual disclosures would need to be block-text tagged ([Smaller Reporting Company](#) ("SRC") issuers would need to comply with these electronic tagging requirements in their third Pay for Performance Disclosure filing). The textual narrative would need to provide clear, concise and understandable disclosures which comply with the SEC's [Plan English](#)

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rules.

As part of a phase in transition period, issuers if desired could cover only the most recently completed three fiscal years, instead of five fiscal years, in their first filing providing the Pay for Performance Disclosure and then only four fiscal years in their second annual Pay for Performance Disclosure filing.

SRC issuers would not be required to provide TSR disclosure for their peer group and if desired can cover only the most recently completed three fiscal years in their Pay for Performance Disclosure filings. SRC issuers may also if desired cover only the most recently completed two fiscal years in their first filing providing the Pay for Performance Disclosure.

[Emerging Growth Company](#) (“EGC”) issuers are not required to provide Pay for Performance Disclosure in their filings.

The Proposed Rules also state that the Pay for Performance Disclosure will not be deemed to be incorporated by reference into any filing under either the Securities Act of 1933 or the Securities Exchange Act of 1934 (the “Exchange Act”) except to the extent that the issuer affirmatively does incorporate it by reference.

## **The below questions and answers provide some additional details.**

### **Which Companies Will be Subject to Pay for Performance Disclosure?**

The Pay for Performance Disclosure requirements would generally apply to publicly-held companies that are subject to the reporting requirements of sections 13(a) or 15(d) of the Exchange Act. However, EGC issuers, [foreign private issuers](#) and registered investment companies would not be subject to the Pay for Performance Disclosure requirements.

### **Which SEC Filings Will Need to Include Pay for Performance Disclosure?**

The Proposed Rules would require issuers to include the Pay for Performance Disclosure in the issuer’s proxy or information statement filings that require executive compensation disclosure under [Item 402 of Regulation S-K](#). The Pay for Performance Disclosure would be subject to the issuer’s [say-on pay advisory vote](#) on disclosed executive compensation.

### **Which Employees are Included in the Pay for Performance Disclosures?**

The Proposed Rules provide that the issuer’s PEO and the other named executive officers are to be covered by the Pay for Performance Disclosures. For SRC issuers, these would be the named executive officers determined under [Item 402\(m\) of Regulation S-K](#). For issuers which are not SRC issuers, these would be the named executive officers determined under [Item 402\(a\)\(3\) of Regulation S-K](#). If more than person served as PEO during a fiscal year then the disclosures for such persons would be aggregated for such year. For the non-PEOs, the disclosed values are the averages of compensation actually paid to all non-PEOs for each fiscal year.

### **What Fiscal Year Compensation is Utilized?**

The Proposed Rules provide that the total compensation value as reported in the SCT for each officer is the starting point for determining the compensation values that are used in the Pay for

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Performance Disclosures. With the exception of the adjustments to equity compensation and pension values (as described above in the What Generally Will The Proposed Rules Do? section), the individual compensation components as reported in the SCT will be used as is in determining the compensation that was actually paid to the officers for each fiscal year.

### **What Time Periods are Covered by the Pay for Performance Disclosure Requirements?**

The Proposed Rules provide that SRC issuers would report on the three most recently completed fiscal years and other issuers would report on the five most recently completed fiscal years. Pay for Performance Disclosures would only need to include fiscal years for which the issuer was a reporting company under sections 13(a) or 15(d) of the Exchange Act. Thus, a new reporting company may be able to include fewer fiscal years in its initial Pay for Performance Disclosure filings. There is also the phase in transition period for which issuers can include fewer fiscal years in their initial Pay for Performance Disclosure filings (as described above in the What Generally Will The Proposed Rules Do? section).

### **Where Would the Pay for Performance Disclosures Appear?**

The Proposed Rules do not prescribe a particular location for the Pay for Performance Disclosures although it is expected to appear along with the other Regulation S-K Item 402 executive compensation disclosures. If the Pay for Performance Disclosures are contained within the issuer's Compensation Discussion & Analysis ("CD&A") section then the issuer should be aware that such inclusion could imply that the Pay for Performance information was considered in making executive compensation decisions. So, an issuer that decided to include Pay for Performance Disclosures in the CD&A section would want presumably want to expressly address the role of the Pay for Performance information in making executive compensation decisions.

### **What is the Measure of Performance?**

The Proposed Rules provide that companies would utilize TSR as the performance metric to which the paid executive compensation would be compared. As noted above in the What Generally Will The Proposed Rules Do? section, TSR would be the same TSR that is utilized by the issuer in responding to the Regulation S-K Item 201(e) requirement. Non-SRC issuers must also report on the TSR for their peer group of companies. This peer group would be either the same peer group of companies used in Regulation S-K Item 201(e) or would be the peer companies that the issuer uses in its CD&A for reporting compensation benchmarking. The identity of the peer companies would need to be disclosed if the peer group is not a published industry or line-of-business index. This identification could be incorporated by reference if the issuer has previously disclosed its peer group of companies. The returns of each peer company would be weighted according to their respective stock market capitalization at the beginning of each period for which a return is indicated.

### **What's Next?**

As noted above, the Proposed Rules contain many requests by the SEC for comments on the provisions of the Proposed Rules. Comments on the Proposed Rules will need to be submitted within 60 days after the publication of the Proposed Rules in the Federal Register. Therefore, companies wishing to influence the outcome of the final regulations are urged to review the Proposed Rules and timely submit any comments.

Companies may also wish to examine their internal compensation accounting systems and consider

what steps they will need to take in order to comply with the Pay for Performance Disclosure requirements if and when they are finalized.

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