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SEC Proposed Rules: Pay Versus Performance

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On April 29, the ***Securities and Exchange Commission (SEC)*** issued proposed rules to implement the portion of the Dodd-Frank Act that added Section 14(i) to the Securities Exchange Act. Section 14(i) directs the SEC to adopt rules requiring public companies to disclose, in any proxy or consent solicitation material, a clear description of executive compensation disclosures under Item 402 of Regulation S-K. The description must include information that shows “the relationship between executive compensation actually paid and the financial performance of the [company]” and should take into account “any change in the value of the shares of stock and dividends of the [company] and any distributions.”

The key areas addressed in the proposed rules that companies would have to implement are as follows:

- Pay vs. Performance Table – The disclosure must include a table showing the total compensation as reported in the Summary Compensation Table (SCT) for the Principal Executive Officer (i.e., the Chief Executive Officer (CEO)), the compensation actually paid to the CEO, the average SCT total compensation and actual compensation paid to other named executive officers (NEOs), the company’s cumulative Total Shareholder Return (TSR), and the cumulative TSR of a company-selected peer group or index.

- Compensation Actually Paid – The actual compensation paid modifies the SCT total compensation by including equity values when vested (instead of when granted) and current year pension service costs.

- Total Shareholder Return – The proposed rules define financial performance as cumulative TSR. The TSR must be calculated for each year covered by the pay vs. performance table in the same manner and over the same five-year period as the stock performance graph required by Item 201(e) of Regulation S-K.

- Additional Disclosure – In addition to the pay vs. performance table discussed above, companies must also provide a clear description of the data set forth in the pay vs.

performance table that details the relationship between compensation actually paid to the CEO and the average paid to the other NEOs, as each is compared to the company's cumulative TSR. A discussion of the company's cumulative TSR as compared to that of the company's peer group must also be included.

The proposed rules exempt emerging growth companies, foreign private issuers, and registered investment companies. The disclosure is limited for smaller reporting companies. For example, while larger reporting companies must report the required disclosure information for the time period covering the five preceding years, smaller reporting companies need only report for the three preceding years. Additionally, for smaller reporting companies, the adjustment and footnote disclosure would not be required with respect to pension benefits, nor would peer group TSR be required to be disclosed in the pay vs. performance table or the accompanying disclosure.

The proposed rules could become final as early as the 2016 proxy season. Companies should prepare *pro forma* disclosure now and—to the extent that such disclosure does not adequately address a company's pay for performance policy—consider disclosing alternative performance measures and presenting the disclosure in a way that better reflects the company's pay for performance policy without being misleading or presenting information with greater prominence than the required disclosure.

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