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## SEC Issues Proposed Rules for “Pay-Versus-Performance”

By [Bruce Newsome](#), [Matthew L. Fry](#) and [Matthew S. Stewart](#)

The U.S. Securities and Exchange Commission (the “SEC”) has issued Proposed Rules (the “Proposed Rules”) to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, addressing what has been commonly referred to as “pay-versus-performance.” The Proposed Rules are intended to provide shareholders of public companies with more information when making decisions regarding voting in director elections and on say-on-pay or other executive compensation-related proposals. Under the Proposed Rules, public companies would be required to describe the compensation actually paid to the company’s principal executive officer (“PEO”) and other named executive officers (“NEOs”) and its relationship to the company’s cumulative total shareholder return, as well as how the company’s cumulative total shareholder return compares to that of the company’s peer group.

### Summary

#### **Covered Companies**

The Proposed Rules would require pay-versus-performance disclosure for all companies other than emerging growth companies, foreign private issuers and registered investment companies. Smaller reporting companies would be subject to scaled disclosure.

#### **New Tabular Disclosure**

Under the Proposed Rules, to be embodied in a new Item 402(v) of Regulation S-K, registrants would be required to present the amount of compensation actually paid and the cumulative total shareholder return (“TSR”) of the registrant and its peers in tabular format. Registrants would also be required to supplement the table with disclosure of the relationship between pay and performance, which could be presented either graphically or narratively.

The general format of the new required tabular disclosure is modeled below:

Year (a)	Summary Compensation Table Total For PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for non-PEO Named Executive Officers (d)	Average Compensation Actually Paid to non-PEO Named Executive Officers (e)	Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)
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The table is intended to provide shareholders with a clear description of the relationship between executive compensation actually paid and the registrant's TSR as well as the relationship between the registrant's TSR and the TSR of its peer group. To facilitate this, the SEC designed the table so that it may be compared across companies.

### ***Disclosure Periods***

Under the Proposed Rules, subject to a phase-in period, registrants would be required to provide the required disclosure for the last five fiscal years. Smaller reporting companies would be required to provide disclosure for only the last three fiscal years. For newly public companies, disclosure would be required for only the years in which the company was a reporting company under the Securities Exchange Act of 1934 (the "Exchange Act").

### ***Measure of Performance***

The Proposed Rules would require that companies use TSR, as defined in Item 201(e) of Regulation S-K with respect to performance graphs, as the measure of financial performance of the company for purposes of pay-versus-performance disclosure. The SEC opted to propose this standard unit of measure in an effort to further the comparability of pay-versus-performance disclosure across companies.

However, the Proposed Rules would permit companies to provide supplemental measures of financial performance as long as any such additional disclosure is clearly identified, not misleading, and not presented with greater prominence than the required disclosure. The flexibility to present alternative measures of performance in addition to TSR may aid companies that believe that TSR is not the best measure of their performance or comparability.

### ***Peer Group***

Under the Proposed Rules, a registrant would need to describe the relationship between its TSR and that of a peer group. The peer group may be the same group chosen for the performance graph under Item 201(e) of Regulation S-K, which may be any of the following:

- A published industry or line-of-business index
- Peer companies selected in good faith by the company
- Companies with similar market capitalizations (but only if the registrant does not use a published industry or line-of-business index and does not believe it can reasonably identify a peer group)

Alternatively, if the registrant uses a different peer group in its compensation discussion and analysis ("CD&A") for purposes of describing compensation-benchmarking practices, it may use that peer group for purposes of the Proposed Rules. Registrants would be allowed to change their peer groups from year to year.

Smaller reporting companies would not be required to present a peer group TSR.

### ***Covered Executives***

The new tabular disclosure would include executive compensation "actually paid" to named executive officers (as defined in Item 402(a)(3) of Regulation S-K, or Item 402(m) for smaller reporting companies). However, while the Proposed Rules would require companies to disclose the executive compensation actually paid to the principal executive officer, the compensation amounts disclosed for the remaining named executive officers would be the average of the compensation actually paid to those executives.



If more than one person served as principal executive officer during a fiscal year covered by the proxy materials, the compensation actually paid for each person who served as a principal executive officer would be aggregated for that fiscal year.

### ***Compensation Covered***

Under the Proposed Rules, executive compensation “actually paid” would equal the total compensation reported in the Summary Compensation Table (included under Item 402(c) of Regulation S-K), with adjustments made to the amounts reported for pension values and equity awards:

- *Pension Values.* For pension values, the changes in actuarial present value of benefits under defined benefit and actuarial pension plans would be deducted from the reported total compensation, but the actuarially determined service cost for services rendered by the executive would be added back. Thus, executive compensation “actually paid” would exclude the portion of the total change in actuarial pension value reported in the Summary Compensation Table that results solely from changes in interest rates, mortality assumptions, age, and other actuarial inputs and assumptions regarding benefits accrued. Smaller reporting companies would not be required to make adjustments in pension amounts because they are subject to scaled compensation disclosure requirements, which do not include pension plan disclosures.
- *Equity Awards.* Equity awards would be considered “actually paid” on the date of vesting and valued at their fair value on the vesting date, as computed under accounting rules. In contrast, equity awards in the Summary Compensation Table are reported at their fair value on the grant date. Both amounts would be disclosed in the new pay-versus-performance table.

Footnote disclosures would be required about the amount of all adjustments, as well as valuation assumptions used in determining any equity award adjustments that are materially different from those as of the grant date, as disclosed in the company’s financial statements.

### ***Filings and Phase-In***

It is not clear whether the Proposed Rules will be finalized in time for the disclosure to be required in 2016 proxy statements in which executive compensation disclosure is required. The disclosure requirements would phase in, and would require three years of data in the first year, four years in the second, and five years in future years. Item 402(v) disclosure would be treated as “filed” for the purposes of the Exchange Act, and would be subject to the say-on-pay advisory vote under Exchange Act Rule 14a-21(a), although it would not be incorporated by reference into other filings unless specifically referenced.

### **Considerations and Action Items**

#### ***Location of Disclosure***

The Proposed Rules contemplate that the disclosure would be provided along with the Item 402 executive compensation disclosures. However, the Proposed Rules provide registrants flexibility in determining where in the proxy statement to provide such disclosure.

The CD&A disclosure required by Item 402(b) of Regulation S-K requires an explanation of “all material elements of the registrant’s compensation of the named executive officers.” While not covered by the CD&A, the proposed disclosure can supplement the discussion in the CD&A as part of the shareholder’s evaluation of the registrant’s executive compensation practices and policies. The SEC cautions, however, that the Item 402(v) disclosure should only be included in CD&A if it was considered in the making of compensation decisions.



Because Section 14(i) of the Exchange Act calls for the proposed disclosure to be provided in solicitation materials for an annual meeting of shareholders, it would not be required in any Form 10-K or any registration statement that also requires Item 402 disclosure.

### ***Additional Voluntary Disclosure***

In its release to the Proposed Rules, the SEC acknowledges that many companies already use the concepts of “realizable pay” and “realized pay” in their proxy statements as a means of comparing pay and performance. A registrant may also provide pay-versus-performance disclosure based on these concepts if it believes that they provide useful information about the relationship between compensation and company performance. Such supplemental disclosure, however, may not be misleading, and may not be presented more prominently than the disclosure required by the Proposed Rules.

### ***How to Prepare***

If enacted, the Proposed Rules would represent a further burden on public companies, which must craft the nuanced calculations and pay-for-performance explanations required in their compensation disclosures. Registrants may consider modeling how their TSR may compare to the compensation “actually paid” to their CEO and other NEOs and to the TSR of their peers. Companies should also consider whether supplemental disclosure measures, such as those discussed above, may prove useful to address any perceived disconnect between pay and performance that might result from the Proposed Rules.

The Proposed Rules are set forth in Release No. 34-74835, available [here](#).

If you have any questions about this topic, please contact a member of our [Capital Markets and Securities Practice Group](#).

[Ryan Cox](#)

214.651.5273

[ryan.cox@haynesboone.com](mailto:ryan.cox@haynesboone.com)

[Greg Kramer](#)

212.835.4819

[greg.kramer@haynesboone.com](mailto:greg.kramer@haynesboone.com)

[Bruce Newsome](#)

214.651.5119

[bruce.newsome@haynesboone.com](mailto:bruce.newsome@haynesboone.com)

[Jan Sharry](#)

214.651.5562

[janice.sharry@haynesboone.com](mailto:janice.sharry@haynesboone.com)

[Marc Folladori](#)

713.547.2238

[marc.folladori@haynesboone.com](mailto:marc.folladori@haynesboone.com)

[Kendall Hollrah](#)

713.547.2089

[kendall.hollrah@haynesboone.com](mailto:kendall.hollrah@haynesboone.com)

[Bill Nelson](#)

713.547.2084

[bill.nelson@haynesboone.com](mailto:bill.nelson@haynesboone.com)

[Greg Samuel](#)

214.651.5645

[greg.samuel@haynesboone.com](mailto:greg.samuel@haynesboone.com)

[Rick Werner](#)

212.659.4974

[rick.werner@haynesboone.com](mailto:rick.werner@haynesboone.com)