

LEGAL UPDATE

May 2015 By: Michael T. Campoli

PAY-VERSUS-PERFORMANCE DISCLOSURE RULES PROPOSED BY SEC

On April 29, 2015, the U.S. Securities and Exchange Commission (the “SEC”) proposed rules that would require most public companies to disclose in a clear manner the relationship between executive compensation actually paid and the financial performance of the registrant.¹ The proposed rules would be contained in a new Item 402(v) of Regulation S-K, and would implement Section 14(i) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Section 14(i) of the Exchange Act was added by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The SEC expressed optimism in the proposing release that the rules, if adopted, would give shareholders a new metric for assessing a registrant’s executive compensation relative to its financial performance, and thus would be helpful to shareholders when they are exercising their relatively-recent rights to cast advisory votes on executive compensation under Exchange Act Section 14A.

Comments on the rule proposal should be received by the SEC on or before July 6, 2015.

OVERVIEW OF PROPOSED DISCLOSURE REQUIREMENT

As per proposed Item 402(v) of Regulation S-K, registrants would be required to provide a clear description of: (1) the relationship between executive compensation actually paid to named executive officers (“NEO’s”) and the cumulative total shareholder return (“TSR”) of such registrants; and (2) the relationship between each registrant’s TSR and the TSR of a peer group chosen by each registrant.²

¹ The SEC’s proposing release can be accessed here: <http://www.sec.gov/rules/proposed/2015/34-74835.pdf>.

² The peer group would be the same peer group used for purposes of the stock performance graph required by Item 201(e) of Regulation S-K, or the peer group used in the

TSR would be determined in accordance with Item 201(e) of Regulation S-K. No requirement to provide this type of disclosure currently exists under the federal securities laws.

Registrants would be required to include the new disclosure in any proxy or information statements for annual meetings of stockholders in which executive compensation disclosure under Item 402 of Regulation S-K is required. However, registrants would not be required to include this information in annual reports on Form 10-K or in registration statements under the Securities Act of 1933, as amended (the “Securities Act”), that require executive compensation disclosure.

The information provided pursuant to Item 402(v) would not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates such information by reference.

FORMAT AND LOCATION OF PROPOSED DISCLOSURE

The SEC did not propose a specific location within the proxy statement or information statement in which the proposed compensation disclosures must be provided, though it did express an expectation that such disclosures would be included in proximity to the other compensation disclosures required by Item 402.

However, the SEC did propose specific requirements regarding the content and presentation of the disclosures.

compensation discussion and analysis for purposes of disclosing the compensation benchmarking practices of registrants.

Specifically, registrants would be required to include in their filings a table containing columns that set forth:

- the total principal executive officer (“PEO”) compensation that is reported in the registrant’s Summary Compensation Table;
- the average total compensation of the non-PEO NEO’s as reported in the registrant’s Summary Compensation Table;
- the compensation “actually paid” to the PEO, as determined in accordance with proposed Item 402(v);
- the average compensation “actually paid” to the non-PEO NEO’s, as determined in accordance with proposed Item 402(v);
- the TSR for the registrant; and
- the TSR for the selected peer group.

In addition, registrants would be required to describe (1) the relationship between the executive compensation actually paid and registrant TSR, and (2) the relationship between registrant TSR and peer group TSR. This disclosure would follow the new Item 402(v) table and could be described as a narrative, graphically or a combination of the two.

As proposed, the disclosure provided in accordance with Item 402(v) would be required to be provided in interactive data format using XBRL.

EXECUTIVES COVERED

The SEC proposed that the “named executive officers” of each registrant would be covered by the new disclosure requirements. For each year, the required compensation information would be presented separately for the PEO and as an average for the remaining NEO’s identified in the Summary Compensation Table, as described above.

DETERMINATION OF “EXECUTIVE COMPENSATION ACTUALLY PAID”

The SEC proposed that “executive compensation actually paid”, as disclosed under Item 402(v), would be based on the total compensation as reported in the Summary Compensation Table, modified to adjust the amounts included for pension benefits and equity awards. Specifically: (i) the change in the actuarial present value of all defined benefit and pension plans would be deducted from the Summary Compensation

Table total (with the actuarially determined service cost for services rendered by the executive during the applicable year added back); and (ii) equity awards would be considered actually paid on the date of vesting and valued at fair value on that date, rather than fair value on the date of grant as required in the Summary Compensation Table.

TIME PERIOD COVERED

Registrants would be required to provide the pay-versus-performance disclosure for the five most recently completed fiscal years. There would also be a phase-in period for registrants to provide the disclosure, whereby registrants would be required to provide the proposed disclosure for three fiscal years, instead of five, in the first applicable filing after the rules become effective, and provide disclosure for an additional year in each of the two subsequent annual proxy filings where disclosure is required. Registrants would only be required to provide the disclosure for years during which they were Exchange Act reporting companies.

SMALLER REPORTING COMPANIES

Smaller reporting companies would be required to present Item 402(v) disclosure for the three most recently completed fiscal years, as opposed to the five most recently completed fiscal years required for other registrants.³ Such companies also would not be required to disclose amounts related to pensions for purposes of disclosing executive compensation actually paid because they are subject to scaled compensation disclosure that does not include pension plans. In addition, smaller reporting companies would not be required to present a peer group TSR.

EXCLUDED REGISTRANTS

The proposed rules would apply to all Exchange Act reporting companies, other than foreign private issuers, registered investment companies and emerging growth companies.

³ Smaller reporting companies would also be subject to a phase-in period whereby they would be required to provide the disclosure for only the last two fiscal years in the first applicable filing after the rules become effective.

If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Michael T. Campoli at mcampoli@pryorcashman.com, or any Pryor Cashman attorney with whom you are working.

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