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SEC Proposed Pay Versus Performance

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On April 29, 2015, the SEC published the anticipated pay versus performance proposed rules. The rules are in the comment period and will not be effective until the SEC publishes final rules. Although timing is unclear, some commentators believe the new rules will be implemented as soon as the 2016 proxy season.

The proposed rules require companies to clearly and concisely disclose the relationship between executive compensation actually paid and the financial performance of the company, taking into account any change in the value of the shares of stock and dividends of the registrant and any distributions. The new proposed disclosure requirements will not apply to emerging growth companies or foreign private issuers. In addition, smaller public companies will have a scaled back disclosure requirement.

The proposed new rules implement Section 14(i) of the Securities Exchange Act of 1934, as amended ("Exchange Act") and as added by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") by amending Item 402 of Regulation S-K. The disclosure must be made in proxy or information statements in which Item 402 disclosure is included. The disclosure is not required in regular Exchange Act reports such as Forms 10-K or 10-Q.

Section 953(a) of Dodd-Frank was enacted at the same time as the Section 951 "say on pay" requirements which were implemented by the SEC in 2011 and phased in for smaller reporting companies in 2013. The new "pay vs. performance" disclosure requirements are meant to complement and provide additional information that will be helpful in exercising shareholder "say on pay" advisory votes. As an Item 402 disclosure, the new pay vs. performance disclosure will also be the subject of the "say

on pay" advisory vote. My blog on say on pay for smaller reporting companies can be read HERE.

Although the current rules require many metrics and details on executive compensation, none previously have required a specific disclosure on the relationship between pay and performance. The Compensation Discussion and Analysis (CD&A) required by Item 402(b) requires an explanation of "all material elements of the registrant's compensation of the named executive officers" and requires general discussions of performance including disclosure of any bonus structures and performance-based compensation. The new disclosure requirements will supplement this information by providing a factual description of how the executive compensation actually paid related to the financial performance of the company.

In accordance with the proposed rules, a company must include a new table disclosing compensation "actually paid" to the principal executive offer or CEO and to the other named executive officers and the corresponding "total compensation" amounts for the prior five fiscal years or three fiscal years for smaller reporting companies. The five- or three-year look-back, as applicable, is subject to a phase-in period for the new rules. The table must include:

The total executive compensation of the CEO and the average of the total compensation of other named executive officers as reported in the summary compensation table (note the summary compensation table is already a required Item 402 disclosure in proxy and information statements);

The executive compensation "actually paid" to the CEO and the average of the executive compensation actually paid to the other named executive officers. The new proposed rules delineate the required elements and calculation for this disclosure;

The cumulative total shareholder return (TSR), calculated in the same manner as the performance graph already required by current SEC rules.

Disclosure of compensation "actually paid"

The proposed new rules delineate the elements of and calculation for the required compensation "actually paid" disclosure. For smaller reporting companies, the compensation "actually paid" is the executive compensation reported in the Summary Compensation Table disclosure already required to be disclosed in the proxy and

information statements in accordance with existing Item 402. All companies other than smaller reporting companies must then modify the disclosed amount to exclude changes in actuarial present value of benefits under defined benefit and actuarial pension plans that are not attributable to the applicable year of service, and to include the fair value of equity awards at vesting rather than when granted.

Relationship with Total Shareholder Return (TSR)

The new rules require companies to measure financial performance using TSR as defined in Item 201(e) of Regulation S-K and to make a comparison with the TSR of the company and the compensation actually paid for both the CEO and an average of all the other named executive officers. Using the values disclosed in the table, the company must disclose the relationship between the executive compensation actually paid and the company's TSR. The company can make the disclosure either using a narrative discussion, a graph or a combination of both. Interestingly, the company has flexibility as to the location of the discussion and it is not required to be included in the CD&A section. Companies that are not smaller reporting companies must also provide disclosure on the relationship between the company's TSR and the TSR of a peer group as chosen by the reporting company.

Additional and Supplemental Disclosure

The reporting company may provide additional and supplemental disclosure to the extent that such additional disclosure is useful to an understanding of the pay vs. performance discussion. As with any information, the additional information cannot be misleading or detract from the basic disclosure elements required by the new proposed rules.

XBRL Tagging

The new disclosure must be tagged in the XBRL files. This is the first time the SEC has required XBRL tagging outside of the financial statements.

Phase-In

The rule allows for a phase-in period. In the first filing following the effectiveness of the proposed rule, companies will only be required to provide two years of disclosure and will need to add an additional year of disclosure for each subsequent year's filing until

the required number of years of disclosure has been achieved (3 years for smaller reporting companies and 5 years for all others).

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

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