

SEC Open Meeting to Adopt Pay Versus Performance Rule Proposal

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Dodd-Frank directs the Commission to require public companies to disclose a clear description 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. Below is a summary of the proposed rules as discussed at today's SEC open meeting that just concluded. The full rule proposal will provide additional details, and we will issue a memo on the proposal.

At the open meeting, the Commission voted to propose amending Item 402 of Regulation S-K and requiring a new table with a new measure of executive compensation – executive compensation “actually paid” – for the CEO and an average of the same measure for the other NEOs. “Actually paid” compensation will start with the total compensation in the summary compensation table, adjusting for the pension amount reported and including only equity awards that have vested and not merely granted, and using the fair value as of the vesting date. The amounts added and deducted from the summary compensation table will be explained in a footnote, for example, if the vesting date valuation assumptions are materially different from the grant date assumptions in the summary compensation table.

Companies must provide a clear description of the (a) relationship of the executive compensation actually paid to cumulative total shareholder return (TSR) and (b) relationship of the company's cumulative TSR to a business index or a company's own chosen peer group. The calculation of TSR will be based on existing Item 201(e) requirements for performance graphs.

The information must be provided for five fiscal years, with a phase-in period so that for the first filing, companies can provide for three completed fiscal years and then an additional year in each of two subsequent years.

Narrative and/or graphic discussion is required to explain the relationships. For the first time, SEC rules will require XBRL tagging of this proxy statement disclosure in order to provide comparability across companies. As is currently the case, companies can provide supplemental disclosure to reflect their specific situations, including using other financial performance measures.

The Commission vote was 3 to 2. Commissioners Gallagher and Piwowar did not support the proposal. Both criticized the timing and priority of this particular rulemaking relative to other outstanding rules also required under Dodd-Frank.

Commissioner Gallagher disagreed with the “prescriptive” nature of how “pay” and “performance” are defined in the proposal, and argues that companies should decide for themselves. Both commissioners believe that one-year TSR, in particular, is not an adequate measure of financial performance, could cause undue focus on short-term results and will force companies to provide numerous supplemental disclosures to explain the results.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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