Client Alert

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Executive Compensation & Benefits

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SEC Proposes Pay-for-Performance Disclosure Rules

By Mark C. Jones, Kathleen D. Bardunias & Kevin Lin*

On April 29, 2015, the Securities and Exchange Commission (SEC) proposed a new rule under the Dodd-Frank Wall Street Reform and Consumer Protection Act that would require public companies to disclose the relationship between the compensation actually paid to certain key executives and the financial performance of the company, as measured by total shareholder return (TSR). This Client Alert summarizes the key features of the proposed rule. If the proposed rule is finalized during 2015, affected companies may be required to make the "pay-for-performance" disclosures as early as the 2016 proxy season.

Companies Subject to the Proposed Rule

The proposed rule generally applies to all reporting companies other than foreign private issuers, registered investment companies and emerging growth companies. Smaller reporting companies are required to provide only three (as opposed to five) years of data and are not required to include peer group information or amounts related to pensions.

Executives Covered by the Proposed Rule

Under the Proposed Rule, certain compensation information for the principal executive officer (PEO) and the remaining named executive officers (NEOs), as a group, must be disclosed. The PEO's compensation information must be presented separately from the average compensation of the remaining NEO's. If more than one person serves as the PEO in a given year, the compensation information relating to such individuals is aggregated.

Applicable Filings

The new "pay-for-performance" information should be disclosed in the company's proxy statement, and thus would be subject to any say-on-pay advisory vote. It would also need to be included in any other information statement that includes the executive compensation information required under Item 402 of Regulation S-K.

Form of "Pay-for-Performance" Disclosures

Covered companies would be required to include the required disclosures using the following new standardized table:

PAY VERSUS PERFORMANCE

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)

Relationship Between Pay Versus Performance

Using the table, companies would be required to describe, in a narrative and/or graphic format:

1. The relationship between executive compensation "actually paid" and the company's TSR.

2. The relationship between the company's TSR and the TSR of its peer group.

The SEC rejected requests by commentators to allow companies to use a performance measure other than TSR. However, companies will be able to present supplemental measures of financial performance, so long as any disclosure is clearly identified and not misleading.

In general, companies must provide the disclosures in the table for the five most recent years, although smaller reporting companies are only required to report for the three most recent years. The proposed rule includes a "phase-in" period in which companies will be required to report the three most recent years (two for smaller reporting companies) in the first year of disclosure, with the remaining years added in the subsequent two years (or one for smaller reporting companies).

Peer Group

In calculating peer group TSR, companies may use the same index or issuers that they use for the "stock performance graph" required under Item 201(e) of Regulation S-K or a peer group reported in the Compensation Discussion & Analysis (CD&A). Companies would be required to disclose the members of the peer group chosen, unless the peer group is a published industry or line-of-business index.

Compensation "Actually Paid"

The proposed rule requires disclosure of compensation "actually paid" to the PEO and NEOs. To calculate the compensation "actually paid" to the executive in a given year, a covered company must start with "total compensation" as reported in the Summary Compensation Table and make the following adjustments:

- <u>Equity Awards</u>: Subtract the fair value of equity awards granted in the applicable fiscal year, and add the fair value of equity awards that vest in the applicable year.
- <u>Pension Plan Benefits</u>: Subtract the change in present value of the executive's pension benefits, and add the actuarially determined service cost for services rendered by executive during the applicable year.

Next Steps

The SEC is accepting comments on the proposed rule through July 6, 2015. In anticipation of the final rule, covered companies may want to work with their advisors to see how closely their current executive compensation programs align with the proposed performance measures.

**We would like to thank our Summer Associate Kevin Lin for his contribution to the alert.*

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or one of the following members of the Executive Compensation & Benefits practice section:

New York

Susan P. Serota (bio)
+1.212.858.1125
susan.serota@pillsburylaw.com

Peter J. Hunt (bio)
+1.212.858.1139
peter.hunt@pillsburylaw.com

James P. Klein (bio)
+1.212.858.1447
james.klein@pillsburylaw.com

Kathleen D. Bardunias (bio)
+1.212.858.1905
kathleen.bardunias@pillsburylaw.com

Bradley A. Benedict (bio)
+1.212.858.1523
bradley.benedict@pillsburylaw.com

Washington, DC / Northern Virginia

Howard L. Clemons (bio)
+1.703.770.7997
howard.clemons@pillsburylaw.com

Justin Krawitz (bio)
+1.703.770.7517
justin.krawitz@pillsburylaw.com

Los Angeles

Mark C. Jones (bio)
+1.213.488.7337
mark.jones@pillsburylaw.com

San Francisco

Christine L. Richardson (bio)
+1.415.983.1826
crichardson@pillsburylaw.com

Marta K. Porwit (bio)
+1.415.983.1808
marta.porwit@pillsburylaw.com

Amber Ward (bio)
+1.415.983.1048
amber.ward@pillsburylaw.com

Michelle K. Enchill (bio)
+1.415.983.1942
michelle.enchill@pillsburylaw.com

San Diego—North County

Marcus Wu (bio)
+1.858.509.4030
marcus.wu@pillsburylaw.com

Lori Partrick (bio)
+1.858.509.4087
lori.partrick@pillsburylaw.com

Silicon Valley

Cindy V. Schlaefer (bio)
+1.650.233.4023
cindy.schlaefer@pillsburylaw.com

Matthew C. Ryan (bio)
+1.650.233.4627
matthew.ryan@pillsburylaw.com

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