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If you have any questions regarding the matters discussed in this alert, please contact the following attorneys or your regular Skadden contact.

Brian V. Breheny
202.371.7180
brian.breheny@skadden.com

Marc S. Gerber
202.371.7233
marc.gerber@skadden.com

Richard J. Grossman
212.735.2116
richard.grossman@skadden.com

Neil M. Leff
212.735.3269
neil.leff@skadden.com

Regina Olshan
212.735.3963
regina.olshan@skadden.com

Erica Schohn
212.735.2823
erica.schohn@skadden.com

Joseph M. Yaffe
650.470.4650
joseph.yaffe@skadden.com

Michael R. Bergmann
202.371.7133
michael.bergmann@skadden.com

Ted Yu
202.371.7592
ted.yu@skadden.com

Caroline S. Kim
202.371.7555
caroline.kim@skadden.com

SEC Proposes New Rules for Pay-Versus-Performance Disclosure

On April 29, 2015, the U.S. Securities and Exchange Commission (SEC) proposed new rules that would require companies to disclose the relationship between the compensation actually paid to named executive officers (NEOs) and the company’s financial performance. The proposed rules are based on the requirements of Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

New disclosure requirements. The proposed rules would require companies to include in those proxy or information statements that are required to include executive compensation disclosure a new table with the following:

- the total executive compensation of the CEO and the average of the total compensation of the other NEOs, as reported in the Summary Compensation Table and already required in the proxy or information statement;
- the executive compensation “actually paid” to the CEO and the average of the executive compensation “actually paid” to the other NEOs, calculated according to the proposed rules; and
- the cumulative total shareholder return (TSR), calculated in the same manner as the performance graph already required by SEC rules, for the company and its peer group.

Subject to a phase-in period, companies would be required to disclose this information for their five most recently completed fiscal years. Emerging growth companies, foreign private issuers and registered investment companies (other than business development companies) would be exempt from the new disclosure requirement. Smaller reporting companies would be subject to scaled disclosure requirements.

Executive compensation “actually paid.” For purposes of the proposed disclosure requirement, executive compensation “actually paid” would be the total compensation for the covered fiscal year for each NEO, as disclosed in the Summary Compensation Table, but adjusted:

- to deduct the change in pension value and add back the actuarially determined pension service cost for services rendered during the applicable year; and
- to deduct the fair value of equity awards granted during the year and add back the fair value on the vesting date of equity awards that vested during the year.
Relationship between pay versus performance. Using values reflected in the new table, companies would be required to describe (1) the relationship between the executive compensation actually paid and the company’s TSR and (2) the relationship between the company’s TSR and the TSR of its peer group. Companies would be permitted to describe these relationships either through a narrative discussion, a graphical presentation or a combination of both.

The proposed rules would give companies flexibility regarding the location of the new disclosure in the proxy or information statement. The disclosure would not be required to be included in the Compensation Discussion and Analysis.

**XBRL.** The new disclosure would have to be tagged in interactive data format using eXtensible Business Reporting Language (XBRL). This would be the first time the SEC requires XBRL tagging outside of the financial statements.

**Supplemental disclosures.** Companies would be allowed to supplement the proposed new disclosure by providing pay-versus-performance disclosure based on other compensation measures, such as “realized pay” or “realizable pay,” if they believe such supplemental disclosures would provide useful information about the relationship between the compensation paid and the company’s financial performance. The supplemental disclosure, however, may not be misleading or presented more prominently than the required new disclosure. This prominence requirement may present particular challenges with respect to pay-for-performance discussions in executive summaries appearing at the front of many proxy or information statements.

**Applicable filings.** The new pay-versus-performance disclosure would be required in any proxy or information statement that is required to include executive compensation disclosure, including those with respect to the election of directors. The disclosure would not be required in annual reports on Form 10-K, Securities Act registration statements or Exchange Act registration statements. The disclosure also 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 company specifically incorporates it by reference.

**Implications.** The new disclosure requirements regarding pay versus performance will not be effective until the SEC adopts final rules. While the timing of the adoption of the final rules is unclear, companies should plan for the possibility that the new requirements could go into effect as soon as the 2016 proxy season.

Comments on the proposed rules are due 60 days after their publication in the Federal Register, and comments may be submitted on the SEC’s website. A copy of the proposed rules can be found here. For additional information on the proposed rules, see the press release issued by the SEC.