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SEC Pay-For-Performance Plan May Actually Boost Exec Pay

By **Ed Beeson**

Law360, New York (April 29, 2015, 6:53 PM ET) -- A plan from the U.S. Securities and Exchange Commission to get public companies to draw a line between executive pay and shareholder returns promises to give activist investors a new tool for prodding corporate governance, but the language of the agency's proposal also may give companies cover to fatten, rather than slim down, C-suite pay.

In proposed rules issued for comment on Wednesday, the SEC envisioned public companies publishing in annual proxy materials a chart that shows both the "actual pay" of their chief executives and other top officials and the company's total shareholder return over a five-year period, if they are larger companies. The plans further would have companies compare their pay-for-performance to a peer group.

The idea is to give investors and others a straightforward and uniform data set that can be compared across almost all U.S. public companies, which in turn may be used in so-called say-on-pay votes to pressure corporate outliers where there is a mismatch between pay and financial performance.

Yet in going the route of showing the "actual pay" an executive took home in a given year, as opposed to the more commonly cited figure of awarded compensation that includes options and bonuses vesting in different years, the proposal may inadvertently give executives some leverage with their firm's compensation committee, noted John Martini, a Reed Smith LLP partner who chairs the firm's global executive compensation and employee benefits practice.

"That number, in many years, is going to be a lower number," Martini said of actual pay, when compared to awarded dollar amounts disclosed in summary compensation tables. "It's going to enable many executives to push for more comp. in the near term."

In the long term, Martini said he expects the proposed rules, if they are finalized, will make a bigger splash with investors than other, more controversial executive compensation measures that the SEC is required to write and finalize under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

These include the proposed pay ratio rule, which would require companies to disclose the pay gap between their CEO and their average worker, and a yet-to-be written plan for mandatory compensation clawbacks in the event of a restatement.

Investors, for example, will likely ignore the pay ratio figure, but certainly will zero in on the relationship between executive pay and shareholder returns, said Martini, who opposes the SEC's proposal and see it as doing the bidding of for-profit proxy advisory firms.

Other observers said pay-for-performance data will mainly impact companies on the margins.

Steve Kline, a director of Towers Watson & Co.'s executive compensation consulting practice, noted that only 2 percent of companies subject to a say-on-pay vote during the 2014 proxy vote failed to get enough shareholder support. Say-on-pay is another Dodd-Frank-mandated rule that requires companies to put their compensation packages up for a nonbinding shareholder vote at least every three years.

The SEC itself was divided over the pay-for-performance proposal, with the commission's two Republican members casting dissenting votes against issuing the plans. However, their complaints focused more on the idea that the SEC should be focusing its attention on other, more pressing Dodd-Frank related regulations.

Also questioned was why the SEC was requiring companies to compare pay to total shareholder return, rather than giving them more flexibility to decide which financial metric to use.

The reaction from industry groups was somewhat more optimistic. In a statement, Tom Quaadman, vice president of the U.S. Chamber of Commerce’s Center for Capital Markets Competitiveness, said the SEC's proposal has promise but in the end should live up to encouraging long-term shareholder value.

"Conceptually, pay-for-performance can be a disclosure that is useful to both investors and businesses. The details are going to be important, and the rule itself cannot be a driver for short-term actions," Quaadman said.

The head of an advocacy group that focuses on corporate governance and pay issues said he applauded the SEC's steps, but said his group would reserve judgment until it analyzes the agency's proposal.

"We believe the goal of this disclosure should be to supplement current disclosures and thus enhance investor understanding of whether the board's intent in linking pay and performance was fulfilled," Timothy Bartl, president of the Center on Executive Compensation, said in a statement. "The center will be looking closely at the proposal through that lens."

Unlike other SEC rulemakings, the proposed rules at the outset do not appear to be particularly daunting for companies to implement, attorneys said, though they added a closer read of the 137-page proposal may yield a different conclusion.

For example, many larger companies already internally track pay-for-performance through metrics such as total shareholder return, said Mary Mullany, a Ballard Spahr LLPpartner who heads the firm's securities group.

"For those companies, it's actually going to be fairly easy because they have been doing it," she said.

But what will be an adjustment, of course, will be disclosing the data to the public.

A Towers Watson study from October found that while issuers have ways of monitoring pay-for-performance, most did not include this data in their 2014 proxy statements.

Adding to the natural unease is the fact the SEC wants companies to disclose the pay-for-performance data in a format known as "eXtensible Business Reporting Language," or XBRL, which will enable analysts and others to quickly compare one company’s practices against a swath of others.

This, in turn, could ramp up the scrutiny on companies, particularly if their extensive narratives in proxy statements about how compensation is set doesn't jibe with what is disclosed in the pay-for-performance tables, said Mike Hermsen, a partner with Mayer Brown LLP.

"It could lead to [proxy advisers] being able to use this information in a way that companies may not like," he said.

But at least everyone will be roughly in the same boat in terms of what data gets disclosed, Kline said.

"At least we'll have a common baseline to say, 'Let's put everyone through the same test,'" he said.

--Editing by Katherine Rautenberg and Emily Kokoll.

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