Regulatory Activity

Mayer Brown attorneys discuss 4 Dodd-Frank proposals companies should think about now

By Anne Sherry, J.D.

On the occasion of Dodd-Frank's fifth anniversary, Mayer Brown lawyers Mike Hermsen and Laura Richman hosted a teleconference discussing the SEC's four compensation-related rulemaking initiatives. Although the rules are all still in the proposal stage, the attorneys suggested that companies should consider well in advance how their requirements will affect disclosure, accounting treatment, and other issues.

Clawbacks. Dodd-Frank required the SEC to promulgate four executive compensation rules. It is not a coincidence, Richman suggested, that the last of these rules, on clawbacks, was proposed just in time for the five-year milestone. Proposed Rule 10D-1 would direct the national securities exchanges and associations to require listed companies to develop and enforce policies for recovering excess compensation after an accounting restatement. Although SOX already requires clawback of excess payments to the CEO or CFO, Rule 10D-1 would require recovery of excess compensation paid to anyone who served as an officer during the performance period, whether or not he or she participated in the wrongdoing that led to the restatement. Richman highlighted the fact that the proposal defines incentive-based compensation as that based in part on attaining a "financial reporting measure," which includes not only accounting measures, but also stock price and total shareholder return. This is one of the most challenging aspects of the proposal, in her view, because it will require companies to estimate how the restatement affects its stock price or TSR.

The rule is still in its earliest stage, Richman noted: the comment period will have to close, the SEC will finalize its rule, and the exchanges will have a year from the effective date to finalize their listing requirements, after which companies will have another 60 days to comply. Nevertheless, it will take time for companies to assess the impact of the clawback proposal, reflect on how their discussions of incentive-based compensation in the CD&A may affect clawbacks, draft provisions to use in new agreements, and be thinking about their policies and procedures—including getting their accountants involved in the discussions. Finally, she noted that companies may want to evaluate the list of people they treat as officers under Section 16, because this list is the model for the rule.

Hedging. A less controversial issue is hedging disclosure: the SEC unanimously approved the proposal without convening a meeting. This rule would require companies to disclose whether employees are permitted to hedge the securities they hold, whether granted as compensation or otherwise held, directly or indirectly. Although hedging policies with respect to named executive officers are already identified as a discussion for the CD&A, Richman stressed that the new hedging disclosure will apply not just to the NEOs, but to all employees, directors, and officers.

Pay-for-performance. New subparagraph (v) to Regulation S-K Item 402 would require a new compensation table showing the relationship between the actual compensation paid and the company's performance, by company and peer group TSR. The pay-versus-performance disclosure would be required to be tagged in XBRL, representing the first such requirement for a proxy statement. Hermsen noted that equity awards will be considered actually paid on the vesting date, whether or not they have been exercised, and they will be valued as of the vesting date, not the date of grant. This will require the extra step of subtracting the stock and option values from the summary compensation table and adding the vesting date amounts back in, along with a footnote disclosing the compensation deducted and added for the CEO and the average of the other NEOs.

Pay ratio. The pay ratio proposal is approaching its own second anniversary, and the SEC is rumored to be voting next month. New subparagraph (u) to Item 402 would require a company to disclose in proxy and information statements in which compensation information is required: the median compensation of employees other than the CEO, the CEO's compensation, and the ratio of the two. The proposal allows flexibility in determining the median; Hermsen summarized the factors that could be included as the size and nature of the workforce; the complexity of the organization; the stratification of pay levels; the types of compensation; the extent to which compensation is paid in multiple currencies; the number of tax and accounting regimes; and the company's number of payroll systems and difficulty in integrating these systems.

Even with the various options for calculating median compensation, Hermsen believes that many companies will find it challenging and costly to gather the information required. He suggests public companies evaluate their payroll and recordkeeping systems for advanced planning purposes and contemplate how they may update their disclosure controls and procedures to comply with the rules when they are finalized. ■