Post #36: Proposed Pay for Performance Disclosures May Actually Help

From Chris Havey, Partner, The Woodlands, TX

The SEC recently proposed rules outlining a new CD&A disclosure coming out of Dodd-Frank (see Meridian Alert here) – these rules require disclosure of the link between performance and compensation "actually paid". While the proposed disclosures will likely require a significant amount of legwork to calculate and there is a lot of information proposed to be included, they might actually do some good.

Summary of the Proposed Disclosures

The proposed disclosures attempt to show performance (both absolute TSR and relative TSR) and a version of realized pay (value of awards at vesting). The following table summarizes the differences between this definition of pay (Actual Pay) and the Summary Compensation Table (SCT).

Pay Element	Actual Pay
Base salary	Same as SCT
Bonus	Same as SCT
Stock Awards	Fair value of all stock awards that vested that year, as of their vesting date
Option Awards	Fair value of all options that vested that year, as of their vesting date (e.g., current Black-Scholes calculation)
Non-Equity Incentive Plan Compensation	Same as SCT
Change in Pension Value	Actuarial present value of accrued pension benefits earned based on an additional year of service
Non-qualified DC Earnings	Same as SCT
All Other Compensation	Same as SCT

Benefits of the Proposed Disclosures

One of the challenges of the current disclosures (i.e., the Summary Compensation Table) is that shareholder and shareholder advisors use this data to evaluate pay and performance alignment. This makes little sense because most of the LTI disclosures use grant date values, which often have little or no correlation with performance.

This was particularly noticeable in the energy industry in 2014. Much of the industry experienced a significant stock price decline in the latter half of 2014, but most companies made their equity awards in the first half of 2014. ISS and others expect the stock awards in the first half of 2014 to reflect stock price performance in late 2014. This has helped contribute to some negative Say on Pay recommendations from ISS in the energy industry.

Many companies included a calculation of "realizable" pay in their proxies, but methodologies differ. The proposed disclosures will help in a few ways:

- Standardize the methodology to allow consistent application and comparison across companies

- Provide validity to the methodology which will hopefully increase ISS and shareholder comfort that the disclosure provides sound pay and performance information

- Add additional data that is not always readily available in current proxy disclosures to help facilitate shareholder analysis

While the proposed rules have some flaws (they're currently in comment period), the additional disclosures should help improve the analysis that shareholders rely upon to inform their Say on Pay votes and could actually do some good.