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Public Company Executive Compensation Hot Topics

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Public Company Executive Compensation Hot Topics Roundtable

November 4, 2015

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Panelists

- **Jessie Lochmann Allen**
  Partner, Foley & Lardner LLP
- **Joshua Agen**
  Senior Counsel, Foley & Lardner LLP
- **Patrick McGurn**
  Special Counsel, Institutional Shareholder Services
- **Amy Jennings**
  Partner, Aon Hewitt
- **Georgia Nelson**
  Director, Compensation Committee, Cummins
- **Eileen Kamerick**
  Director, Legg Mason Closed End Mutual Funds, Associated Banc Corporation and Westell Technologies, Inc.

Institutional Shareholder Services (ISS) Policy Update

ISS 2016 Investor Survey

- Use of Adjusted Performance Measures in Incentive Programs
  - 81% of investors believe that adjusted performance metrics in incentive compensation programs are sometimes acceptable, depending on the nature and extent of the adjustments
    - Non-GAAP measures considered acceptable by 66% of these investors, provided that the measures used are reconciled to GAAP and adjustments are adequately explained
  - A majority of investors identified specific types of adjustments that may be appropriate, including:
    - Discontinued operations
    - Non-recurring or extraordinary charges
    - Foreign exchange volatility
  - A majority of investors disapproved of adjustments for:
    - Goodwill write-downs
    - Litigation expenses
    - Compensation expenses

ISS 2016 Investor Survey

- Outside Directors and Equity Compensation
  - Investors generally approved of equity grants of lieu of cash meeting fees or retainers
  - However, performance-based restricted stock and options/SARs were not favored because they might create (real or perceived) conflicts of interest, as directors set performance targets
- Say on Pay at Externally Managed Issuers (REITs):
  - More than 70% of investors were in favor of ISS recommending a vote against say-on-pay resolutions where issuers provided minimal (or no) disclosure about executive compensation because such compensation is paid by an external manager
  - When a say-on-pay resolution is not on the ballot, some investors indicated they might vote against compensation committee members if compensation disclosure was inadequate

SEC Rulemaking Update

SEC Rulemaking on CEO Pay Ratio

- The SEC issued final CEO Pay Ratio rules on August 5, 2015.
- Requires disclosure of ratio of median compensation of all employees to the compensation of the principal executive officer
- Timing
  - Disclosure required for compensation for full fiscal years beginning on and after January 1, 2017
  - For calendar year issuers, pay ratio disclosure will first be required in proxy or information statement for the 2018 annual meeting, based on 2017 compensation

Scope of the Required Disclosure

- The pay ratio will need to be disclosed by all U.S. issuers subject to the reporting requirements of the Securities Exchange Act of 1934, other than smaller reporting companies, emerging growth companies, foreign private issuers and U.S.-Canadian Multijurisdictional Disclosure System filers
- The pay ratio disclosure will generally be required in proxy statements, information statements, annual reports and registration statements that require disclosure of executive compensation under Item 402 of Regulation S-K

Components of the Required Disclosure

- The required pay ratio disclosure will consist of the following items:
  - The median of the annual total compensation of all employees of the company and its consolidated subsidiaries (Median Pay) other than the principal executive officer (CEO);
  - The annual total compensation of the CEO (CEO Pay); and
  - The ratio of the Median Pay to the CEO Pay, expressed either as a ratio in which the Median Pay is one (e.g., 1 to 100) or in narrative as a multiple (e.g., "our CEO's pay for 2015 was 100 times the median of the total compensation of all of our employees (other than our CEO) for 2015")

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Calculation of "Pay" in the Ratio

- Both the Median Pay and the CEO Pay will be calculated on the same basis as total compensation for purposes of the Summary Compensation Table under Item 402(c)(2)(x) of Regulation S-K
- Under these rules, total compensation is the sum of (1) base salary, (2) bonuses (both discretionary bonuses and those paid under a pre-established incentive plan), (3) grant date fair value of equity awards, (4) change in pension value and above-market or preferential nonqualified deferred compensation earnings, and (5) all other compensation, including such items as perquisites, tax gross-ups, and severance

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Calculation of "Pay" in the Ratio

- Total compensation may, but is not required to be, annualized for all permanent full-time and part-time employees who were employed for less than the full fiscal year
  - Rules will not permit full-time adjustments for part-time workers or annualization for temporary or seasonal employees
  - A company may use reasonable estimates to determine the Median Pay, but not to determine the CEO Pay
- Personal benefits aggregating less than $10,000 and compensation under non-discriminatory benefit plans may be included in the median employee's annual compensation so long as the items are also included in the CEO's annual compensation
- Any material difference between the CEO's annual compensation used in the pay ratio disclosure and the compensation shown in the Summary Compensation Table will need to be explained

Identifying the Median Employee

- Potential pool of employees will include all individuals employed by the listed company or any of its consolidated subsidiaries on a single date during the last three months of the most recently completed fiscal year
- Any date during the three month period may be used for purposes of identifying the median employee
  - If the date selected by the company changes from year to year, the company must explain the reason for the change

Identifying the Median Employee

- Pool of employees will include all full-time, part-time, seasonal, or temporary workers employed on the day selected by the company, whether located in the U.S. or outside the U.S. (subject to limited exceptions for certain non-U.S. employees)
  - No exclusion for employees who are subject to a collective bargaining agreement
  - Employee would not include workers who are employed, and whose compensation is determined, by an unaffiliated third party but who provide services to the company or its consolidated subsidiaries as independent contractors or leased workers

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Identifying the Median Employee

- In determining the employees from whom the median employee is identified, companies will be permitted to use either their entire employee population or statistical sampling or other reasonable methods
- In identifying the median employee from the relevant group, companies will be permitted to use either (1) actual annual total compensation, calculated using the Summary Compensation Table rules, or (2) any other annual compensation measure that is consistently applied to all employees included in the calculation
- The regulations provide as examples of alternative compensation measures amounts derived from the company's payroll or tax records
  - These records may be used to identify the median employee even if they are kept on an annual basis other than the fiscal year of the registrant

Identifying the Median Employee

- In identifying the median employee, companies may (but are not required to) make cost-of-living adjustments to the compensation of employees in jurisdictions other than the jurisdiction in which the CEO resides so that the compensation is adjusted to the cost of living in the jurisdiction in which the CEO resides
  - If a cost-of-living adjustment is made to identify the median employee, and the median employee resides in a jurisdiction different from the CEO, then the same cost-of-living adjustment must be used in calculating the median employee's annual total compensation
  - In this situation, the jurisdiction of the employee must be disclosed, along with a brief description of the cost-of-living adjustments used and the median employee's annual total compensation and pay ratio without the adjustments

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Identifying the Median Employee

- Companies will be required to disclose the methodology used to identify the median employee and disclose any material assumptions, adjustments or estimates that are used to identify the median or to determine any elements of total compensation
  - Estimated amounts will need to be clearly identified
  - Explanation required for any change in methodology from year to year, including the reason for the change and an estimate of its impact on the median and the ratio

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Excluding Non-U.S. Employees

- Data privacy
  - Companies may exclude non-U.S. employees for whom the company cannot, despite reasonable efforts, obtain or process the compensation information required for the ratio without violating data privacy laws or regulations
    - Reasonable efforts must include, at a minimum, using or seeking an exemption or other relief under any governing data privacy laws or regulations
    - If employees are excluded under this exemption, the company must list the excluded jurisdictions and the specific data privacy laws at issue, explain how complying with the pay ratio rule would violate the law, describe the efforts made to seek relief, disclose the approximate number of employees exempted by jurisdiction and file a supporting legal opinion as an exhibit

Excluding Non-U.S. Employees

- 5 Percent Rule
  - Companies may exclude non-U.S. employees to the extent either (1) the issuer's and its consolidated subsidiaries' non-U.S. employees as a whole account for 5 percent or less of the issuer's and its consolidated subsidiaries' total worldwide employees or (2) the non-U.S. employees being excluded account for less than 5 percent of the issuer's and its consolidated subsidiaries' total non-U.S. employees
  - If an issuer excludes any employees in a non-U.S. jurisdiction because they account for less than 5 percent of total non-U.S. employees, it must exclude all non-U.S. employees in the jurisdiction
  - Also must disclose the jurisdictions from which employees are being excluded, the approximate number of employees excluded from each jurisdiction, the total number of U.S. and non-U.S. employees and the total number of U.S. and non-U.S. employees used in calculating the 5 percent limit
  - To the extent employees are excluded under the data privacy exemption, those employees apply against the 5 percent cap on the number of employees who may be excluded under this de minimis exemption

Median Employee - Every Three Years

- The median employee will need to be identified only once every three years, unless there was a change in the employee population or employee compensation arrangements during the company's last completed fiscal year that the company reasonably believes would significantly affect the pay ratio disclosure
  - The median employee's median pay must be recalculated each year
- If the company uses the same median employee for multiple years, it must disclose that fact and describe the basis for its reasonable belief that no changes have occurred that would significantly affect the pay ratio disclosure
- If there is a change in the median employee's circumstances that the company reasonably believes would result in a significant change in its pay ratio disclosure, the company may use another employee whose compensation is substantially similar to the original median employee based on the compensation measure used to select the original median employee

Status of Pay Ratio as "Filed"

- Under the final rules, the pay ratio disclosure will be considered "filed," and not merely "furnished," for purposes of liability under the Securities Act of 1933 (Securities Act) and the Securities and Exchange Act of 1934 (Exchange Act)
- Filed information is subject to liability under Section 18 of the Exchange Act, which imposes liability for misleading statements in reports or documents filed with the SEC, and is subject to automatic incorporation by reference into the company's Securities Act registration statements, which could give rise to liability under Section 11 of the Securities Act

Potential Process for Pay Ratio

- **Step 1**: Determine whether it is likely that any non-U.S. employees will be excluded from the calculation and, if so, which employees
- **Step 2**: Evaluate compensation measures available to use in identifying the median employee. The appropriate measure will depend on a number of considerations, including:
  - Which compensation measures are currently available in your existing systems (payroll, HR, tax)
  - Which of the available measures can be consistently applied across all jurisdictions in which the company or its consolidated subsidiaries have employees that must be included in the median employee calculation

Potential Process for Pay Ratio

- For many companies, total cash compensation as recorded for payroll purposes may be an appropriate measure
- Another alternative would be taxable wages as recorded for tax reporting and withholding purposes
- Whichever measure is selected should be one that acts as a reasonable proxy for annual compensation
- If existing systems do not record any single measure that can be used in this way, then consider using statistical sampling
- For most companies, calculating total Summary Compensation Table compensation for all employees would be a manual process and, as a result, a last resort

Potential Process for Pay Ratio

- **Step 3**: Verify whether existing systems will capture all of the employees required to be considered in the median employee determination, or if manual or other changes will be needed
  - The employees who must be covered are all full-time and part-time employees and all seasonal and temporary employees who are employed by the company and its consolidated subsidiaries on a single date, excluding any non-U.S. employees covered by the exemptions described in Step 1. (The single date will be one selected by the company that falls within the last 3 months of the fiscal year.)
- **Step 4**: Consider whether any particular determination date within the last three months of a fiscal year will be more desirable than another for the calculation of the ratio, keeping in mind that individuals not employed on the determination date will not be included in the calculation of the ratio

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Potential Process for Pay Ratio

- **Step 5**: Determine whether to apply a cost-of-living adjustment to the compensation amounts for employees in jurisdictions other than the CEO's jurisdiction
- **Step 6**: Run a test calculation of the ratio and prepare a "mock up" of the disclosure
- **Step 7**: Consider whether to include any supplemental disclosures, such as explanations for the ratio or alternative ratios (e.g., U.S. employees only)

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SEC Rulemaking on Clawbacks

- Timing
  - Proposed rules issued July 1, 2015
  - Comment period ended September 14, 2015
- Scope
  - Stock exchanges would adopt rules requiring listed companies to adopt compensation recovery policies
  - Rules would generally apply to all issuers with a class of securities listed on a national securities exchange or association, including foreign private issuers, controlled companies, smaller reporting companies and emerging growth companies

Proposed Clawback Rules

- Policy would be triggered by an accounting restatement required to correct an error that is material to previously issued financial statements
- Policy would apply to incentive-based compensation received by current or former executive officers during the three fiscal years preceding the date on which the issuer is required to prepare the accounting restatement
- Incentive-based compensation subject to the clawback would include compensation received due to achievement of a goal based on accounting principles or on stock price or total stockholder return (TSR)
  - Stock options that are granted, earned and vested based solely on continued employment would not be subject to the policy

Proposed Clawback Rules

- Amount of the recovery would be the excess of the amount of incentive-based compensation the executive officer actually received over the amount the executive officer would have received based on the restated numbers
  - Determined on a pre-tax basis
  - Where the incentive compensation is based on stock price or TSR, reasonable estimates could be used to calculate the excess amount
- It would not be relevant whether there is any fault on the part of the executive officer who received the compensation or whether the officer was involved in preparing the financial statements subject to the restatement

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Proposed Clawback Rules

- Mandatory
  - Enforcement of the clawback policy required except in narrowly defined exceptions: generally only where the cost of enforcement would exceed the amount of the recovery or the recovery would be illegal under home country law
  - Issuers would not be allowed to indemnify officers or pay for insurance to cover clawback amounts

Proposed Clawback Rules

- Disclosure
  - Clawback policy must be filed as an exhibit to annual report
  - Issuers would be required to disclose certain information about their enforcement of their clawback policies in proxy statements, information statements and Form 10-K in specified circumstances

SEC Rulemaking on Mandatory Pay for Performance Disclosure

- Mandatory pay for performance disclosure
  - SEC proposed rules for comment in April 2015
  - Comment period ended July 6, 2015
  - Rules as proposed would require disclosure of:
    - The relationship between executive compensation actually paid to the registrant’s executive officers and the cumulative TSR of the registrant; and
    - The relationship between the registrant’s TSR and the TSR of a peer group chosen by the registrant

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Pay for Performance Rules

- Under the proposed rules, the required disclosure consists of two components:
  - The following table covering the preceding 5 years (3 years for smaller reporting companies), using XBRL:

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)

  - A graph or narrative (or both) providing a "clear description" of (1) the relationship between executive compensation actually paid and registrant TSR, and (2) the relationship between registrant TSR and peer group TSR

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Pay for Performance Rules

- Under the proposed rules, compensation "actually paid" would be based on Summary Compensation Table, but with a few differences:
  - Value of equity awards included at time of vesting rather than grant
  - Pension plan value would be limited to changes attributable to the applicable year of service

Pay for Performance Rules

- Smaller reporting companies would be permitted to provide scaled disclosure:
  - Required to disclose only the three most recently completed fiscal years;
  - Not required to disclose amounts related to pensions; and
  - Not required to present a peer group TSR
- Emerging-growth companies and foreign private issuers would be exempt
- Transition period to phase in full disclosure (3 years initially)

Say on Pay

Say on Pay – 2015 Proxy Season Results

- Overall results similar to 2015, although the results for individual companies varied
  - Average support was 91% across all companies (2% failure rate)
  - The proportion of Pay programs receiving less than 70% - the threshold that draws additional ISS scrutiny – fell slightly from 2014.
- Shareholder engagement appeared to work for some companies with failed votes in 2014; 38% of these companies received greater than 80% support in 2015
- On the other hand, of the 49 companies that lost pay votes this year, 31% received over 80% approval in 2014

*Statistics courtesy of Westcott, 2015 Proxy Season Wrap-up (*The Advisor* August 2015)

Say on Pay – Consequences of a Failed Vote

- The consequences of a failed “say on pay” vote include the following:
  - Although all companies will be required to address the “say on pay” vote and any responsive actions in CD&A, this disclosure takes on greater importance for companies with failed “say on pay” votes
  - Proxy advisory services may recommend withholding votes from directors if remedial measures not satisfactory
  - Potential for litigation

Say on Pay and Equity Plan Proposals – Constituent Engagement

- Company engagement with shareholders on say on pay and equity plan issues
  - Timing: prior to proxy season
  - Methods:
    - Surveys
    - Group meetings
    - One-on-one meetings
    - Conference calls
    - E-Forums
    - Additional soliciting material
    - Compensation committee chair blog posting?
      - Coca-Cola equity stewardship guidelines
  - Designation of compensation "spokesperson"
- Consider engaging with ISS as well

Pay for Performance

Pay for Performance

- What Does "Pay for Performance" Mean in Practice?
  – Measuring pay
    - "Real" or "realizable" pay versus Summary Compensation Table
    - Relative – selection of peers
  – Measuring performance
    - Total shareholder return
    - Financial measures used for incentive compensation
    - Other measures
    - Relative – selection of peers

Pay for Performance

- How should "pay for performance" be presented to shareholders (CD&A)?
  – Use of charts or other graphics
  – Location in proxy statement
  – Establishing workable precedent
  – SEC requirements:
    - GAAP presentation or reconciliation
    - Not materially misleading (balance)

Shareholder Litigation on Compensation

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Shareholder Litigation on Compensation – Failed Say on Pay Votes

- Several shareholder derivative lawsuits involving compensation-related claims have been filed or threatened since the advent of say on pay
  - Typically occur following a failed say on pay vote and/or in advance of a shareholder meeting at which shareholder approval for an equity compensation plan is sought
  - Dodd-Frank expressly stated that it did not impose new or enhanced fiduciary duties in connection with the requirement to hold say on pay votes
  - Lawsuits based on failed say on pay votes generally have not been successful, but plaintiff firms continue some activity in this area
- Cheniere Energy, Inc. postponed its 2014 annual meeting due to a lawsuit filed four days earlier alleging deficiencies in the Cheniere equity incentive plan and the proxy statement disclosures concerning the plan

Shareholder Litigation on Compensation – Director Pay

- Director pay, as well as executive pay, has been the subject of shareholder litigation
- *Calma v. Templeton* (the "Citrix" case)
  - In April 2015, the Delaware Court of Chancery Court refused to dismiss a breach of fiduciary duty claim brought by shareholders against the Board of Directors arising from equity compensation awards that Citrix Systems, Inc. had granted to its non-employee directors
  - The fact that Citrix's shareholders had approved individual award limits in the equity plan under which the directors' awards were granted did not secure business-judgment-rule deference with respect to the amount of the director pay because the limits in the plan were not "meaningful"
  - Instead, director defendants would have to show that their compensation was "entirely fair"

Shareholder Litigation on Compensation – Director Pay

- Other recent cases similar to *Citrix*
  - An excessive compensation lawsuit was filed in 2014 against the officers and directors of Facebook
    - Alleges directors received excessive compensation
    - Argues that the "demand" requirement is excused "Because . . . all the non-employee Director Defendants . . . received the challenged compensation pursuant to an incentive plan that contains no limits on their compensation, let alone meaningful ones, the Director Defendants stand on both sides of the compensation awards."
  - The Facebook complaint follows the 2012 Delaware case, *Seinfeld v. Slager*, which likewise alleged that directors had paid themselves excessive compensation
    - The court allowed plaintiffs to proceed without making a demand because the directors were not considered disinterested
- **Recommendation:** Consider establishing separate, "meaningful" award limits for non-employee directors in shareholder-approved omnibus plans or using a separate shareholder-approved plan for awards to non-employee directors

Shareholder Litigation on Compensation – Issues Under Code Section 162(m)

- Another category of compensation-related litigation that some plaintiffs have pursued relates to Code Section 162(m)
- Summary of Section 162(m):
  - Compensation paid by a publicly traded company to certain officers is generally not deductible by the company to the extent it exceeds $1 million per person per year under limits prescribed by Internal Revenue Code Section 162(m)
  - There is an exception for qualified "performance-based compensation," which does not count against the $1 million limit if applicable requirements under Section 162(m) are met

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Shareholder Litigation on Compensation – Issues Under Code Section 162(m)

- A number of lawsuits have been brought asserting that boards have failed to satisfy their fiduciary duties in various ways by paying compensation in excess of $1 million limit under Section 162(m) and failing to satisfy the requirements to qualify the compensation as performance-based
- Many of the Section 162(m)-based cases have been unsuccessful, but some have survived motions to dismiss

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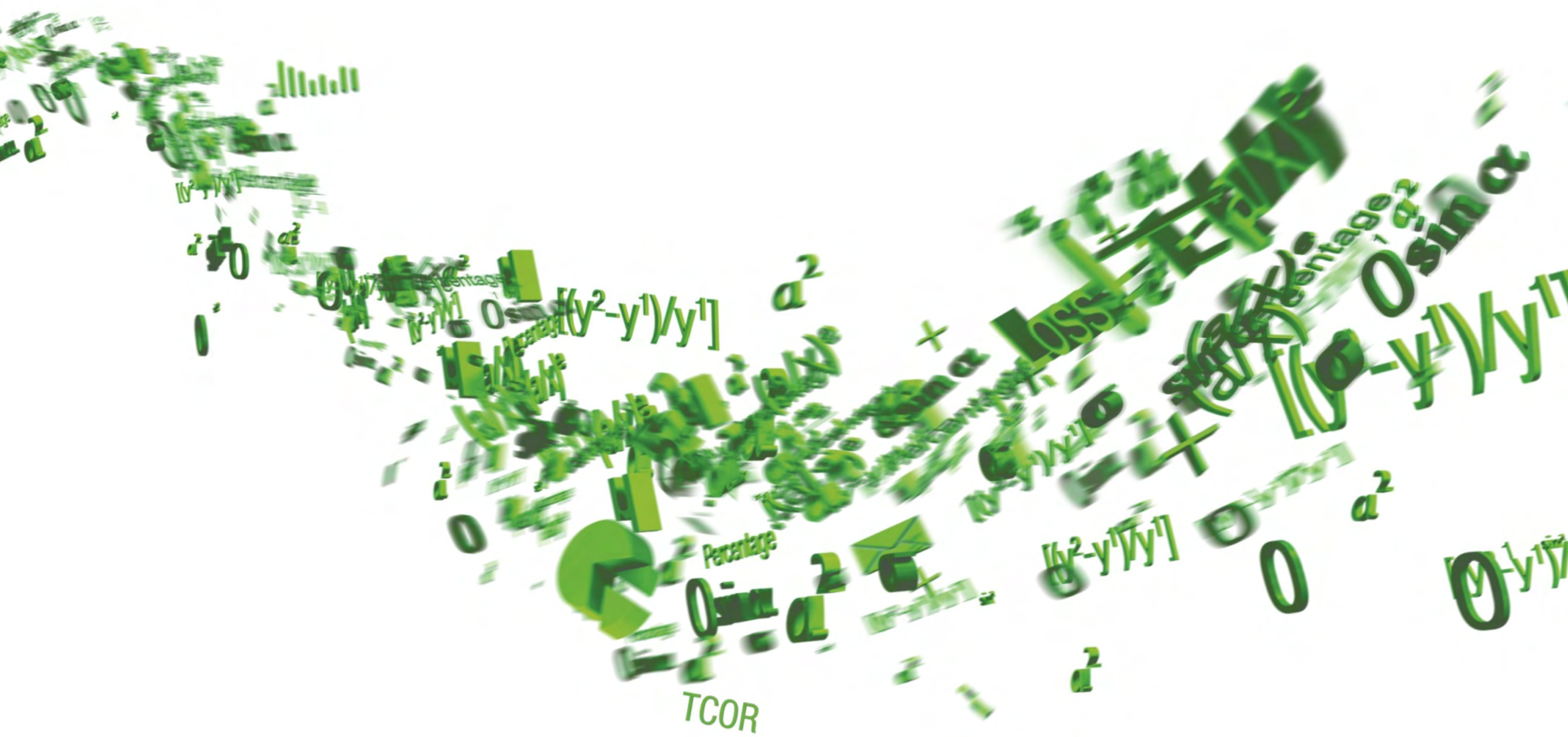
Recommendations to Minimize Exposure to Potential Section 162(m) Litigation

- Monitor the five-year re-approval requirement to ensure that performance goals are resubmitted to shareholders in a timely manner
- Review proxy statement disclosures concerning incentive awards to ensure that they do not include a promise of compensation deductibility under Section 162(m) and that they disclose any discretion of the compensation committee to award non-deductible compensation above the limits stated in the governing plan
- Ensure that the performance goals selected by the compensation committee for specific awards of incentive compensation are included in the shareholder-approved "menu" of potential goals listed in the governing plan
- Ensure that the proxy statement seeking approval of performance goals for Section 162(m) purposes accurately describes the plan's operations

Public Company Executive Compensation Hot Topics Roundtable

November 4, 2015



2015 Hot Topics in Executive Compensation

June 2015

Overview of Results

Aon Hewitt's 2015 Hot Topics in Executive Compensation Survey covers responses from 208 organizations, representing a cross-section of industries. This survey provides market direction with regard to program design and corporate governance topics. While regulations and public opinion can cause change in the external environment, a focus on "refinement" continues to be the common theme rather than overall "redesign."

The primary concerns for organizations continue to be centered on ensuring pay competitiveness and aligning pay with company performance.

- Companies continue to review/modify incentive programs to ensure that the right combination of features, performance measures, and equity vehicles provide a sufficient structure to evaluate performance and deliver competitive and justified pay opportunities.
- They are also looking beyond traditional target pay and reviewing definitions of "earned" pay to better understand the relationship between executive pay and performance.

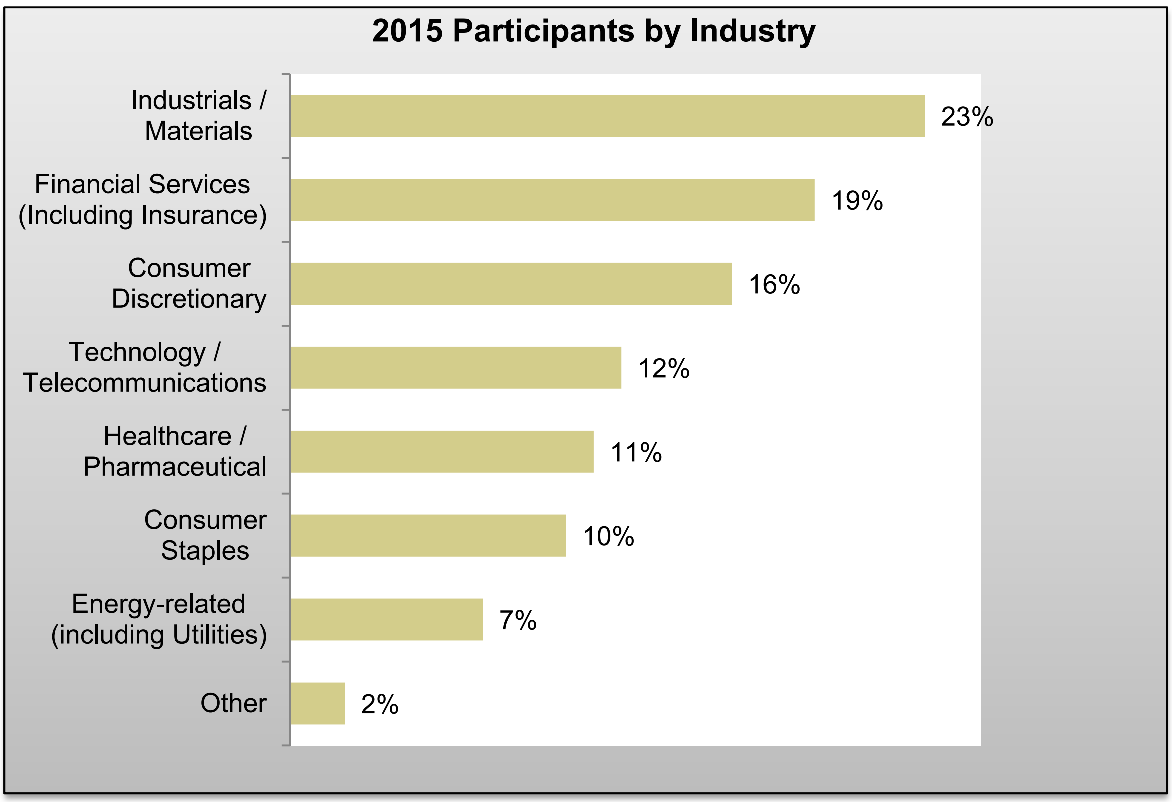
Additional survey insights include:

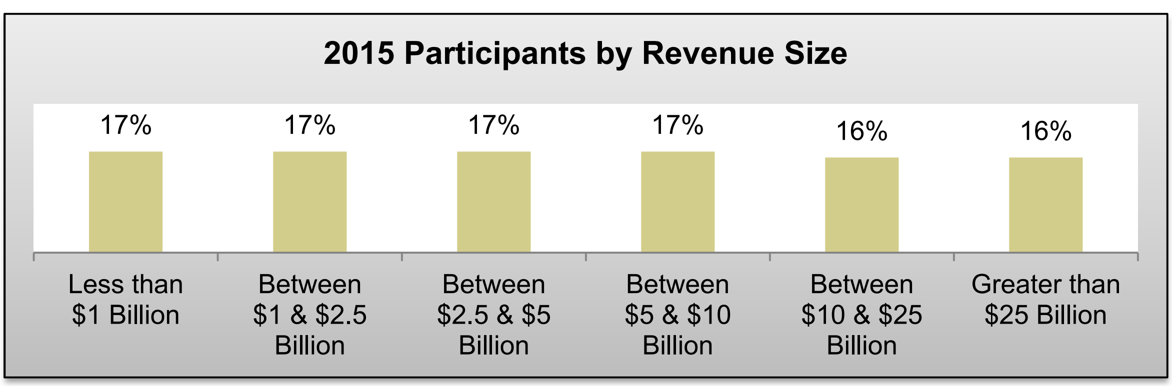
- Respondents list Board compensation committees as having the most influence over executive compensation structures but recognize the influence on the committees of:
  - External market data, the CEO, as well as proxy advisory groups and institutional shareholders.
- Executives prioritize competitiveness of targeted and earned pay, which leads to concerns around goal-setting in both annual and long-term incentive programs. In addition:
  - Executives generally understand and are satisfied with their compensation program.
  - However, there is some concern by compensation professionals that executives view incentive compensation as guaranteed rather than being truly tied to performance measures.
- Reviews of "earned" pay continue to grow in prevalence as companies seek to better understand the pay for performance relationship.
  - There continues to be many ways to define "earned" pay, with no strong consensus. (Note: the SEC recently issued preliminary regulations on a definition of "earned" pay and comparing pay to Total Shareholder Return (TSR). Timing for final regulations is yet to be disclosed.)
- Long-Term Incentives
  - 2015 award levels are similar to 2014
  - While stock option prevalence has slightly declined and performance-based shares/units continue to be most common, stock options are not "dead"
  - Eligibility levels, payout opportunities, and vehicle use are the primary plan design aspects that organizations anticipate reviewing during 2015
- Short-Term Incentives
  - 2015 award levels are similar or larger than 2014, with most programs providing a payout within +/- 10% of target
  - Mix of performance evaluation factors (i.e., financial metrics, non-financial goals, and individual performance) is the primary plan design aspect that organizations anticipate to review in 2015
- Base Salary
  - 2015 budgets are expected to be similar to 2014, with 3% remaining the standard
  - Providing meaningful increases with relatively small budgets remains a challenge

Organizations Participating in This Survey

Survey results are based on responses from 208 participating organizations. A complete participant listing is provided in the "Participating Organization" section at the end of this report.

- Seventy-one percent (71%) of the organizations responding are publicly-held, while 19% are privately-held. The remaining participant population represents subsidiaries (8%) and not-for-profit entities (2%).
- Sample is evenly distributed by revenue size.





About This Survey

Submissions were received during 2015 from late March to early May.

- Results are provided for three executive populations: CEO, Level 2, and Level 3. Level 2
  - CEO—The highest authority in an organization or subsidiary
  - Level 2—Includes any Officer of an organization, including any member of the leadership/management team and/or direct reports to the corporate CEO
  - Level 3—Includes any other employees classified as an executive (i.e. typically VPs and above, not included in Level 2).
- Results are also provided by “Publicly-held” and “Privately-held.”
  - “Publicly-held” includes publicly-held standalone organizations and subsidiaries/divisions of publicly-held standalone organizations
  - “Privately-held” includes privately-held standalone organizations and subsidiaries/divisions of privately-held standalone organizations
- References to past survey editions have been used for trending purposes.

Survey Results

2015 Organizational Priorities

We anticipate that organizations will continue to balance compensation best practices with business strategy and the views of shareholder advisory firms. Similar to past years, surveyed organizations identify pay competitiveness and pay for performance alignment as the most prevalent priorities for 2015.

2015 Priorities	Prevalence
Competitiveness of the targeted total compensation package for executives relative to the external market	66%
Alignment of executive compensation to company performance (i.e., financial and/or TSR performance)	45%
*Redesign or implementation of specific compensation programs	38%
Improving the internal communication regarding the total rewards program provided to executives	38%
Implementation/upgrade of HR Systems and tools to address current talent and reward programs/initiatives	37%
*Governance Topics	35%
Control of compensation and benefit costs	31%
*Executive Talent Topics	21%
Addressing integration issues following merger and/or acquisition activities	18%
Development of a centralized compensation structure to harmonize global compensation practices	16%
Compliance with the Federal Reserve's Sound Incentive Guidance (Responses limited to Financial Services/insurance industry participants)	15%
Assessment of risk-levels impacting compensation programs	14%
External competitiveness of your outside director compensation program	7%

Note: *The asterisks in the table above indicate further detail can be found on the following pages.*

The prevalence of responses for these specific priorities can be further detailed as follows:

*Redesign or implementation of specific compensation programs	*Governance Topics	*Executive Talent Topics
Long-term Incentives (83%)	Development of appropriate peer group(s) (47%)	Executive succession planning (93%)
Short-term Incentives (74%)	Enhancement of Proxy/CD&A disclosures (40%)	Retaining current executives (50%)
Non-retirement benefits (9%)	Addressing Shareholder/Say-On-Pay concerns (36%)	Attracting/recruiting new executives (36%)
Perquisites (8%)	Addressing the policies/regulations of Proxy Advisory Groups (25%)	
Retirement benefits (5%)	Review or implementation of specific governance policies (15%)	

2015 Executive Concerns

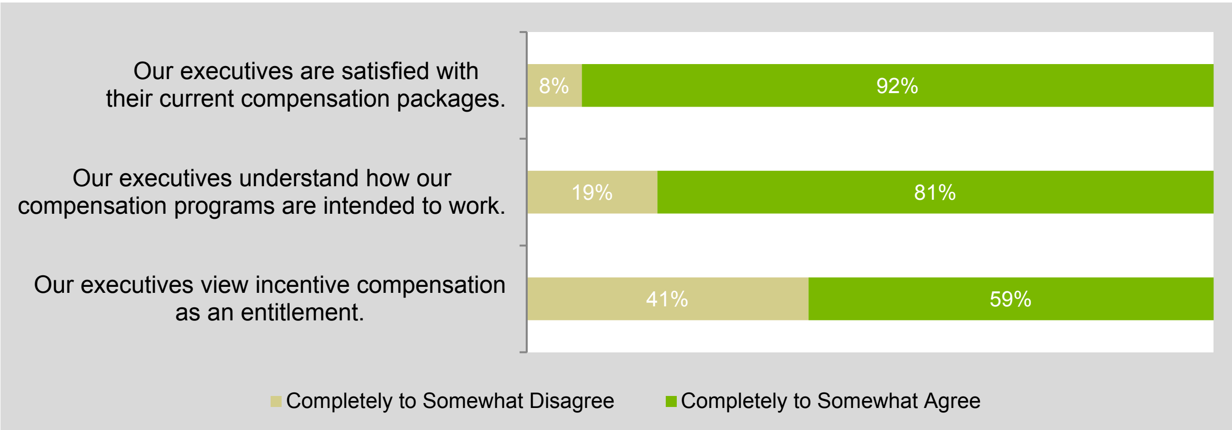
Surveyed organizations identify pay competitiveness as the most common issue that their executives are concerned about.

2015 Priorities	Prevalence
Competitiveness of target total compensation package	67%
Long-term incentive payout opportunities	53%
Short-term incentive payout opportunities	47%
How performance goals are set for short-term incentive payout opportunities	44%
Competitiveness of earned pay (i.e., realized or realizable)	37%
How performance goals are set for long-term incentive payout opportunities	35%
Base salary levels	28%
Line of sight relative to metrics utilized under incentive arrangements	28%
Compliance with Federal Reserve incentive compensation requirements	13%

Executive Perspectives

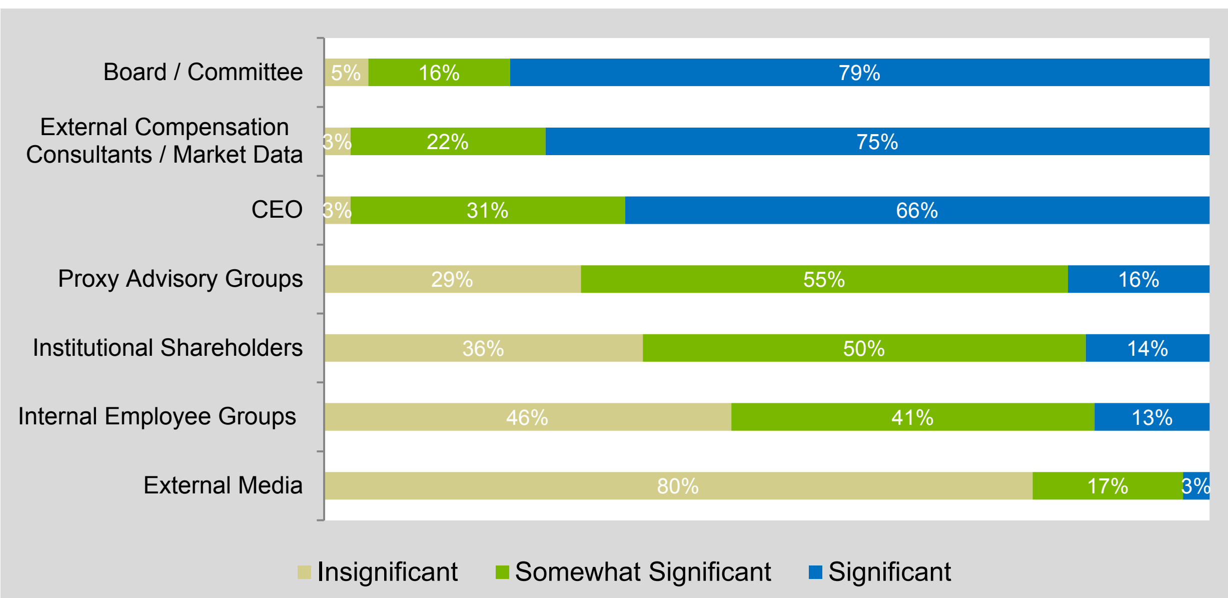
Most organizations indicate that their executives are generally satisfied with their current pay packages and believe they understand how their pay programs are intended to work.

- However, there is some concern by compensation professionals that executives view incentive compensation as an entitlement and a guaranteed component of their pay rather than being truly tied to reflect performance metrics.



Influencers on Compensation Programs

Executive compensation decisions can be impacted by many different drivers. According to this year's respondents, Board/Compensation Committees, along with external market data, provide the greatest impact on these decisions.

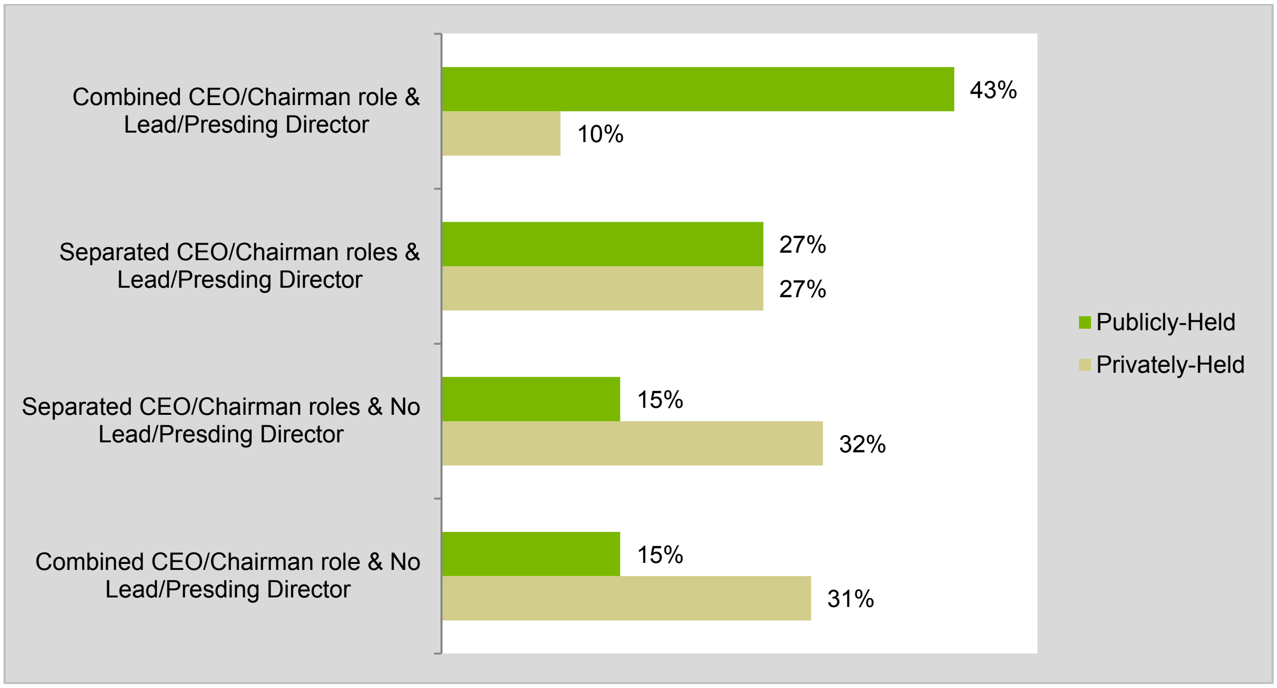


Governance Practices

Independence

Organizations continue to address independent oversight at the Board level.

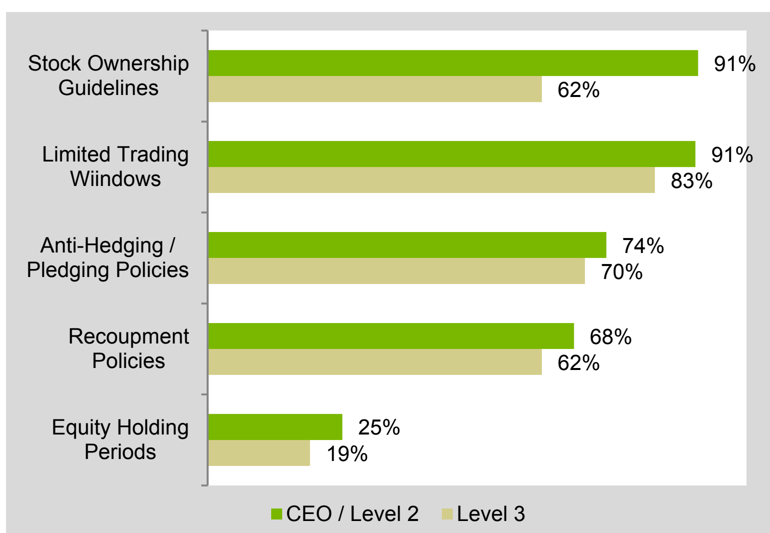
- Among publicly-held respondents, most identify that the roles of CEO and Chairman are not separated, but have a designated Lead/Presiding director.



Prevalence of Governance Programs (Publicly-Held; Full Sample)

Among publicly-held surveyed organizations, CEOs and their direct reports are commonly included in governance-related programs, with prevalence decreasing as you move farther down the organization.

- Eighty-one percent (81%) utilize both a hedging and pledging policy, while 17% only use hedging.
- The majority of respondents (84%) recoup both short and long term incentives.
- In regards to Equity Holding Periods, shareholder/governance considerations and proxy advisory regulations outweigh internal accounting expense issues as primary rationales for including them as a governance practice



Say-On-Pay

Thirty percent (30%) of this year's survey participants maintain that Say-On-Pay has had an impact on their pay practices and many have made modifications to their programs to address shareholder and proxy advisory group concerns, including:

- Enhancing communication through supplemental disclosures;
- Adjustments to compensation mix and/or pay philosophy;
- Heightened focus on relationship between pay levels and company performance;
- Introduction/refinement of governance policies such as hedging and recoupment; and
- Modification of incentive program design elements (e.g., different performance measures for short- and long-term plans, adjusting plan leverage, changing vehicles).

CEO Pay Ratio

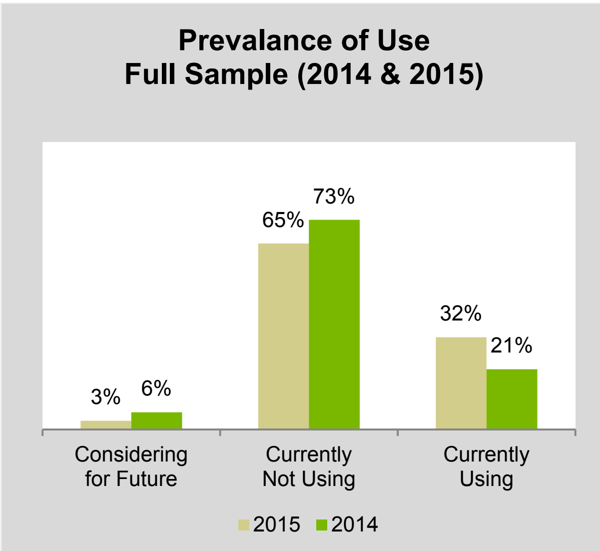
The Office of Information and Regulatory Affairs has recently pushed back their issuance of final rules regarding the CEO Pay Ratio from October 2015 to April 2016. The proposed effective date for the ratio is for fiscal years that begin after the final rules are issued. For calendar year filers, the first disclosure could occur in the 2018 proxy season.

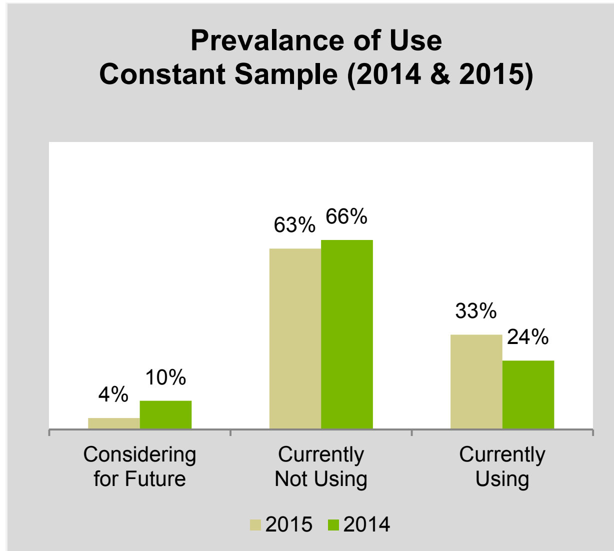
Approximately 30% of this year's survey participants suggest they have started to address the issue in one or more ways, as follows:

- Outlining an approach to collect data (69%);
- Identifying data challenges based on internal systems (64%);
- Preparing a preliminary estimate of the pay ratio (49%); and
- Identifying statistical sampling methods (29%).

Earned Pay

Although still not a prevalent practice, reviewing compensation under alternative pay definitions has become more popular. 2015 survey results, relative to the 2014 responses, continue to highlight this movement.





The intent of using an alternative pay definition is to provide clarity to Management and/or Boards with regard to pay and performance alignment. The primary reasons identified by survey participants are consistent with responses received from our 2014 survey.

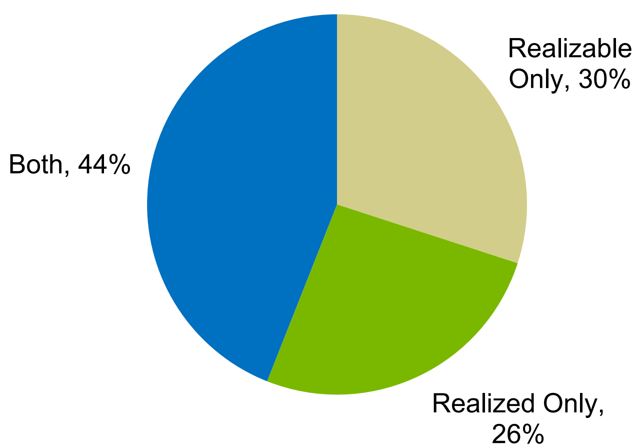
Primary reasons for using an alternative pay definition	2015	2014
To educate Management and/or the Compensation Committee	51%	47%
To illustrate difference/relationship between target pay and earned pay	41%	45%
To test pay and performance alignment (typically Board/Committee request)	38%	34%
To demonstrate that although target pay is positioned at median vs. peers/industry, earned pay was higher/lower than median due to performance	25%	30%
Realizable/earned pay was below Summary Compensation Table and better aligned with performance	18%	15%
To identify if incentive plan goals have been set too high or too low	8%	9%
Other: Non-specified	7%	4%

There is no standard definition of “earned” pay. However, the most common definitions are referred to as “realizable” or “realized” compensation.

<table>
<tr><th>Realizable</th><th>Realized</th></tr>
<tr><td colspan="2">Base salary paid</td></tr>
<tr><td colspan="2">Annual incentive/bonus earned (even if paid in following year)</td></tr>
<tr><td>Value of stock options based on share price at end of the measurement period</td><td>Spread value of stock options exercised during the measurement period</td></tr>
<tr><td>Value of RSA/RSUs granted based on share price at end of the measurement period</td><td>Value of vested RSA/RSUs based on share price on vesting date</td></tr>
<tr><td colspan="2">Long-term performance cash earned during the measurement period (even if paid in following year)</td></tr>
<tr><td>Value of performance shares earned based on share price at end of the measurement period</td><td>Value of performance shares vested during the measurement period</td></tr>
<tr><td>May include changes in pension value and/or other compensation from Summary Compensation Table</td><td>May include the value of benefits or perquisites paid during the measurement period</td></tr>
</table>

The lack of a common definition is highlighted by the fact that most organizations conduct both a “realized” and “realizable” pay analysis. Among those using only one definition, a “realized” or “realizable” pay definition is evenly used by survey participants.

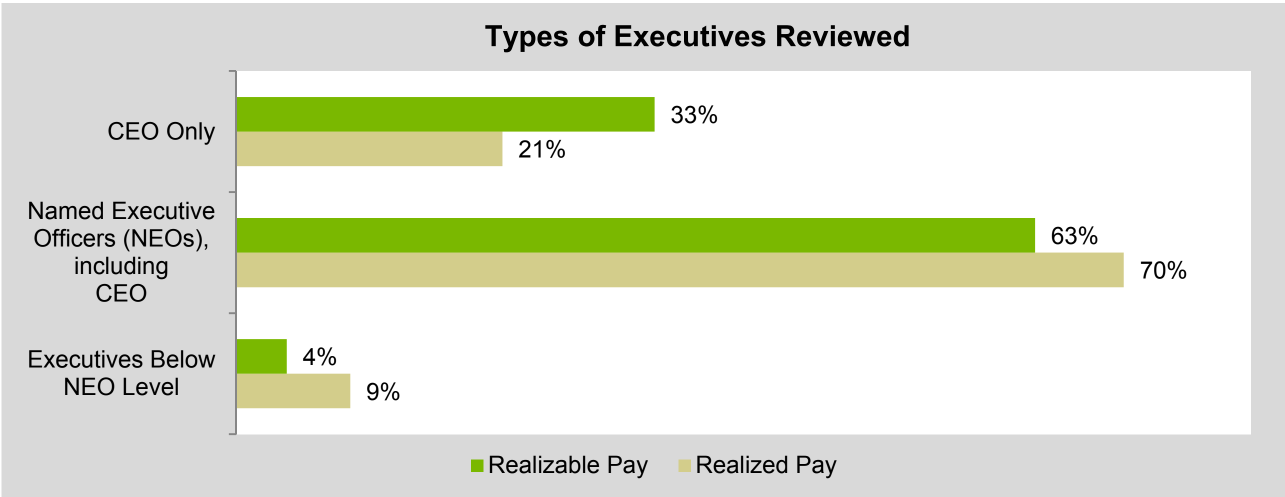
Prevalence of Use



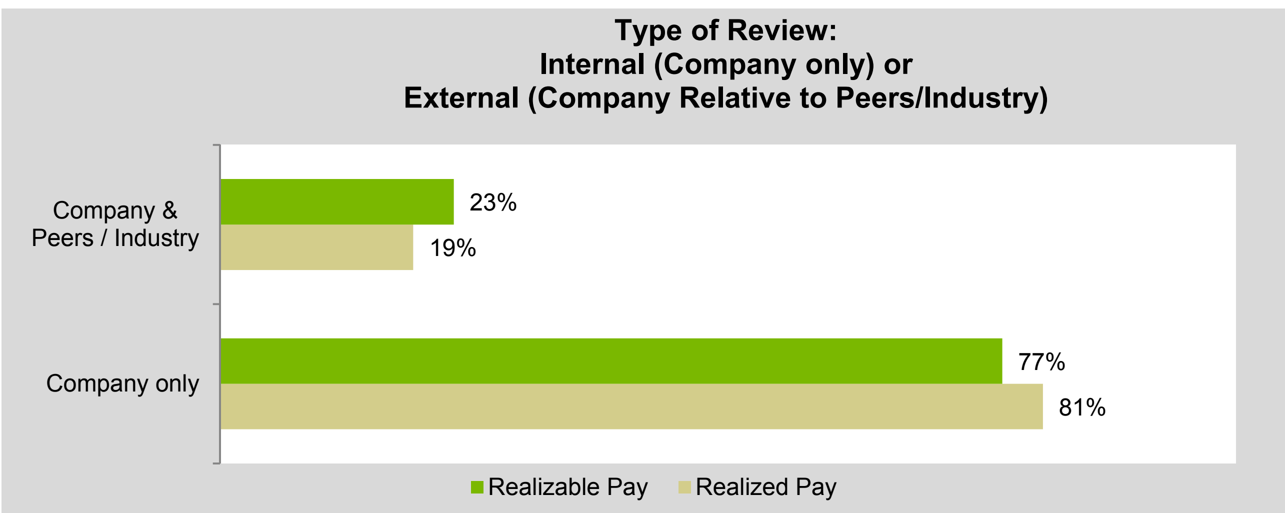
Modifications to compensation programs have been limited as a result of an alternative pay review. The most prevalent updates have been centered on long-term incentive performance measures and how equity value is being delivered among vehicles (options, restricted stock, performance-based shares/units, etc.).

Regardless of how "earned" pay is defined, as seen in the following charts, many methodology characteristics are similar.

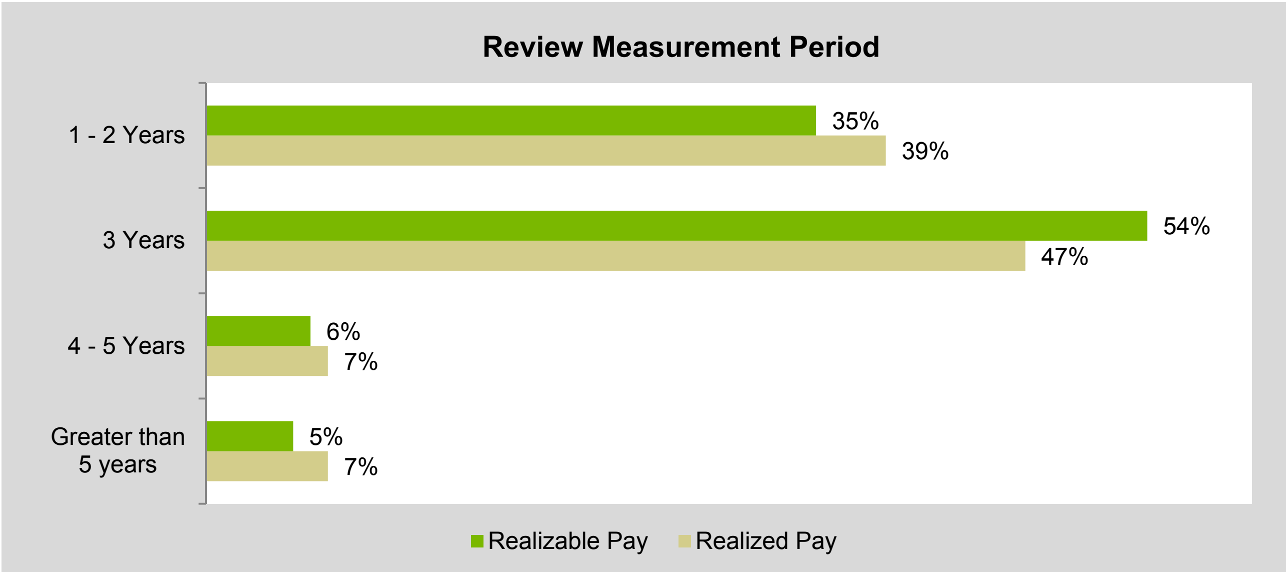
- Executive population reviewed typically consists of Named Executive Officers.



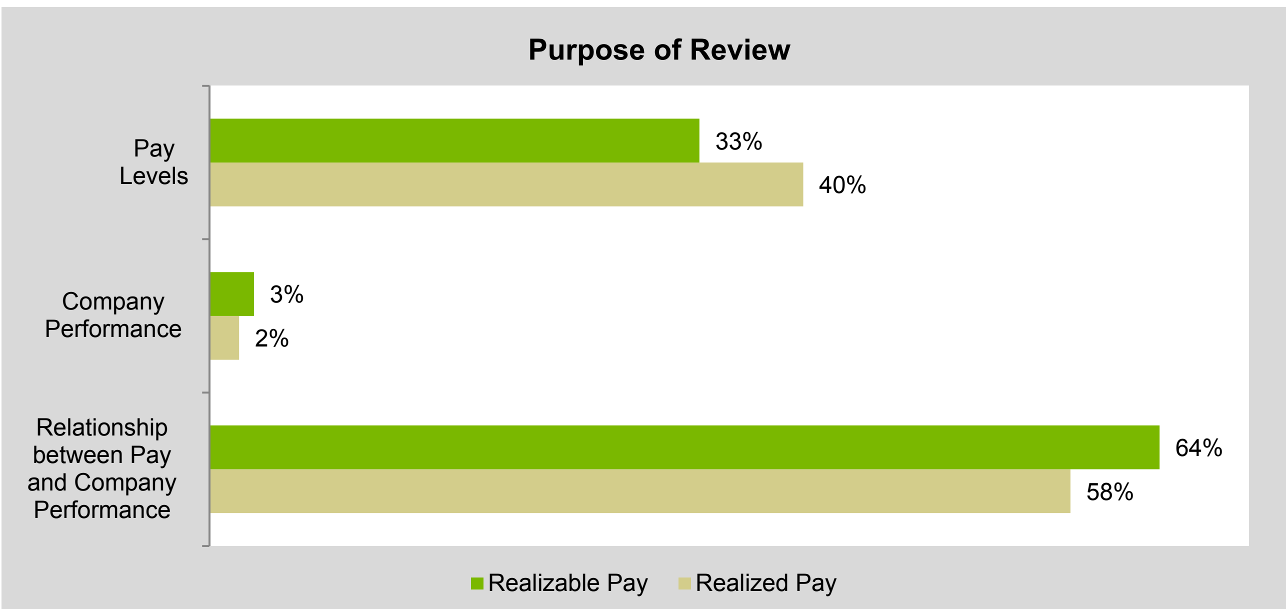
- Reviews are primarily focused internally, and not relative to comparator organizations. The results of the review are most often communicated at the Board level and/or disclosed externally in public proxy disclosures.



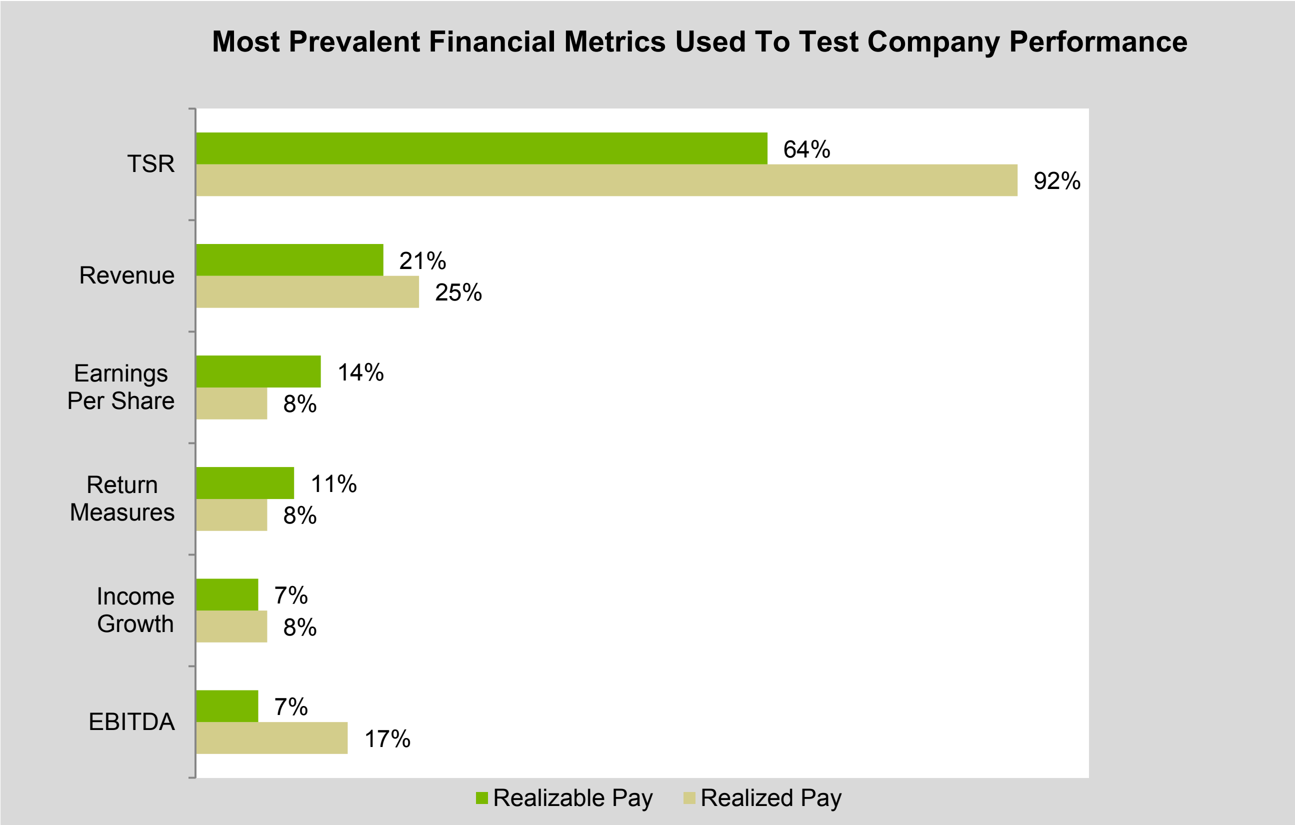
- Reviews typically consist of 1-3 years of data.



- Most organizations use the review to test the relationship between pay levels and company performance.



- Total Shareholder Return is most frequently used to test the alignment between pay and company performance; however, other measures have also been employed.

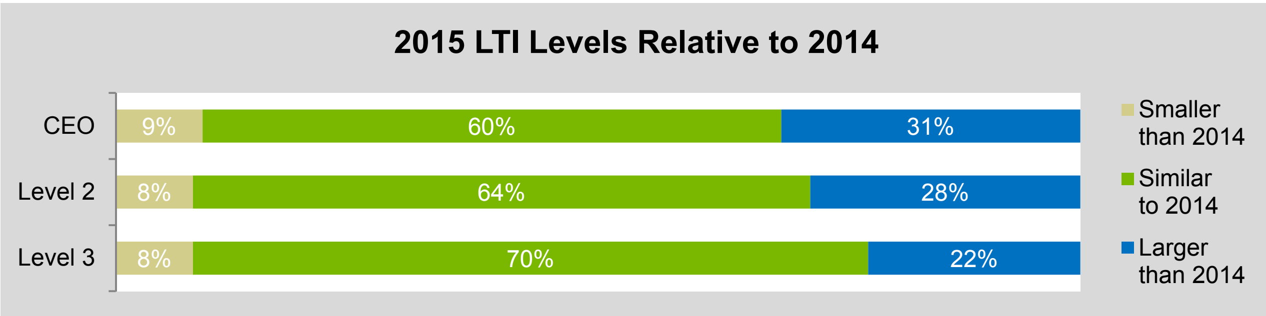


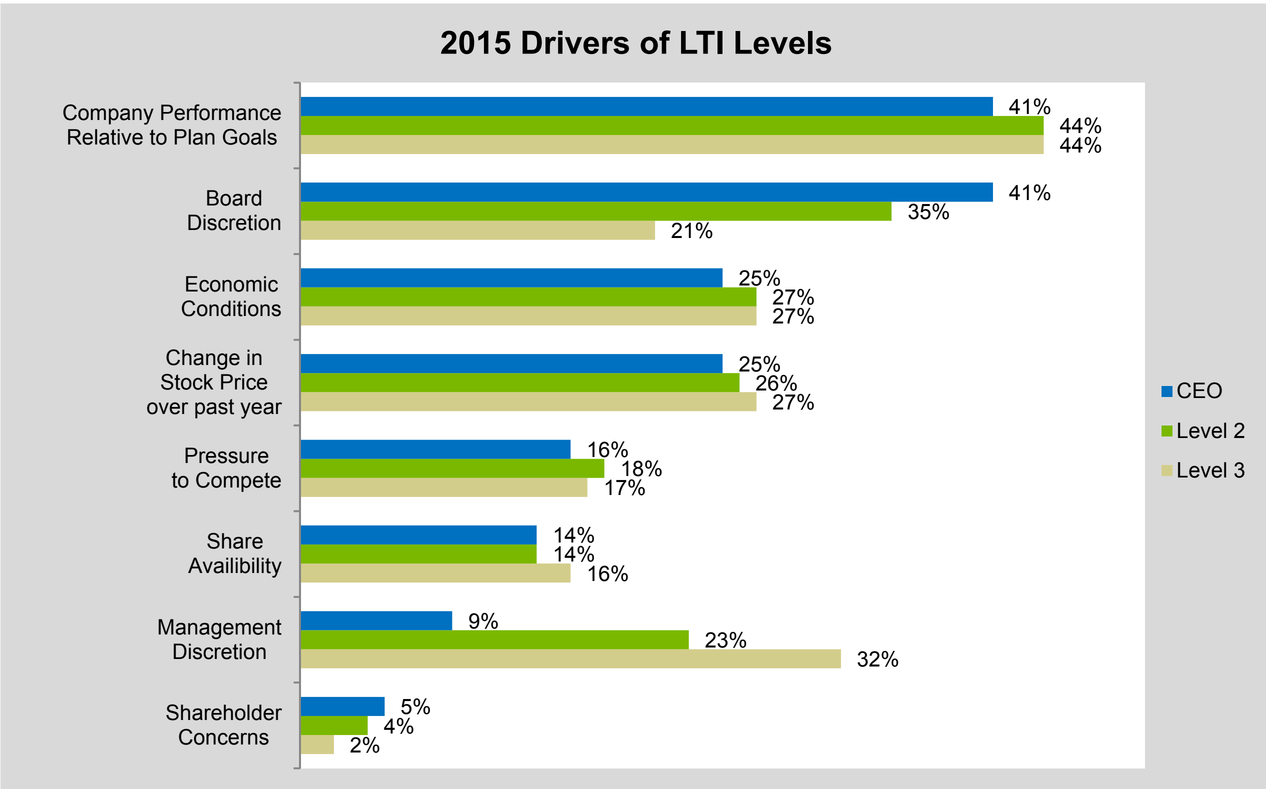
Summary of Results—Long-Term Incentives

Expectations among the survey population regarding how current long-term incentive payouts compare to the value delivered in the previous year are generally consistent across executive populations. Most indicate that 2015 payouts are similar to or larger than the levels provided in 2014.

- A recent analysis of 2015 Form-4 filings indicate that the total year-over-year change in long-term incentive value is approximately 7%.

Several drivers can affect the level of value delivered. The level of company performance relative to the goals established for the plan is considered the most common factor, but others may also have some influence.

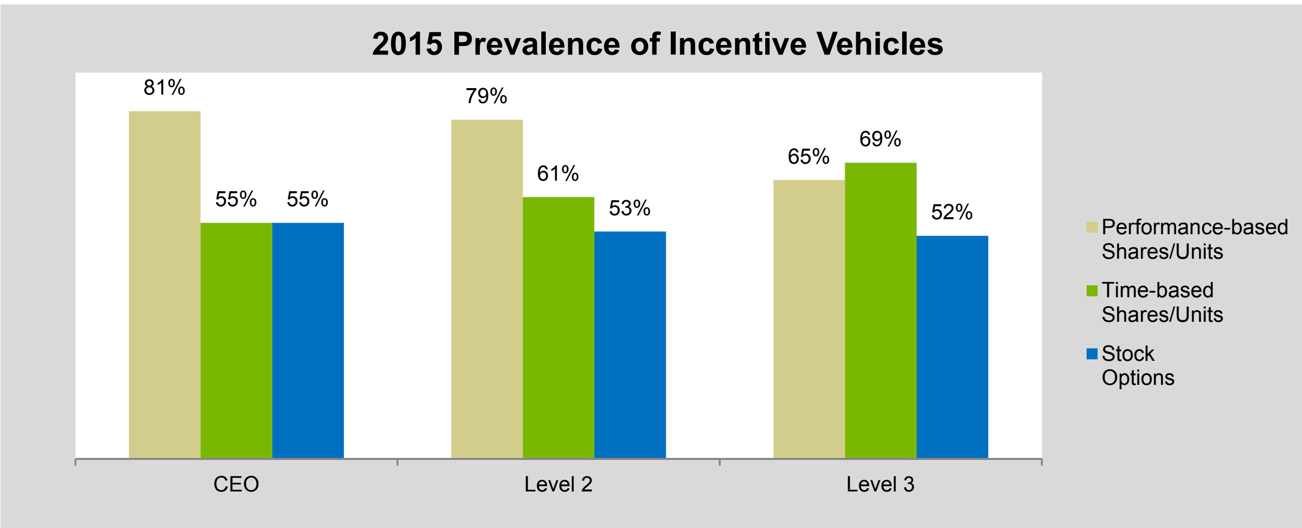


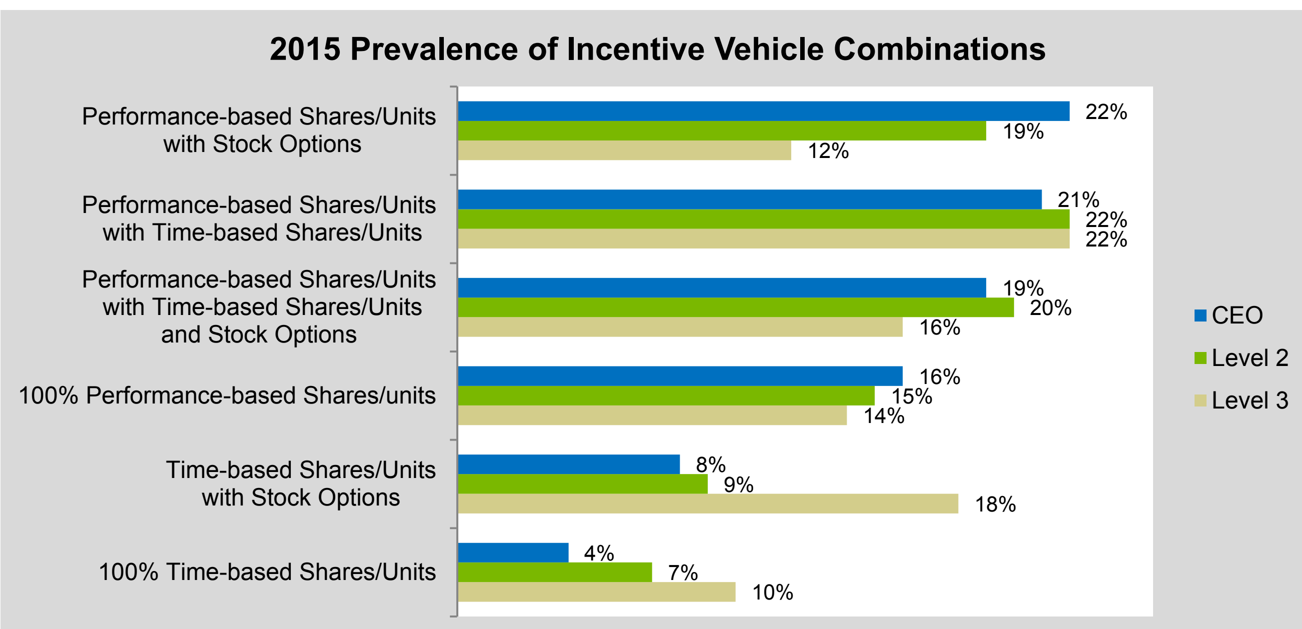


Long-Term Incentives—2015 Incentive Vehicle Utilization

Performance-based share/unit arrangements continue to be the most frequently used vehicle to deliver long-term incentive value, especially at the CEO level and their direct reports. The use of stock options is consistent across all executive levels, while the use of time-based restricted shares/units is more prevalent with Level 3 executives.

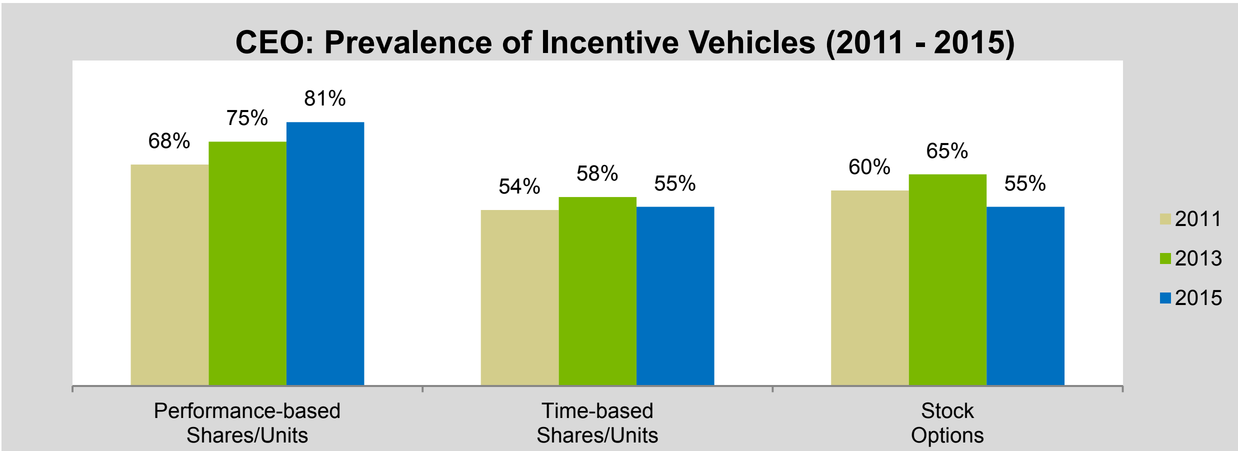
Combinations of vehicles vary among the surveyed organizations. Most use performance-based shares/unit coupled with another vehicle. Approximately one-half of organizations surveyed use at least two vehicles.

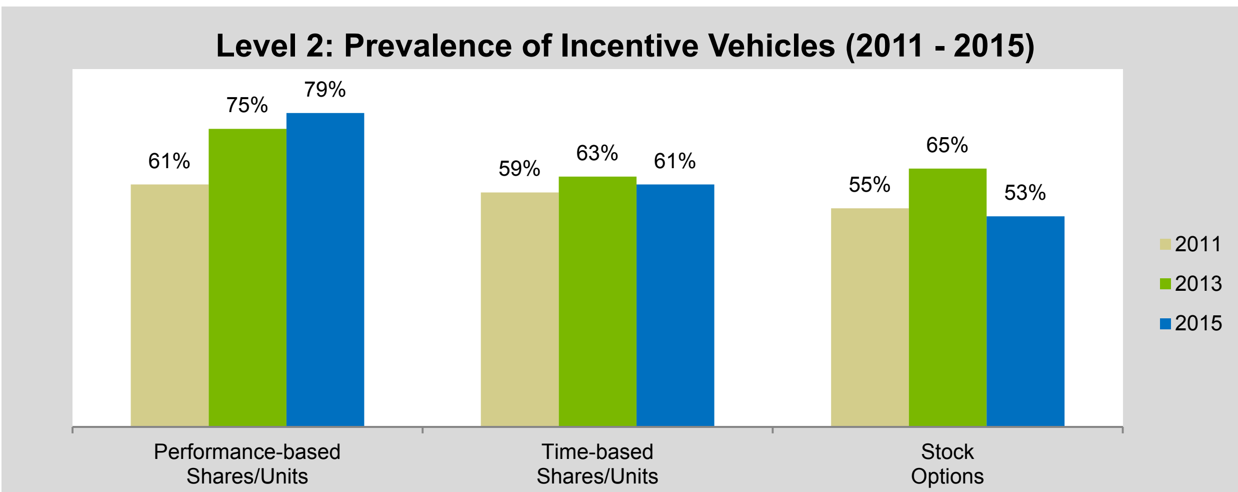


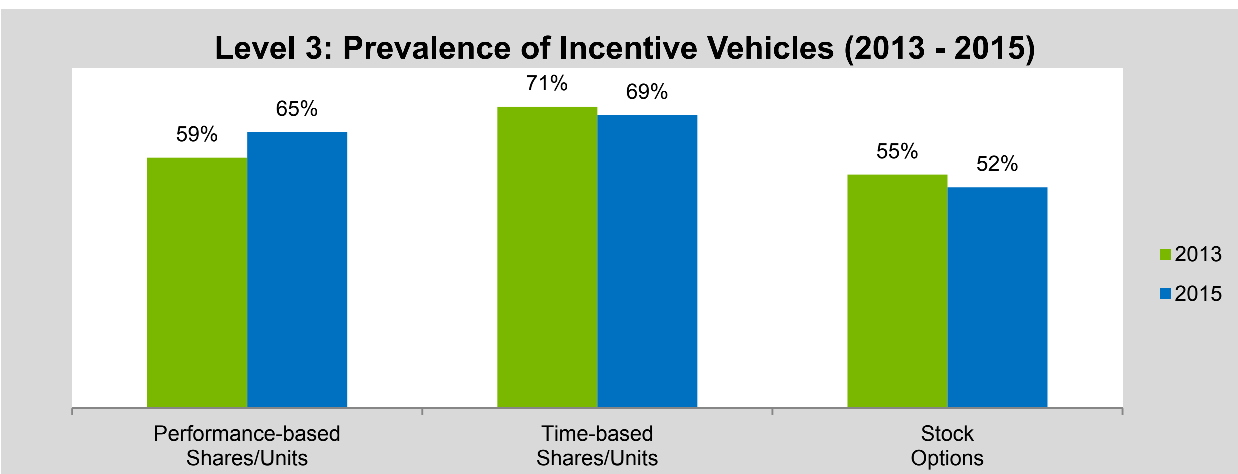


Note: *Most prevalent combinations reported shown.*

Over the past 5 years, long-term incentive vehicle utilization illustrates an increased use of performance-based programs to deliver value. The use of time-based restricted shares has generally been stable, while a slight decline in stock option prevalence can be observed.



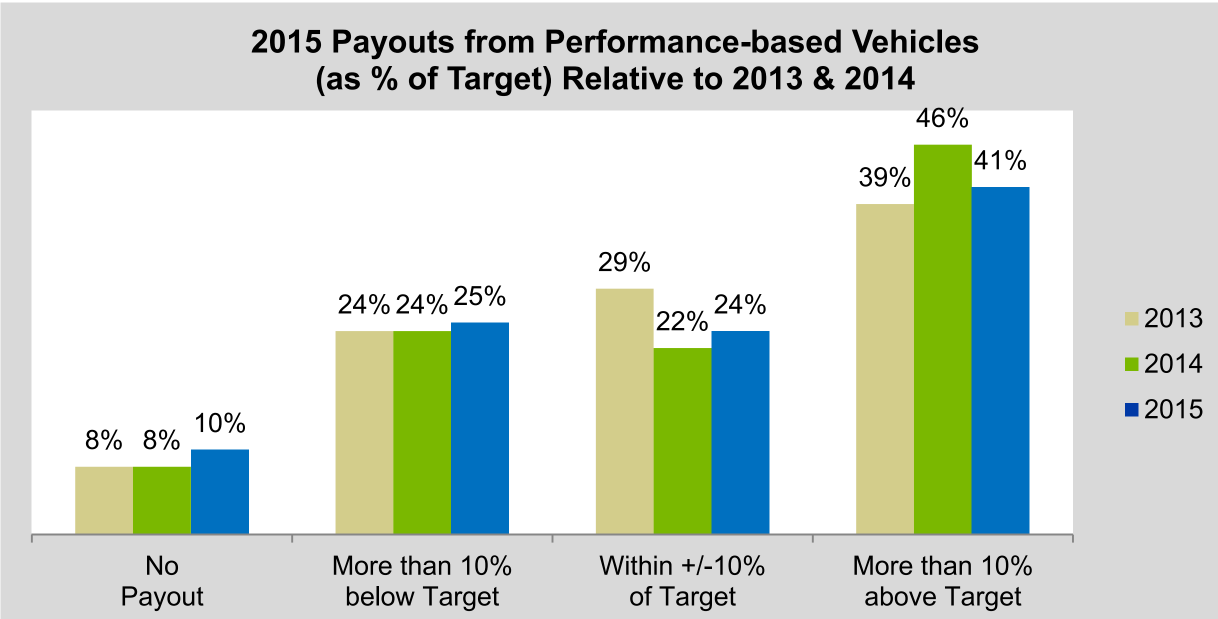




Note: *Results from the 2011, 2013, and 2015 editions of the Hot Topics in Executive Compensation survey. Data for Level 3 executives was not collected in 2011.*

Long-Term Incentives—Performance-based Vehicle Payouts

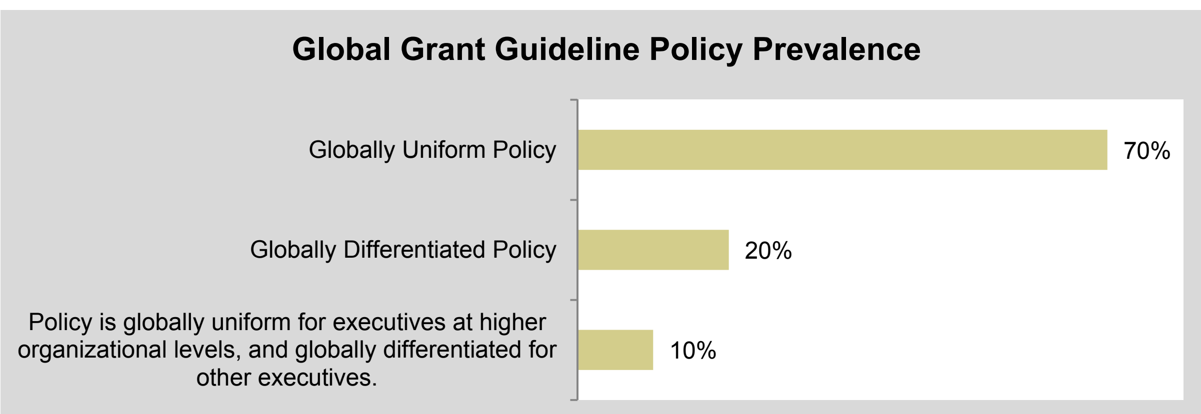
Consistent with results from 2013 and 2014, over half of surveyed organizations provided above-target payouts from their performance-based programs.



Note: *Results based on participants with stated performance-based vehicle targets and a recently concluded measurement cycle. Survey results are similar across all executive groups.*

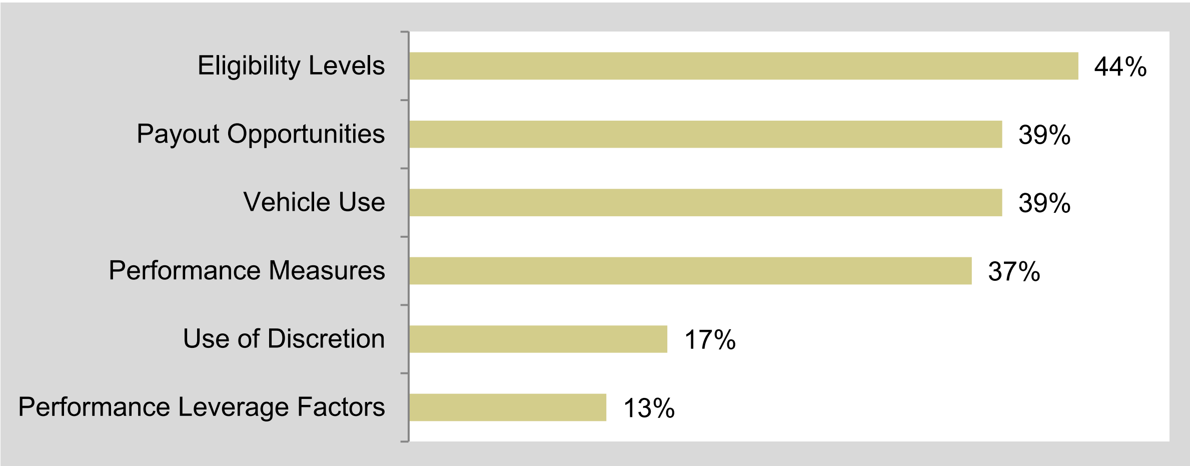
Long-Term Incentives—Global Grant Guidelines

Seventy percent (70%) of the survey population currently grants long-term incentives outside of the United States. The majority indicate that they maintain the same grant guideline policy for their executives, regardless of their global location. Smaller percentages provide levels of differentiation.



Long-Term Incentives—Areas of Review for 2015

Approximately 30% of respondents anticipate aspects of their long-term incentive programs will be reviewed. The primary features identified include:



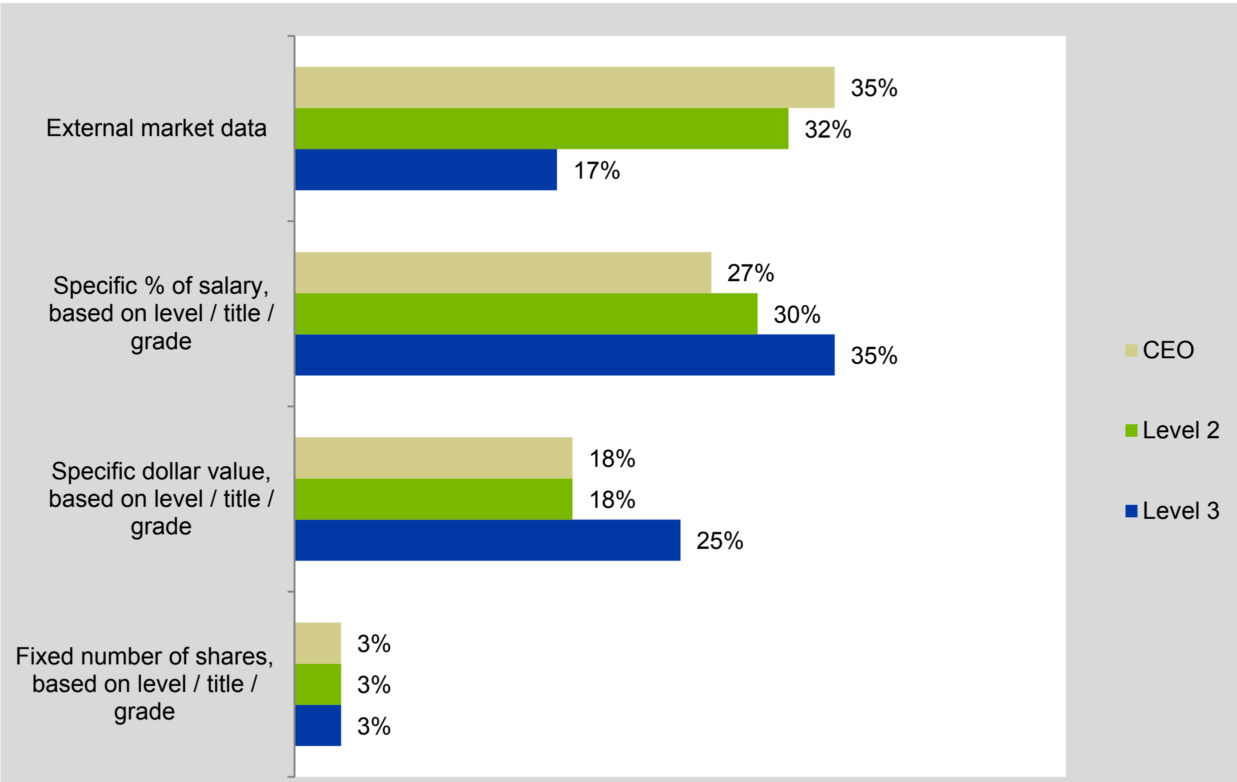
***Note:** Statistics may exceed 100% due to multiple responses.*

- The most prevalent actions considered for each aspect reviewed were identified as follows:

Aspect	Actions Considered
Eligibility Levels	▪ 60% to possibly extend eligibility to a broader employee population
Payout Opportunities	▪ 78% to consider modifying Target Award Opportunities
Vehicle Use	▪ 94% to deliver more value through performance-based vehicles as opposed to pure time-based vehicles
Performance Measures	▪ 82% to modify the performance measures used
Use of Discretion	▪ Evenly split between providing Board and Management the ability to use discretion and limiting the amount of discretion that can be used
Performance Leverage Factors	▪ Approximately 80% will review minimum performance levels used to trigger minimum payout opportunities

Long-Term Incentives—Ongoing Equity Grant Determination

The typical approach to determining the size of an overall annual long-term incentive grant varies by executive level.



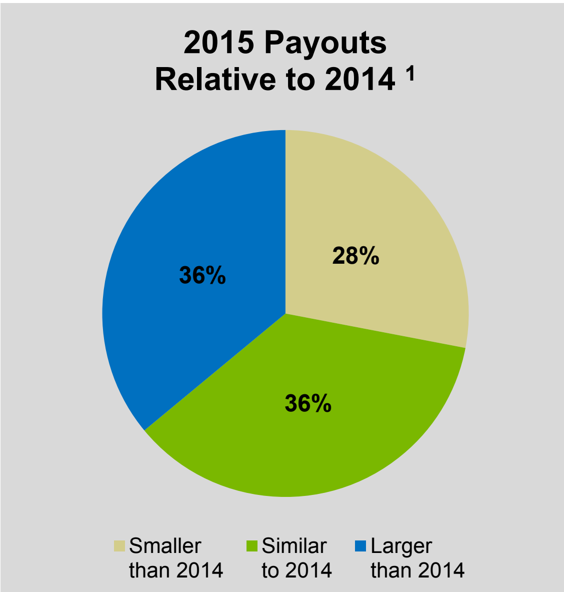
Additional Findings

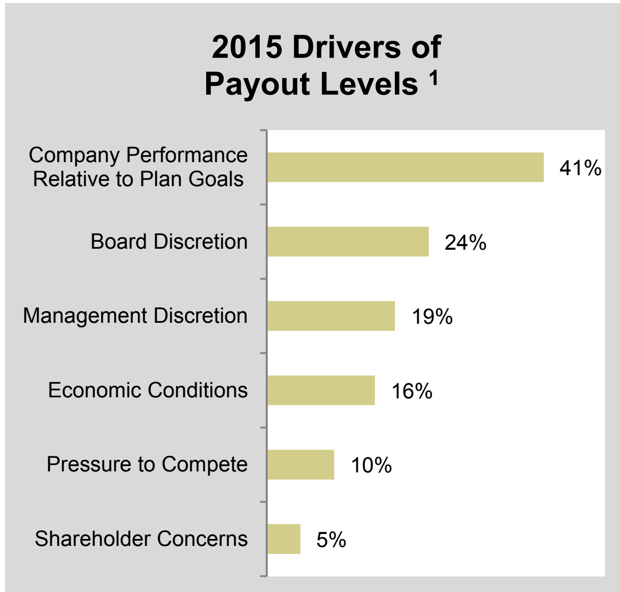
- The majority of companies indicating the use of a fixed number of shares report that they review their grant levels vs. the market on an annual basis.
- The amount of shares awarded as part of the annual grant is most typically (70%) based on the closing share price as of the date of grant. Other approaches include:
  - Closing share price as of the day before the grant
  - Average closing price from the past 10–20 days prior to the grant
  - Average of the low and high price as of the day of grant

Summary of Results—Annual Incentives

Expectations varied among the survey population regarding how current annual incentive payouts compared to the value delivered in the previous year. Most indicate that 2015 payouts are similar to or larger than the levels provided in 2014.

Several drivers affect the expected level of value delivered through an annual incentive program. The level of company performance relative to the goals established for the plan is considered the most common factor, but others may also have some influence.



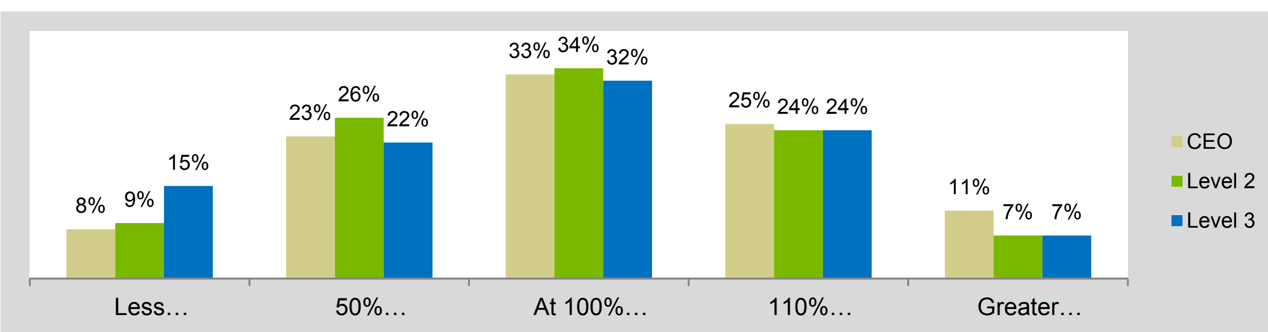


Note: *Statistics may exceed 100% due to multiple responses.*

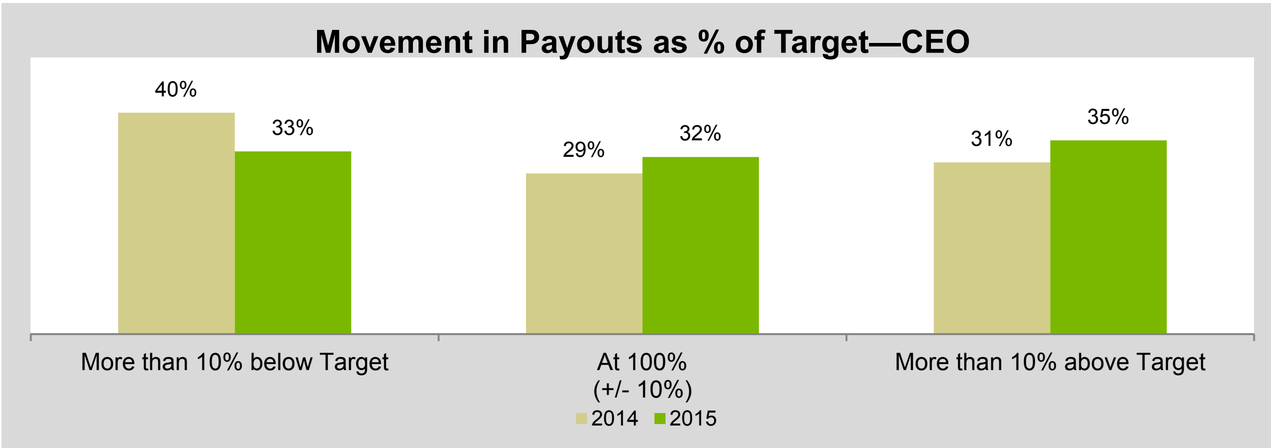
[1] Consistent expectations were identified across all surveyed executive levels. Results for Level 2 are illustrated above for reporting purposes.

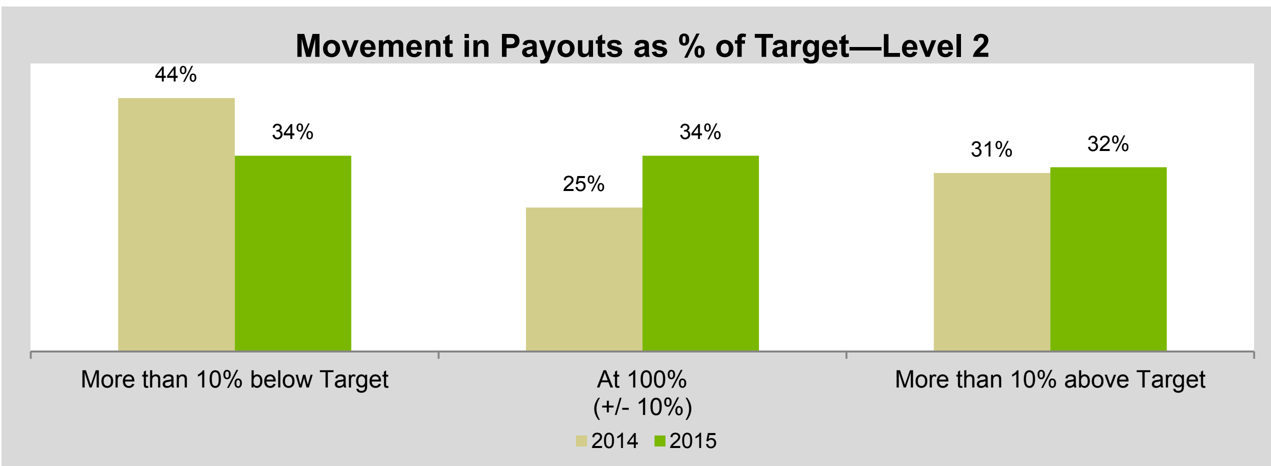
Short-Term Incentives—Payouts for 2015

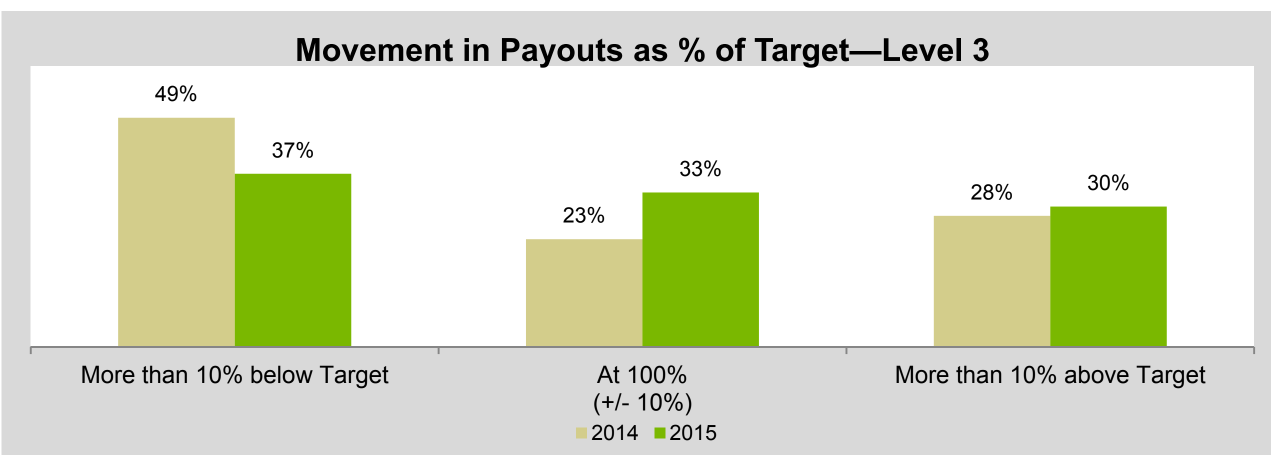
The payouts for 2015 were reported to be near the target opportunities established at the beginning of annual performance cycle.



- A shift in payout levels from a below-target to an at or above target position can be seen relative to a constant sample of participating organizations from our 2014 and 2015 surveys.



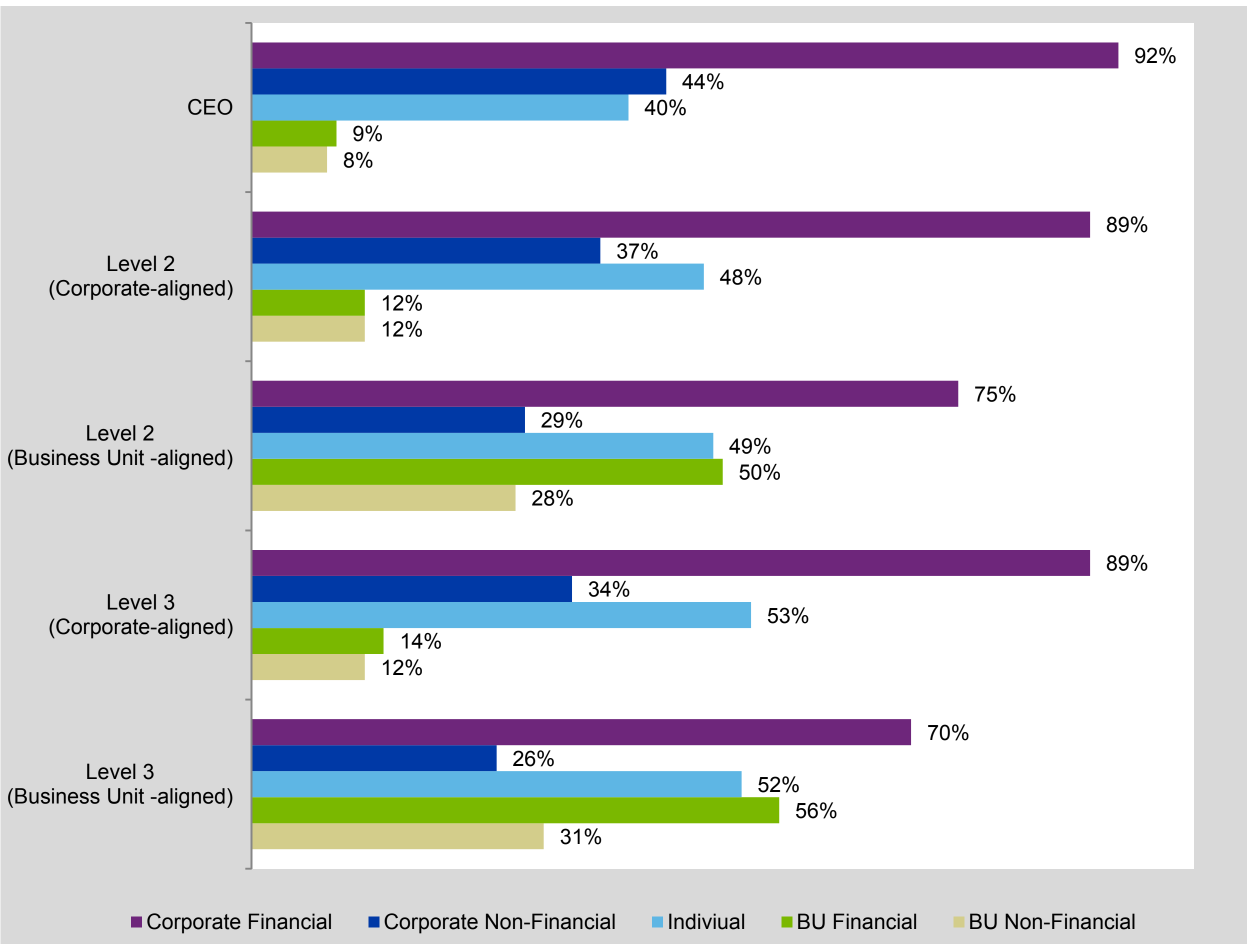




Short-Term Incentives—Performance Evaluation Categories

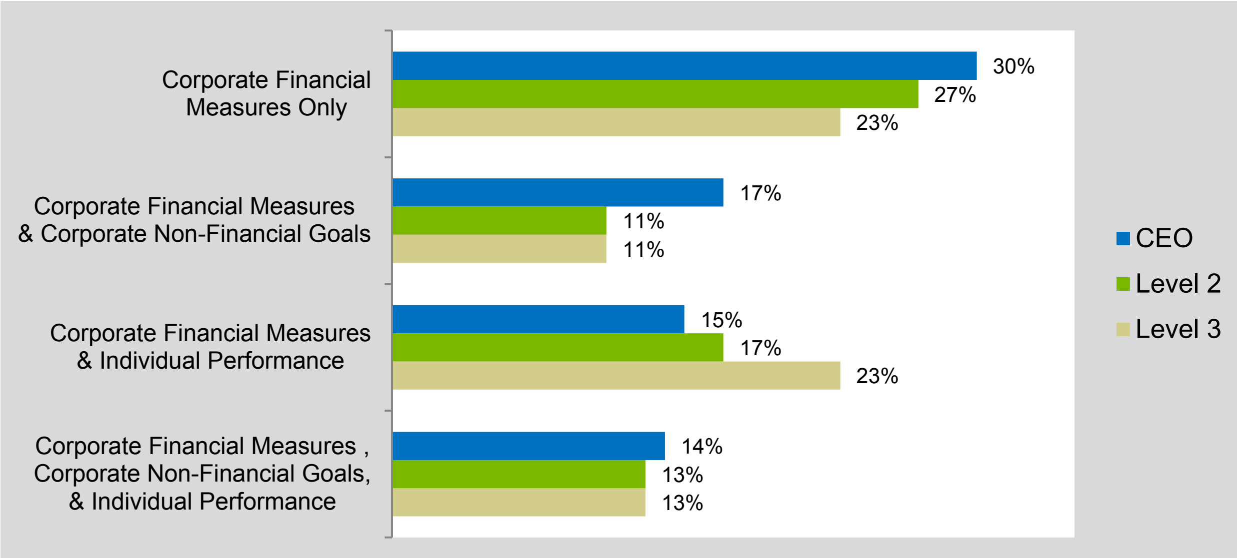
As referenced previously, company performance relative to plan goals is a significant factor when evaluating plan success. Nearly 90% of surveyed organizations indicated that corporate financial performance plays a primary role in this process. The achievement of non-financial/strategic initiatives and individual performance also has significant influence, particularly across executive levels.

The combination of factors and weights vary among the surveyed organizations. Corporate financial results, either alone or coupled with non-financial and individual performance, are most common among corporate-aligned executives. Incentive compensation for executives aligned to a specific business unit may have dependence on the performance of that business unit.



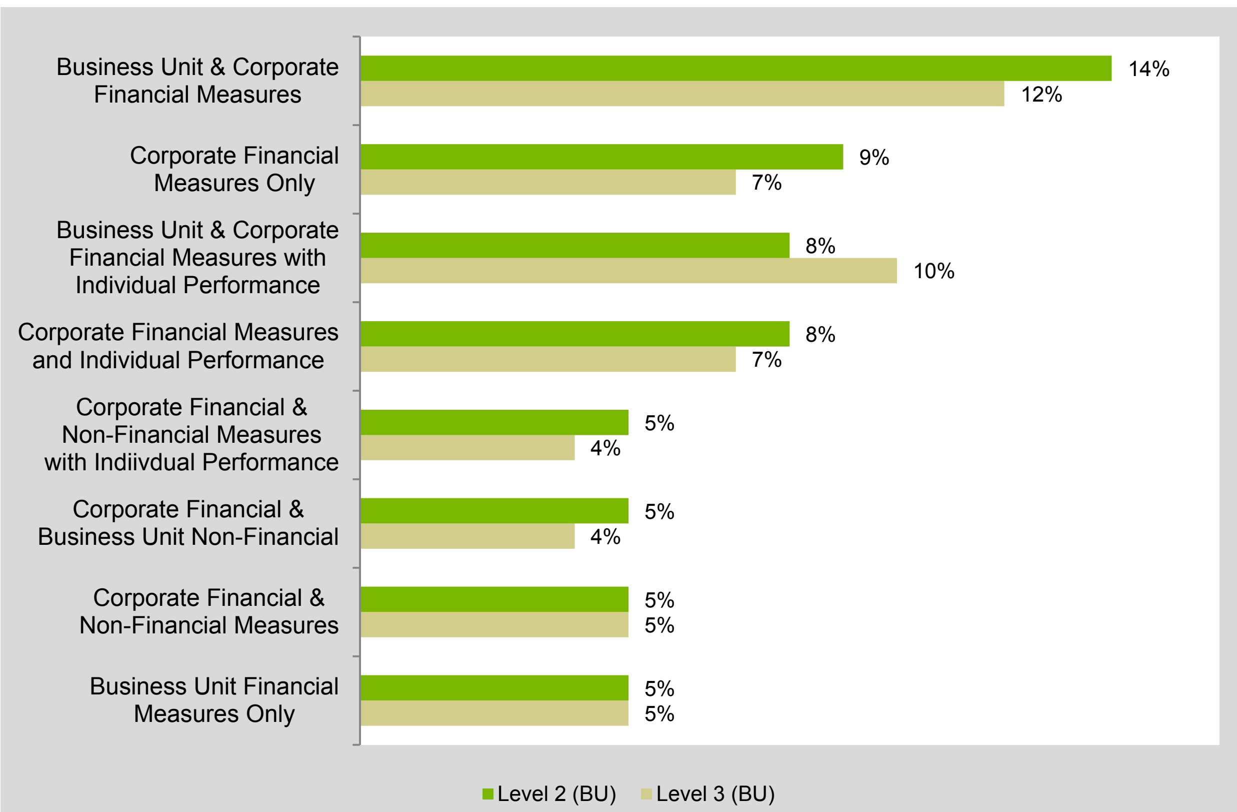
Note: *Statistics may exceed 100% due to multiple responses.*

- Among corporate-aligned executives, the most prevalent combinations of performance measures are identified in the table below:



Note: *Only most prevalent combinations reflected. Results will not equal 100%.*

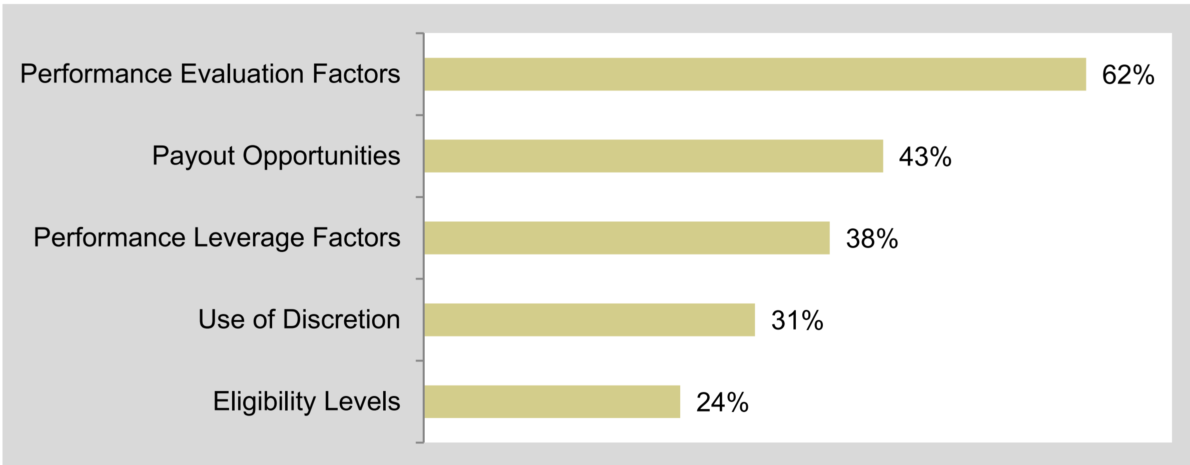
- Among business unit-aligned executives, the most prevalent combinations of performance measures are identified in the table below:



Note: *Only most prevalent combinations reflected. Results will not equal 100%.*

Short-Term Incentives—Areas of Concern for 2015

Approximately 40% of respondents anticipate that aspects of their annual incentive programs will be reviewed. The primary features identified for review include:



Note: *Statistics may exceed 100% due to multiple responses.*

- The most prevalent actions considered for each aspect were identified as follows:

Aspect	Actions Considered
Performance Evaluation Factors	▪ Varied approaches to adjusting the weighting among financial measures, non-financial initiatives, and individual performance
Payout Opportunities	▪ 67% to review Target Award Opportunities
Performance Leverage Factors	▪ Approximately 60% will review minimum and maximum performance levels to trigger minimum/maximum payout opportunities
Use of Discretion	▪ 54% to modify existing levels of discretion provided to Board / Management; 46% to provide Board/Management with discretion
Eligibility Levels	▪ 80% to possibly extend eligibility to a broader employee population

Summary of Results—Executive Merit Increases

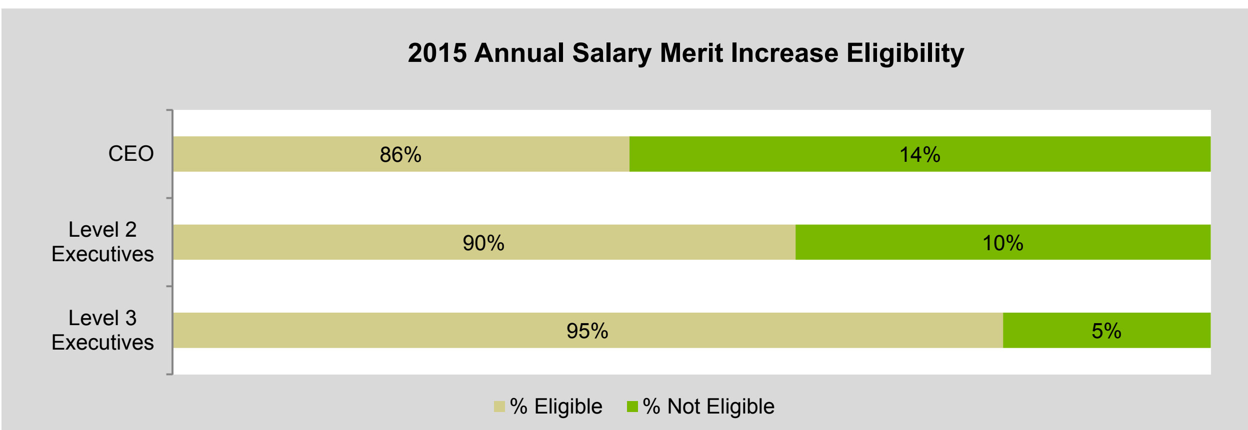
Fixed cash compensation in the form of annual base salary remains a primary component of an executive's compensation package. Many organizations use base salary increases as part of a pay for performance strategy, and as a result, do not view them as automatic or guaranteed.

- Organizations have been consistent in what they identify as the most challenging aspects of their overall merit process:

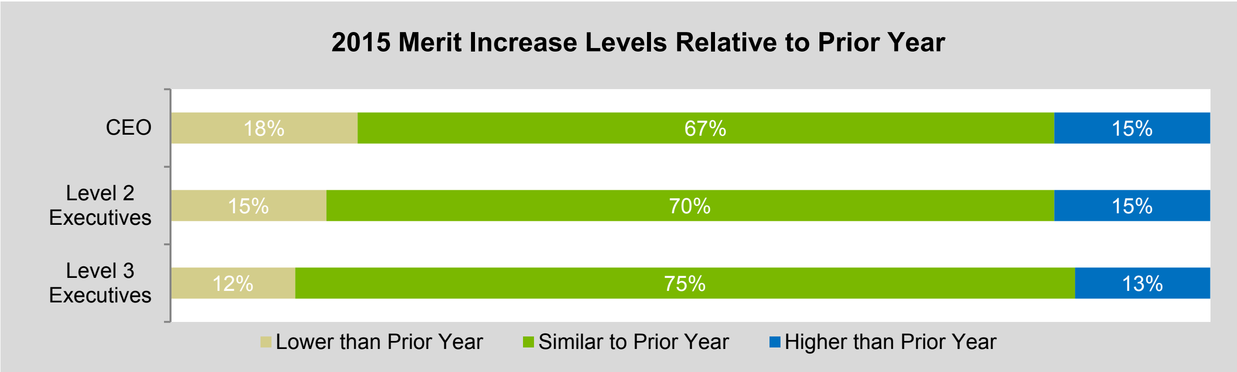
	2015	**2014**
Providing meaningful increases with relatively small merit budgets	60%	74%
Linkage between performance assessments and actual merit increase	39%	48%
Executive perception that merit increases are an entitlement	31%	41%
Pressure to increase pay for executives above the target market position	22%	33%
Pressure to compete with peer companies/industry actions	24%	26%
Balancing small merit increases with large incentive payments	10%	7%

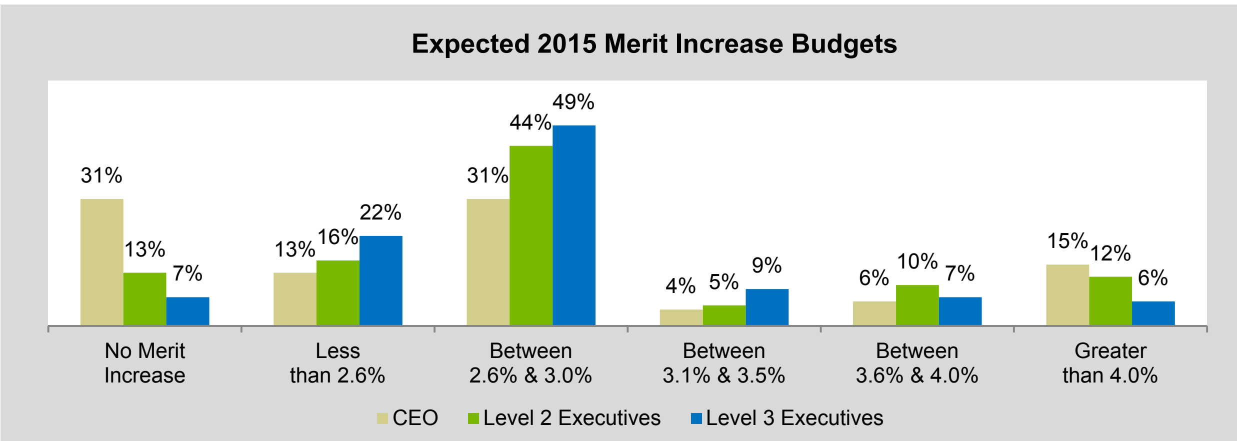
***Note**: Statistics may exceed 100% due to multiple responses.*

- Survey results indicate that 5–14% of executives (depending on level) were not eligible for an annual salary merit increases in 2015.

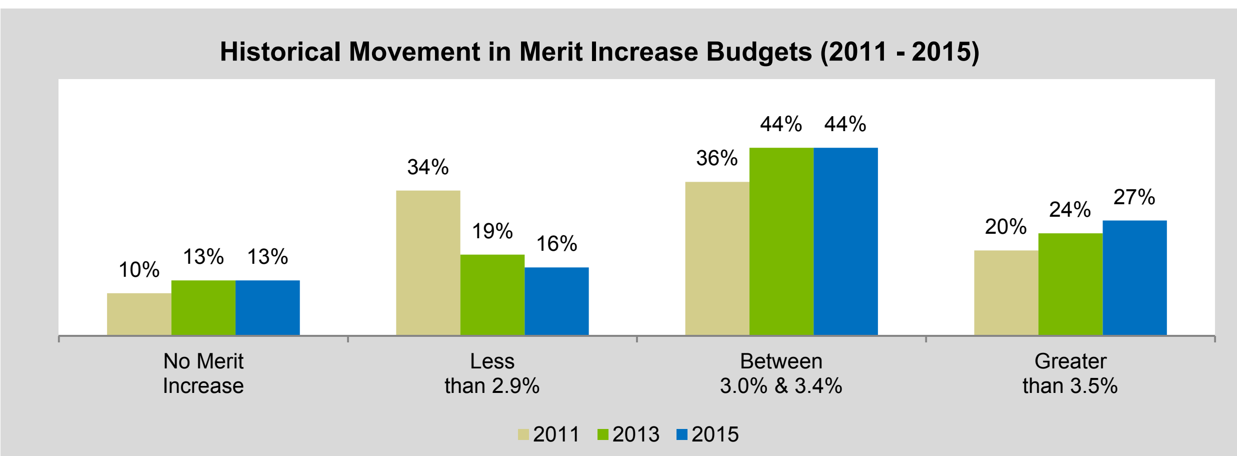


- Surveyed organizations indicate salary increases were similar to prior years, with a budget pool of 3% continuing as standard.





- Based on past survey results over the past 5 years, executive merit increases have shown some positive growth since 2011, but have been level since 2013.

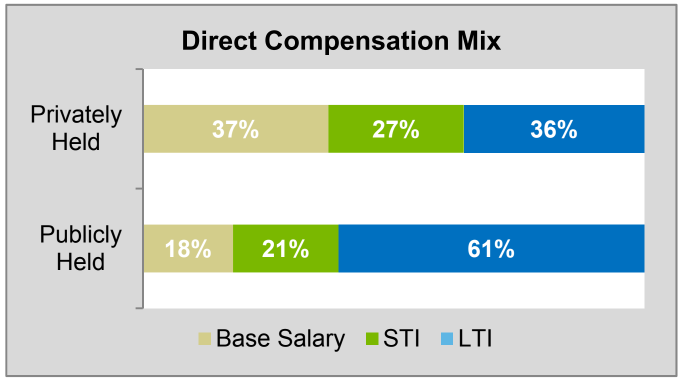


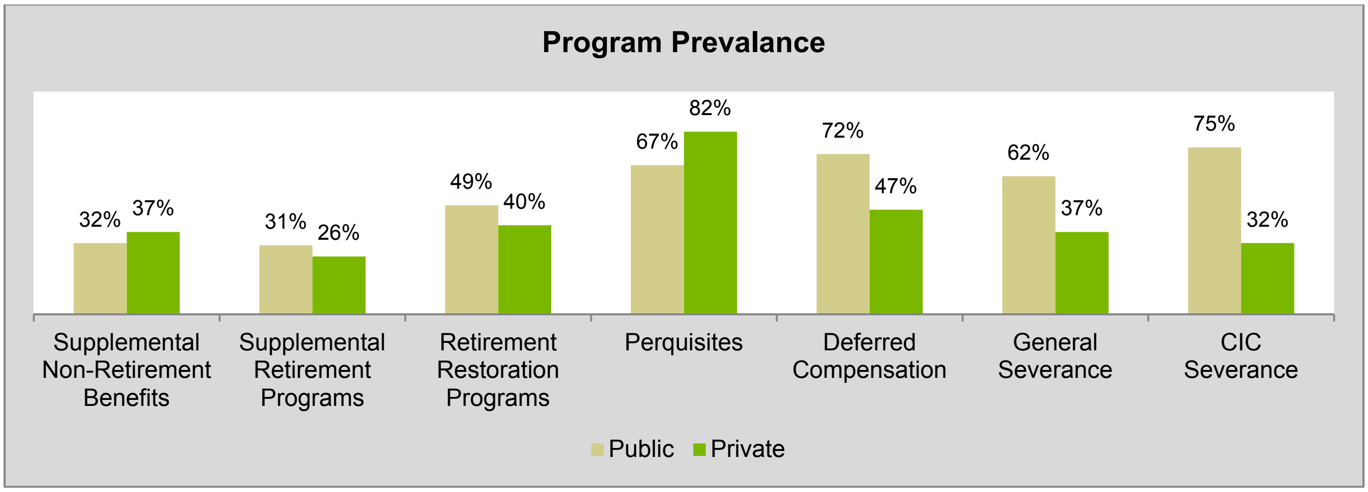
***Note**: For reporting purposes, statistics reported have been based on Level 2 executive responses from the 2011, 2013, and 2015 editions of the Hot Topics in Executive Compensation survey.*

Executive Profile—CEO (Public vs. Private)

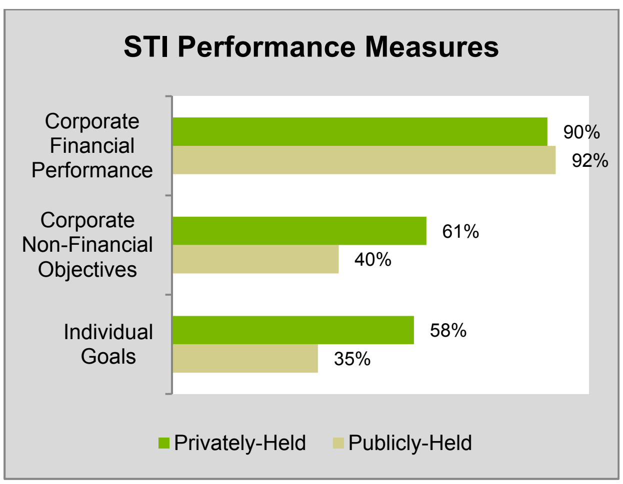
The following provides a detailed breakdown of how responses vary between publicly and privately-held organizations.

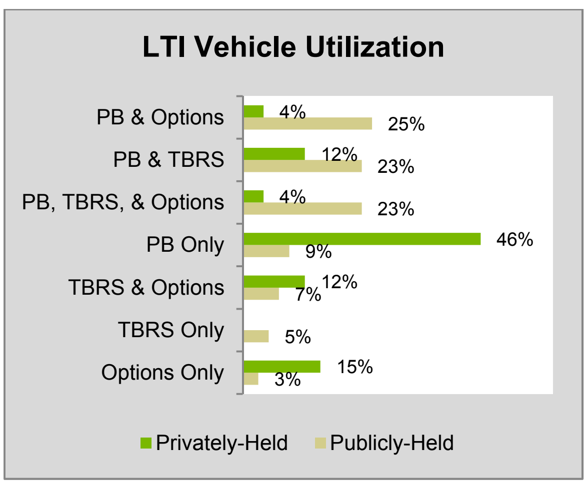
	Publicly-Held	**Privately-Held**
Merit Increase		
▪ **% Eligible for Merit Increase**	86%	86%
▪ **% Receiving Merit Increase**	63%	90%
Short-term Incentives (STI)		
▪ **% Eligible**	97%	90%
▪ **% Receiving Payout**	98%	98%
▪ **Avg. Payout** **(as % of Target)**	108%	102%
Long-term Incentives (LTI)		
▪ **% Eligible**	99%	69%
▪ **% Receiving Grants**	99%	90%





Note: *Statistics may exceed 100% due to multiple responses.*



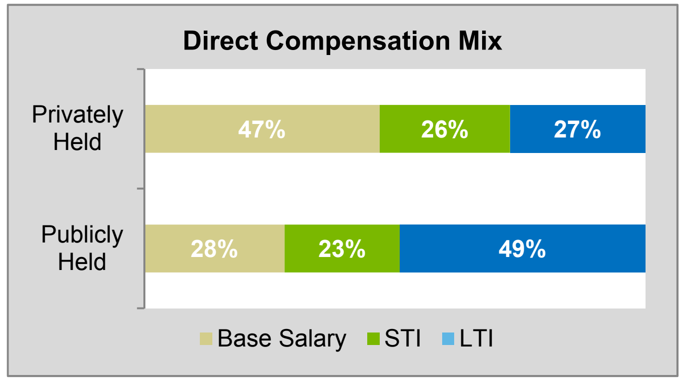


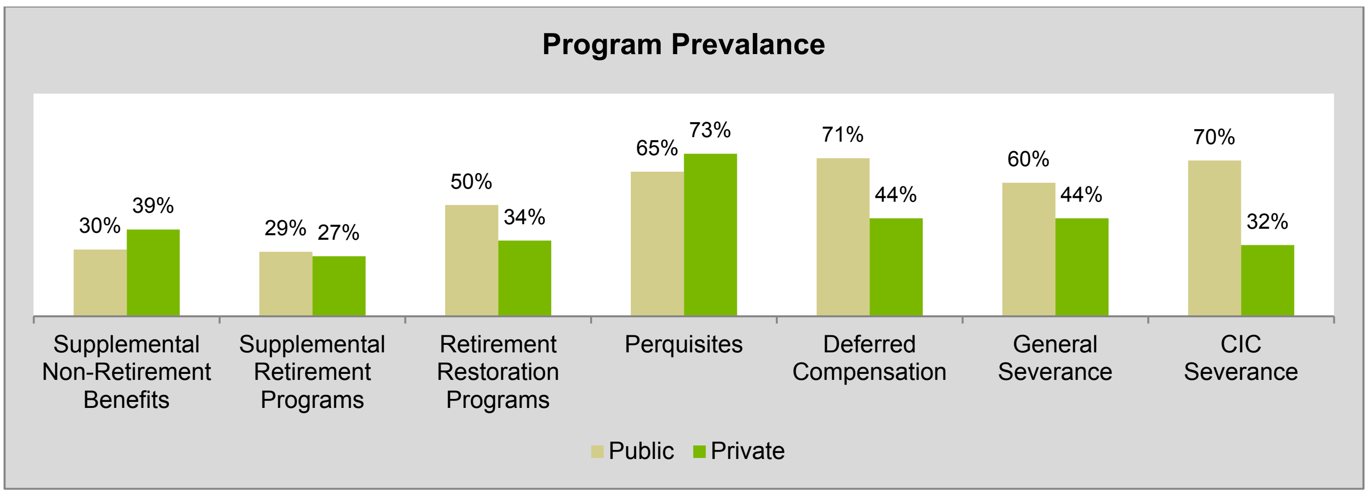
Note: *PB = Performance-Based and TBRS = Time-Based Restricted Stock*

Executive Profile—Level 2 (Public vs. Private)

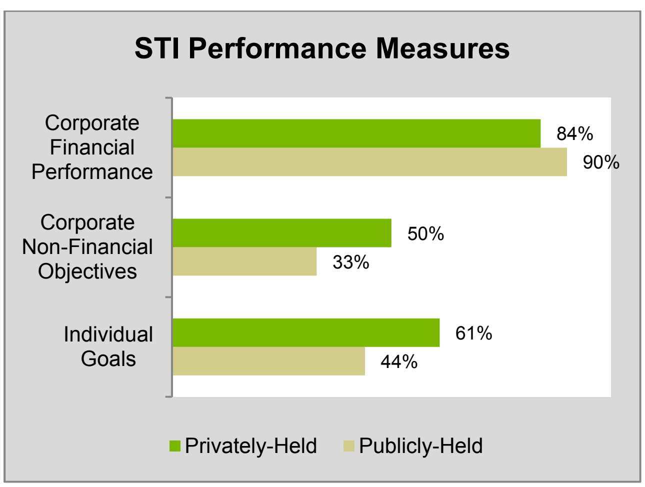
The following provides a detailed breakdown of how responses vary between publicly and privately-held organizations.

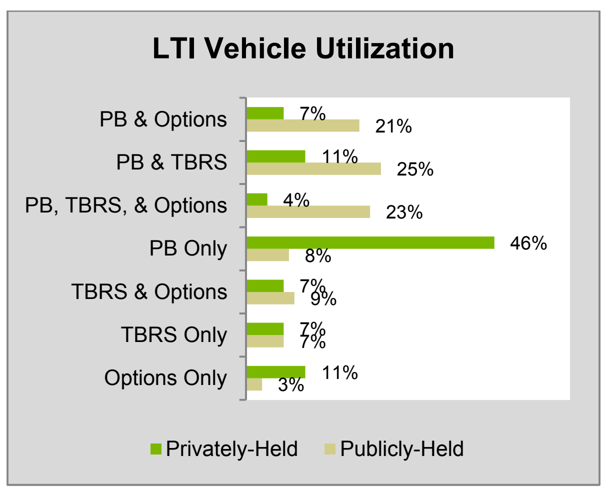
	Publicly-Held	Privately-Held
Merit Increase		
▪ **% Eligible for Merit Increase**	91%	90%
▪ **% Receiving Merit Increase**	86%	95%
Short-term Incentives (STI)		
▪ **% Eligible**	99%	98%
▪ **% Receiving Payout**	99%	100%
▪ **Avg. Payout (as % of Target)**	102%	94%
Long-term Incentives (LTI)		
▪ **% Eligible**	100%	70%
▪ **% Receiving Grants**	99%	94%





Note: *Statistics may exceed 100% due to multiple responses.*



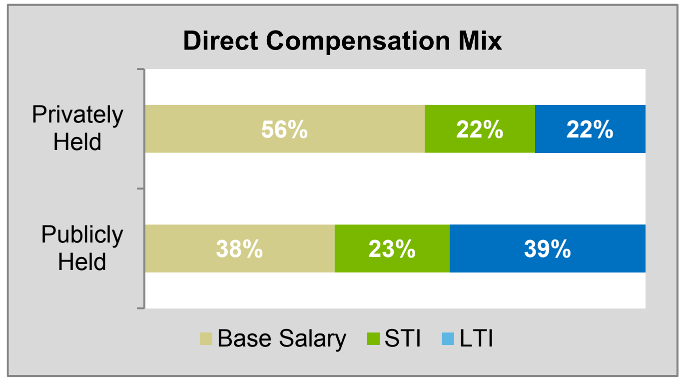


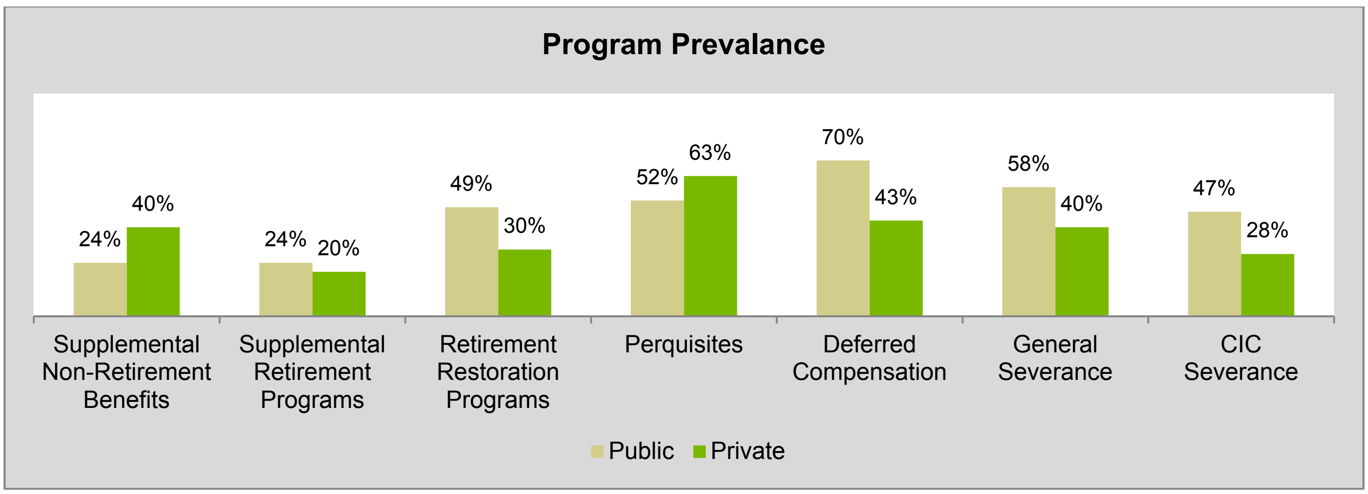
Note: *PB = Performance-Based and TBRS = Time-Based Restricted Stock*

Executive Profile—Level 3 (Public vs. Private)

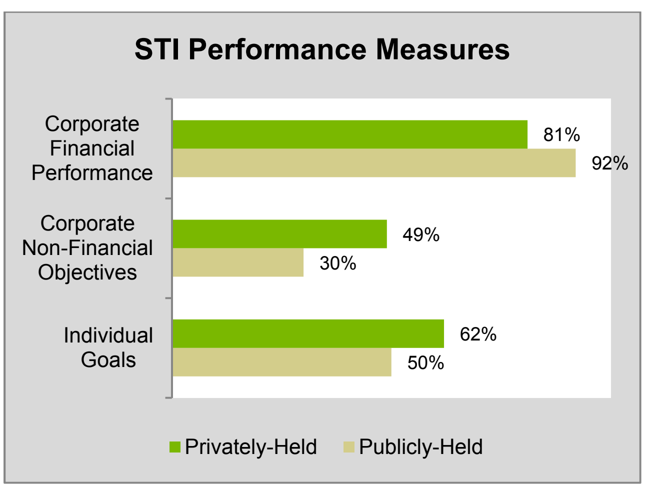
The following provides a detailed breakdown of how responses vary between publicly and privately-held organizations.

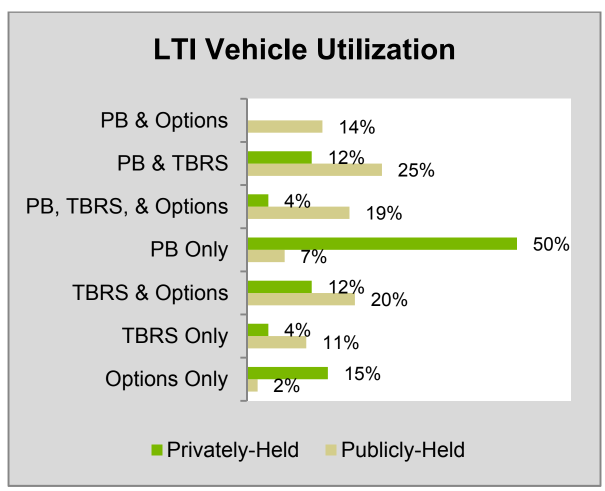
	Publicly-Held	Privately-Held
Merit Increase		
▪ **% Eligible for Merit Increase**	97%	92%
▪ **% Receiving Merit Increase**	91%	98%
Short-term Incentives (STI)		
▪ **% Eligible**	99%	98%
▪ **% Receiving Payout**	99%	100%
▪ **Avg. Payout (as % of Target)**	97%	89%
Long-term Incentives (LTI)		
▪ **% Eligible**	100%	64%
▪ **% Receiving Grants**	100%	93%





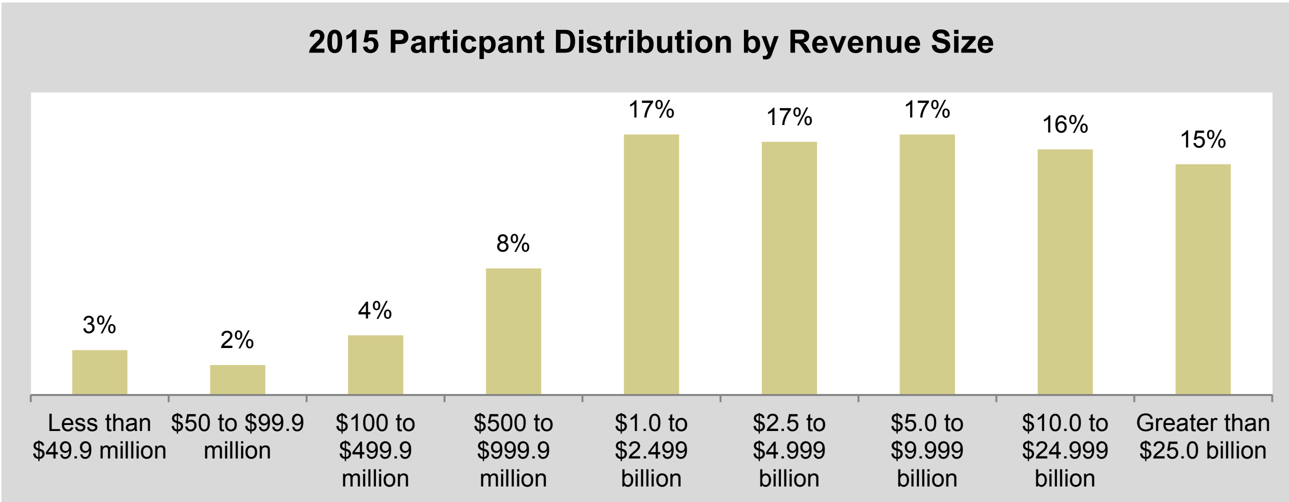
Note: *Statistics may exceed 100% due to multiple responses.*

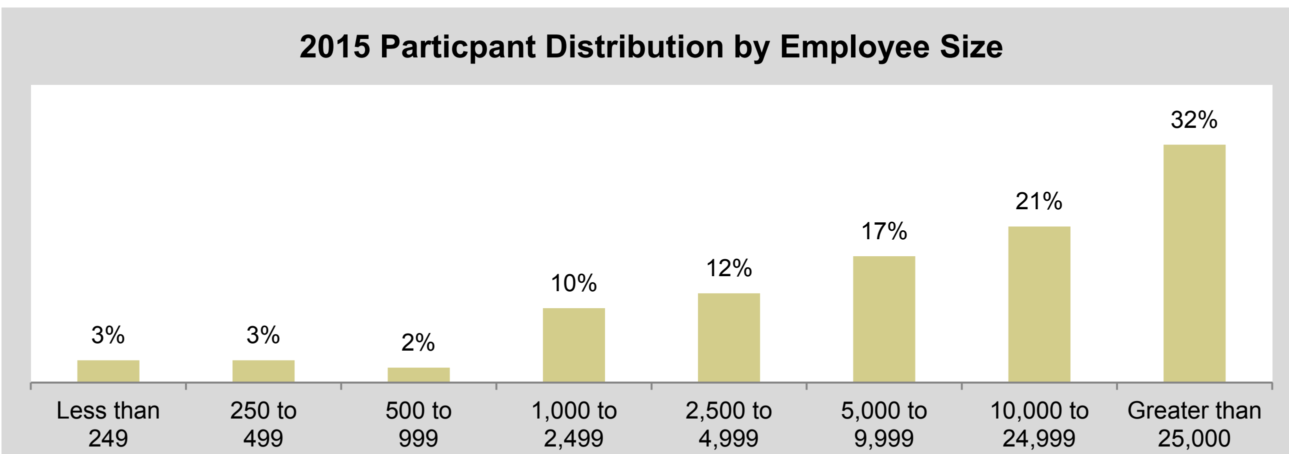


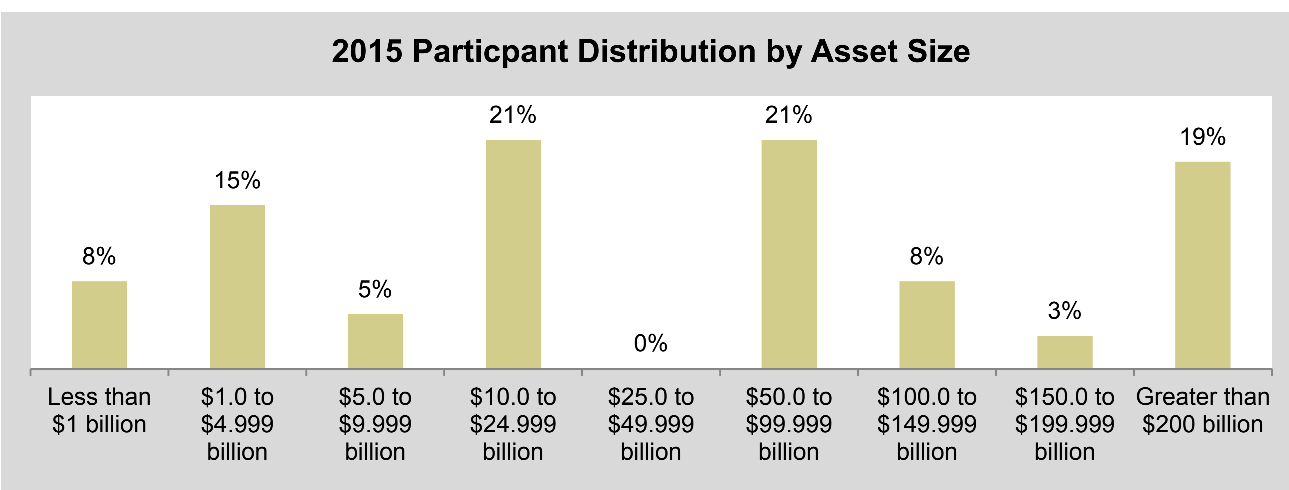


Note: *PB = Performance-Based and TBRS = Time-Based Restricted Stock*

Participating Organization Information







Note: *Limited to Financial Services participants.*

Participating Organizations (Alphabetical)

AbbVie	Baxter International	Colgate-Palmolive
Abercrombie & Fitch	Belden-Duna Kábel Kft.	Columbus McKinnon Corp
American Blue Ribbon Holdings	Bloomberg	Comerica Bank
ADP	Bloomin Brands, Inc.	Commerce Bank
Aetna, Inc.	Blue Cross Blue Shield of Kansas	ConocoPhillips
Agilent Technologies, Inc.	Blue Diamond Growers	Con-way Inc.
Akamai Technologies	Blue Shield of California	Cox Enterprises
Allstate Insurance Company	BlueLinx Co	Crestwood Midstream Partners
Altria Group, Inc.	BMC Software	Cummins Inc.
Ameren Corporation	BNSF Railway Company	Darden Restaurants
American Express	Booz Allen Hamilton	Deere & Company
American Family Insurance	Brunswick Corporation	Del Monte Foods, Inc.
Ameriprise Financial	Campbell Soup Company	DineEquity
Ametek	Canon USA	Discover Financial Services
Apogee Enterprises, Inc.	Cardinal Health	Duke Energy
Armstrong World Industries	CareCore National	Dun and Bradstreet
Associated Banc-Corp	Career Education	EarthLink
AT&T Inc.	Cargill	Eastman Chemical Company
AutoZone, Inc.	Castlight Health	Expert Global Solutions (EGS)
Avis Budget Group	Caterpillar	Eli Lilly and Company
AXA	Centene Corporation	Energy Transfer Partners
Ball Corporation	C.F. Industries Holdings, Inc.	Entergy
Bank of America	Chicos FAS Inc.	ESCO Technologies Inc.
Bank SNB	Chubb & Son	Farm Credit Foundations
Bankers Financial Corporation	Citizens Financial Group	FCA US LLC

Participating Organizations (Alphabetical)

FedEx Corporation	Highmark Health	Lockheed Martin Corporation
FEI Company	HomeAway	Mansfield Oil Company
First Data Corporation	Hubbell, Incorporated	Marriott Vacations Worldwide
FirstEnergy Corp.	Huntington Ingalls Industries	Mary Free Bed Rehabilitation
Fiserv	Hyundai Capital America	MassMutual
Florida Blue	Illinois Tool Works	MasterCard
Flowserve Corporation	IMS Health	Mattel, Inc.
Ford Motor Company	Indeed	McDonalds Corporation
Fossil Group, Inc.	Ingersoll Rand	McKesson
Gap Inc.	Ingram Industries Inc.	Mead Johnson Nutrition
GENCO	Integral Ad Science	Meijer, Inc.
Gilead	International Dairy Queen	Merck
Glanbia Performance Nutrition	Inteva Products	MetLife
Guardian Life	Intuit	Mohawk Industries
Gundersen Health System	JBT Corporation	Mondelez International
H.B. Fuller Company	Johnson & Johnson	Mosaic
Hallmark Cards, Inc.	Joy Global, Inc.	Mutual of Omaha
Halyard Health	KeyBank	MWH Global
HancockWhitney Bank	Kforce, Inc.	Navigant Consulting, Inc.
Harley-Davidson	Kohler Co.	Nestle USA
Hasbro	KONE Inc.	Nordson
HealthPartners	Kroger Co.	Northrop Grumman
Henkels & McCoy	Labcyte Inc.	NOVA Chemicals
Herman Miller, Inc.	Layne Christensen Co	NSF International
Hewlett-Packard	Legg Mason	ON Semiconductor

Participating Organizations (Alphabetical)

Oncor Electric Delivery	Rowan Companies	The Hershey Company
Panduit	SAIC	Travelers
Peoples United Bank	Salesforce	Trupanion
PerkinElmer	Selective Insurance	Tupperware Brands
Perrigo	Shale-Inland	U.S. Bank
PetroQuest Energy	Silicon Valley Bank	U.S. Xpress, Inc.
Pfizer	Sonic Corp.	UnitedHealth Group
PGi	Spectra Energy Corp	Universal Insurance Managers
Pinnacle Foods	Staples, Inc.	Universal North America
Potash Corporation	Stryker Corporation	Visteon Corporation
Precision Drilling Corporation	SunGard	Walt Disney Parks & Resorts
Price Chopper Supermarkets	Supervalu	Wells Fargo & Co.
Procter & Gamble	TE Connectivity	Wheaton Franciscan Healthcare
Questar Corporation	Teradata	Whirlpool Corp
Randstad NA	The Boeing Company	Wind River
Regal	The Brinks Company	WPX Energy
Reynolds American	The Clorox Company	Wyndham Worldwide
Rockwell Automation	The Hanover Insurance Group	Zimmer Inc.

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SEC Adopts Final Rules on CEO Pay Ratio Disclosure

By Joshua A. Agen and Leigh C. Riley
18 August 2015

Legal News: Employee Benefits & Executive Compensation
On August 5, 2015, the Securities and Exchange Commission (SEC) finalized rules requiring publicly traded companies to disclose the ratio of median compensation of all employees to the compensation of the principal executive officer. The SEC adopted the rules in response to the mandate of Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

When Will Compliance With the Pay Ratio Rules Be Required?

Issuers will be required to comply with the new rules with respect to compensation for full fiscal years beginning on and after January 1, 2017. Disclosure of the pay ratio will first be required in the annual report covering that fiscal year or, if filed later, the proxy or information statement for the next annual meeting following the end of that fiscal year, subject to a requirement that the pay ratio be filed within 120 days after the end of the fiscal year.

This means that, in the normal course for calendar year issuers, the pay ratio will first be required in the proxy or information statement for the 2018 annual meeting, based on 2017 compensation.

Are the Final Rules Similar to the Proposed Rules Issued in 2013?

Several aspects of the final rules are unchanged from the proposed rules:

- As in the proposed rules, the disclosure will consist of the following three elements:
  - The median of the annual total compensation of all employees (Median Pay) other than the principal executive officer (CEO);
  - The annual total compensation of the CEO (CEO Pay); and
  - The ratio of the Median Pay to the CEO Pay, expressed either as a ratio in which the Median Pay is one (e.g., 1 to 100) or in narrative as a multiple (e.g., “our CEO’s pay for 2015 was 100 times the median of the total compensation of all of our employees (other than our CEO) for 2015”).
- Consistent with the proposed rules, the ratio is based on the median employee’s annual total compensation rather than that of the average employee. The “median” employee refers to the “middle” employee as measured by compensation level. The SEC declined to follow the suggestion of some commenters on the proposed rules to permit the use of the average employee in calculating the ratio, citing the specific reference in the statute to the median employee.
- The median employee for purposes of the ratio must be identified from *all* employees, including all U.S. and non-U.S. full-time, part-time, seasonal, or temporary workers, subject to limited exceptions for certain non-U.S. employees discussed below.
- In determining the employees from whom the median employee is identified, issuers may elect to use either the entire employee population or statistical sampling or other reasonable

methods. Issuers will be required to disclose the method used.

- In identifying the median employee with reference to compensation, issuers are not required to calculate the "total compensation," as defined by the SEC for purposes of the Summary Compensation Table, for their entire employee population or the statistical sample. Instead, issuers may use any compensation measure that is consistently applied to all employees included in the calculation, including amounts derived from payroll or tax records. Once the median employee has been identified using such a compensation measure, however, the issuer will need to use the SEC's Summary Compensation Table definition of "total compensation" to calculate and disclose the compensation of the median employee and the ratio.
- Smaller reporting companies, emerging growth companies, U.S.-Canadian Multijurisdictional Disclosure System filers and foreign private issuers that file annual reports and registration statements on Form 20-F are exempt from the pay ratio disclosures. In addition, although the pay ratio will generally be required in registration statements that call for disclosure of compensation information under Item 402 of Regulation S-K, it will not be required in a Form S-1 or Form S-11 filed in connection with a company's initial public offering.

What Are the Most Significant Differences in the Final Rules Compared to the Proposed Rules?

Although the overall framework of the final rules is similar to the proposed rules, the final rules include a number of changes, most of which provide additional flexibility to issuers:

- Issuers will need to identify the median employee only once every three years (rather than every year, as under the proposed rules) unless there is a change in the issuer's employee population or compensation arrangements that the issuer reasonably believes would significantly impact the pay ratio disclosure.
- Issuers may choose any date within the last three months of the most recently completed fiscal year (rather than the last day, as under the proposed rules) as the date on which the issuer determines the median employee from among all employees.
- In identifying the median employee and calculating the pay ratio, issuers may make cost-of-living adjustments for the compensation of employees in jurisdictions other than the jurisdiction in which the CEO resides so that the compensation is adjusted to the cost of living in the jurisdiction in which the CEO resides. If a cost of living adjustment is made, however, disclosure of unadjusted amounts will still be required in addition to the adjusted amounts.
- Issuers will not need to consider compensation information for employees of joint ventures or subsidiaries that are not consolidated for financial reporting purposes (rather than, as under the proposed rules, considering compensation information for employees of all commonly controlled subsidiaries).
- Issuers may exclude certain non-U.S. employees in two limited circumstances:
    - Non-U.S. employees for whom the issuer cannot, despite reasonable efforts, obtain or process the compensation information required for the ratio without violating data privacy laws or regulations.
    - Non-U.S. employees to the extent either (1) the issuer's and its consolidated subsidiaries' non-U.S. employees as a whole account for 5 percent or less of the issuer's and its consolidated subsidiaries' total worldwide employees or (2) the non-U.S. employees being excluded account for less than 5 percent of the issuer's and its consolidated subsidiaries' total non-U.S. employees. If an issuer excludes any employees in a non-U.S. jurisdiction because they account for less than 5 percent of the issuer's and its consolidated subsidiaries' total non-U.S. employees, however, it must exclude all non-U.S. employees in the jurisdiction.
- Supplemental disclosures are expressly authorized, including additional ratios, so long as the supplemental disclosures are clearly identified, not misleading and not presented with

greater prominence than the required ratio.

- Issuers with multiple CEOs during a year may calculate the ratio either by (1) annualizing the partial year compensation of the CEO serving on the date used to calculate the ratio or (2) combining the compensation of the CEOs.
- Newly public issuers and issuers leaving exempt status will have special transition periods for complying with the rules.

What Should Companies Do to Prepare for the Pay Ratio Disclosures?

- Assess which method of determining the median employee will be most appropriate in the context of existing systems, whether statistical sampling is a desirable alternative and whether any modifications to existing systems are needed to permit this determination.
- Determine the extent to which the compensation of part-time, seasonal and temporary workers, as well as international workers, is captured by existing systems.
- Consider which determination date within the last three months of a fiscal year will be most appropriate for the calculation of the ratio. Individuals not employed on the determination date will not be included in the calculation of the ratio.
- Evaluate whether any non-U.S. data privacy laws or regulations will apply to non-U.S. employees' compensation information and, if so, whether obtaining or processing the compensation information will violate such laws or regulations, whether reasonable efforts would permit compliance and whether an exemption or other relief is available.
- Determine whether any non-U.S. employees may be excluded under the 5 percent *de minimis* rule and, if so, identify which employees will be excluded.
- Consider whether to include any supplemental pay ratios or other supplemental disclosures.

Detailed Summary of the Final Rules

A detailed summary of the final pay ratio rules follows below.

Components and Scope of the Required Disclosure. The rules will require U.S. issuers subject to the reporting requirements of the Securities Exchange Act of 1934, other than smaller reporting companies, emerging growth companies, foreign private issuers and U.S.-Canadian Multijurisdictional Disclosure System filers to disclose the following items:

- The median of the annual total compensation of all employees of the company and its consolidated subsidiaries (Median Pay) other than the principal executive officer (CEO);
- The annual total compensation of the CEO (CEO Pay); and
- The ratio of the Median Pay to the CEO Pay, expressed either as a ratio in which the Median Pay is one (e.g., 1 to 100) or in narrative as a multiple (e.g., "our CEO's pay for 2015 was 100 times the median of the total compensation of all of our employees (other than our CEO) for 2015").

This disclosure will generally be required in proxy statements, information statements, annual reports and registration statements that require disclosure of executive compensation under Item 402 of Regulation S-K.

Calculation of Pay for Purposes of the Ratio. Both the Median Pay and the CEO Pay will be calculated on the same basis as total compensation for purposes of the Summary Compensation Table under Item 402(c)(2)(x) of Regulation S-K. Under these rules, total compensation is the sum of (1) base salary, (2) bonuses (both discretionary bonuses and those paid under a pre-established incentive plan), (3) grant date fair value of equity awards, (4) change in pension value and above-market or preferential nonqualified deferred compensation earnings, and (5) all other compensation, including such items as perquisites, tax gross-ups, and severance.

Under the final rules, companies may, but are not required to, annualize the total compensation for all permanent full-time and part-time employees who were employed for less than the full fiscal year. However, the rules will not permit full-time adjustments for part-time workers or annualization for temporary or seasonal employees. A company may use reasonable estimates to determine the Median Pay, but not the CEO Pay.

Personal benefits aggregating less than $10,000 and compensation under non-discriminatory benefit plans may be included in the median employee's annual compensation so long as the items are also included in the CEO's annual compensation. Any material difference between the CEO's annual compensation used in the pay ratio disclosure and the compensation shown in the Summary Compensation Table will need to be explained.

Identifying the Median Employee. In identifying the median employee whose pay will be the basis for the Median Pay, the potential pool of employees will include all individuals employed by the listed company or any of its consolidated subsidiaries on a single date during the last three months of the most recently completed fiscal year. The listed company may identify any date during the three month period for purposes of identifying the median employee. If the date selected by the company changes from year to year, the company must explain the reason for the change.

The pool of employees will include all full-time, part-time, seasonal, or temporary workers employed on the day selected by the company, whether located in the U.S. or outside the U.S. (subject to limited exceptions for certain non-U.S. employees described below). There is no exclusion for employees who are subject to a collective bargaining agreement. However, the definition of employee would not include those workers who are employed, and whose compensation is determined, by an unaffiliated third party but who provide services to the company or its consolidated subsidiaries as independent contractors or leased workers.

Non-U.S. employees may be excluded in two limited circumstances:

- Non-U.S. employees for whom the company cannot, despite reasonable efforts, obtain or process the compensation information required for the ratio without violating data privacy laws or regulations. Reasonable efforts must include, at a minimum, using or seeking an exemption or other relief under any governing data privacy laws or regulations. If employees are excluded under this exemption, the company must list the excluded jurisdictions and the specific data privacy laws at issue, explain how complying with the pay ratio rule would violate the law, describe the efforts made to seek relief, disclose the approximate number of employees exempted by jurisdiction and file a supporting legal opinion as an exhibit.
- Non-U.S. employees to the extent either (1) the issuer's and its consolidated subsidiaries' non-U.S. employees as a whole account for 5 percent or less of the issuer's and its consolidated subsidiaries' total worldwide employees or (2) the non-U.S. employees being excluded account for less than 5 percent of the issuer's and its consolidated subsidiaries' total non-U.S. employees. If an issuer excludes any employees in a non-U.S. jurisdiction because they account for less than 5 percent of total non-U.S. employees, however, it must exclude all non-U.S. employees in the jurisdiction. It must also disclose the jurisdictions from which employees are being excluded, the approximate number of employees excluded from each jurisdiction, the total number of U.S. and non-U.S. employees and the total number of U.S. and non-U.S. employees used in calculating the 5 percent limit. In addition, to the extent employees are excluded under the data privacy exemption described above, those employees apply against the 5 percent cap on the number of employees who may be excluded under this *de minimis* exemption.

Employees of an acquired business may be excluded from the determination of the median employee for the year in which the acquisition occurs, but the approximate number of employees omitted must be disclosed and the employees should be included in the total employee count for the triennial calculations of the median employee in the year following the transaction for purposes of evaluating whether a significant change has occurred. The company must identify any acquired business the employees of which are excluded under this rule.

In determining the employees from whom the median employee is identified, companies will be permitted to use either their entire employee population or statistical sampling or other reasonable methods.

In identifying the median employee from the relevant group, companies will be permitted to use either (1) actual annual total compensation, calculated using the Summary Compensation Table rules, or (2) any other annual compensation measure that is consistently applied to all employees included in the calculation. The regulations provide as examples of alternative compensation measures amounts derived from the company's payroll or tax records. Such records may be used to identify the median employee even if they are kept on an annual basis other than the fiscal year of the registrant.

In identifying the median employee, companies may (but are not required to) make cost-of-living adjustments to the compensation of employees in jurisdictions other than the jurisdiction in which the CEO resides so that the compensation is adjusted to the cost of living in the jurisdiction in which the CEO resides. If a cost-of-living adjustment is made to identify the median employee, and the median employee resides in a jurisdiction different from the CEO, then the same cost-of-living adjustment must be used in calculating the median employee's annual total compensation. In this situation, the jurisdiction of the employee must be disclosed, along with a brief description of the cost-of-living adjustments used and the median employee's annual total compensation and pay ratio without the adjustments.

Companies will be required to disclose the methodology used to identify the median employee and disclose any material assumptions, adjustments or estimates that are used to identify the median or to determine any elements of total compensation. Estimated amounts will need to be clearly identified. A company will need to explain any change in methodology from year to year, including the reason for the change and an estimate of its impact on the median and the ratio.

The median employee will need to be identified only once every three years, unless there was a change in the employee population or employee compensation arrangements during the company's last completed fiscal year that the company reasonably believes would significantly affect the pay ratio disclosure. The median employee's Median Pay, however, must be recalculated each year.

If the company uses the same median employee for multiple years, it must disclose that fact and describe the basis for its reasonable belief that no changes have occurred that would significantly affect the pay ratio disclosure. If there is a change in the median employee's circumstances that the company reasonably believes would result in a significant change in its pay ratio disclosure, the company may use another employee whose compensation is substantially similar to the original median employee based on the compensation measure used to select the original median employee.

Transition Periods. The rules include a one-year transition period for newly public companies and companies that cease to be smaller reporting companies or emerging growth companies.

Status of Pay Ratio as Filed Rather Than Furnished. Under the final rules, the pay ratio disclosure will be considered "filed," and not merely "furnished," for purposes of liability under the

Securities Act of 1933 (Securities Act) and the Securities and Exchange Act of 1934 (Exchange Act). Filed information is subject to liability under Section 18 of the Exchange Act, which imposes liability for misleading statements in reports or documents filed with the SEC, and is subject to automatic incorporation by reference into the company's Securities Act registration statements, which could give rise to liability under Section 11 of the Securities Act.

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SEC Proposes Rules on Compensation Clawback Policies

By Joshua A. Agen and Leigh C. Riley
13 July 2015

Legal News: Employee Benefits & Executive Compensation

On July 1, 2015, the Securities and Exchange Commission (SEC) proposed rules relating to compensation clawback policies. The rules, if adopted, would implement the requirements of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd Frank) by directing national securities exchanges and associations, such as the NYSE and Nasdaq, to adopt listing standards that would require listed companies to develop and implement compensation clawback policies.

Under the proposed rules, listed companies would be required to have written compensation clawback policies that require the recoupment of certain incentive-based compensation received by current or former executive officers. The listing standards would also require companies to make certain disclosures about their clawback policies. The listing standards would generally apply to all issuers with a class of securities listed on a national securities exchange or association, including foreign private issuers, controlled companies, smaller reporting companies and emerging growth companies.

Executive Summary

- The proposed rules would require the clawback policy to be triggered by an accounting restatement required to correct an error that is material to previously issued financial statements
- The policy would apply to incentive-based compensation received by current or former executive officers during the three (3) fiscal years preceding the date on which the issuer is required to prepare the accounting restatement
- Incentive-based compensation subject to the clawback would include compensation received due to achievement of a goal based on accounting principles or on stock price or total stockholder return (TSR). Stock options that are granted, earned and vested based solely on continued employment would not be subject to the policy
- The amount of the recovery would be the excess of the amount of incentive-based compensation the executive officer actually received over the amount the executive officer would have received based on the restated numbers, determined on a pre-tax basis. Where the incentive compensation is based on stock price or TSR, reasonable estimates could be used to calculate the excess amount
- It would not be relevant whether there is any fault on the part of the executive officer who received the compensation or whether the officer was involved in preparing the financial statements subject to the restatement
- The issuer would be required to enforce the clawback policy except in narrowly defined exceptions: generally only where the cost of enforcement would exceed the amount of the recovery or the recovery would be illegal under home country law

- Issuers would not be allowed to indemnify officers or pay for insurance to cover clawback amounts
- The issuer would need to file its clawback policy as an exhibit to its annual report, and issuers would be required to disclose certain information about their enforcement of their clawback policies in proxy statements, information statements and Forms 10-K in specified circumstances

Required Elements of the Clawback Policies

The clawback policies mandated by the proposed rules would have to meet various requirements as to their scope and application, as summarized below.

> **1. Type of Restatement Triggering Recovery of Compensation.** Under the proposed new Rule 10D-1, the clawback policy would be triggered when an issuer is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws. A restatement would be considered "due to material noncompliance" if it is required to correct an error that is material to previously issued financial statements.

Rule 10D-1 does not further define materiality, but the adopting release advises that issuers should consider whether a series of immaterial error corrections, whether or not resulting in filed amendments to financial statements, could be considered a material error in the aggregate.

Consistent with accounting standards, certain changes would not constitute an error correction, including the following: retrospective applications or a change in accounting principle; retrospective revisions to reportable segment information due to a change in internal organization structure; retrospective reclassification due to a discontinued operation; retrospective application of a change in reporting entity; retrospective adjustment to provisions amounts in connection with a prior business combination; and retrospective revision for stock splits.

> **2. Definition of "Incentive-Based Compensation" Subject to Recovery.** Under Rule 10 D-1, the clawback policy would be required to apply to "incentive-based compensation." Incentive-based compensation would be defined as compensation that is granted, earned or vested based wholly or in part upon the attainment of a "financial reporting measure." A "financial reporting measure" would mean a measure that is determined and presented in accordance with the accounting principles used in preparing financial statements, any measures derived from such measures, and stock price and total stockholder return (TSR).

The clawback policy would not apply to discretionary bonuses or any compensation that is earned solely on the basis of continued employment. Accordingly, stock options that are granted, earned and vested solely on the basis of continued employment would not be subject to the clawback policy, despite Dodd-Frank's specific reference to "stock options awarded as compensation" and the fact that time-vesting stock options are eligible to qualify as performance-based compensation under Section 162(m) of the Internal Revenue Code of 1986 (Code). Only options that are granted, earned or vested based on an accounting, stock price or TSR measure would be subject to the clawback under the rules as proposed.

> **3. Time Periods Covered.** The clawback policy would apply to incentive-based compensation "received" during the three fiscal years preceding the date on which the issuer is required to prepare the accounting restatement. Compensation would be deemed "received" when the performance condition is satisfied, even if the compensation is not actually paid or granted until a later date. The date on which the issuer is required to prepare the accounting restatement would be the earlier of (a) the date the board, committee or

authorized officer concludes, or should reasonably have concluded, that previously issued financial statements contain a material error or (b) the date a court, regulatory or other authorized body orders a restatement to correct a material error.

4. Individuals Covered. The clawback policy would apply to any individual who served as an executive officer at any time during the performance period that applied to the incentive-based compensation that the individual received. Accordingly, the policy would apply to both current and former executive officers. Rule 10D-1 uses a definition of “executive officer” similar to the definition under Section 16 of the Securities Exchange Act of 1934 (Exchange Act), rather than the definition of “executive officer” under Rule 3b-7 under the Exchange Act. This definition generally includes the issuer’s president, principal financial officer, principal accounting officer (or, if none, the controller), any vice-president in charge of a principal business unit, division or function, and any other officer who performs a policy-making function, or any other person who performs similar policy-making functions.

It will not be relevant whether there is any fault on the part of the officer or whether the officer was involved in preparing the financial statements. Companies would not be able to indemnify officers or pay for insurance to cover amounts that are clawed back.

5. Amount of Recovery. The amount of the recovery would be the excess of the amount of the incentive-based compensation the executive officer actually received over the amount the executive officer would have received based on the restated numbers. Where the incentive compensation is based on stock price or TSR, reasonable estimates can be used to calculate the excess amount. The amount of the recovery would be calculated on a pre-tax basis, but, in the case of equity awards, would be calculated net of any exercise price paid by the executive.

For cash awards paid from bonus pools funded by the achievement of a financial performance measure (a structure frequently used for purposes of Code Section 162(m) compliance), if the actual bonuses awarded had been reduced from the maximum permitted by the overall size of the pool and the bonus pool amount based on the restatement was large enough to cover the reduced bonuses, then no amount would need to be recovered. If recovery is required from amounts paid under a bonus pool where the individual awards are determined on a discretionary basis, then the recovery must be implemented on a pro rata basis according to the size of the individual awards; discretion is not permitted as to the amount recovered from individuals. Amounts recovered from the executive under Section 304 of the Sarbanes-Oxley Act of 2002 would be credited as a reduction in the amount required to be recovered under the Rule 10D-1 clawback.

6. Recovery Mandatory Unless Impracticable. Under proposed Rule 10D-1, recovery of incentive-based compensation subject to the clawback would be mandatory unless it is “impracticable.” For U.S. companies, recovery would be considered impracticable only if the direct costs of enforcing recovery would exceed the recoverable amounts. A determination of impracticability could be made by the issuer’s board of directors only after making a reasonable attempt to recover the compensation, documenting the recovery attempts and providing the documentation to the stock exchange on which the issuer’s stock is listed.

For companies whose home country law is not U.S. law, recovery would be considered impracticable if the recovery would be illegal under home country law. The determination of illegality would need to be based on a legal opinion from home country counsel as to illegality, and the illegality must be based on home country law as it existed prior to the publication of the proposed clawback rule in the federal register.

Recovery would not be considered impracticable solely on the basis of inconsistency between existing compensation contracts and the rules. The proposing release suggests that issuers may be able to implement their clawback policies with respect to existing compensation arrangements and agreements through amendments to their bylaws.

The proposing release indicates that issuers would be permitted to exercise discretion as to the means of recovery. The recovery, however, must be effectuated reasonably promptly, with the applicable stock exchange determining whether the steps taken constitute compliance with the clawback policy. The proposing release did not indicate what would be considered “reasonable promptness” and asked for comment on that subject.

Clawback Policy Disclosures

The proposed rules would include several disclosure requirements relating to the clawback policy. An issuer’s compliance with the disclosure requirements would be an element of the listing standards under the proposed rules.

> **1. Filing of Clawback Policy.** The issuer would need to file the clawback policy as an exhibit to its annual report on Form 10-K.
>
> **2. Proxy Statement/Annual Report Disclosures.** The proposed rules would amend Item 402 of Regulation S-K to require disclosure by listed issuers if at any time during the last completed fiscal year either (a) a restatement that required recovery was completed or (b) there was an outstanding balance of excess incentive-based compensation attributable to a prior restatement.

The required disclosure under Item 402 would include:

- For each restatement, (a) the date on which the issuer was required to prepare the restatement, (b) the aggregate dollar amount of excess compensation attributable to the restatement, (c) the aggregate dollar amount of excess compensation that remains outstanding at the end of the last year and (d) if the excess compensation was based on a stock price or TSR performance measure, the estimates used to calculate the amount of the excess compensation
- If the issuer decided not to pursue recovery during the last fiscal year from any individual, the name of each individual, the amount foregone and a brief description of the reason the issuer decided not to pursue recovery
- The name of each individual who had outstanding unrecovered excess compensation at the end of the last fiscal year that had been unpaid for 180 days or longer, as well as the amount of such compensation

If the amount of excess compensation has not yet been determined, that fact must be disclosed along with an explanation. As long as an issuer provides the new Item 402 disclosure with respect to clawbacks, the issuer need not also make a disclosure under Item 404(a) relating to related party transactions with respect to the clawback activity.

The Item 402 disclosure would need to be provided in XBRL format, but would be required only in annual reports on Form 10-K and proxy and consent solicitation materials whenever other Item 402 disclosure is required. The disclosure, therefore, would not be required in registration statements under the Securities Act of 1933. In addition, the disclosure would not be deemed incorporated by reference into any filing under the Securities Act of 1933 unless specifically incorporated by reference.

For any registered management investment company subject to Rule 10D-1, information mirroring the new Item 402 disclosure would be included in annual reports on Form N-CSR and in proxy statements and information statements relating to the election of directors. Foreign private issuers would be required to provide the new Item 402 disclosure in annual reports filed with the SEC under Section 13(a) of the Exchange Act.

The Summary Compensation Table rules would be amended to require that any amounts recovered under a clawback policy reduce the amount reported in the table for the fiscal year in which the original payment was reported and be identified in a footnote.

Timing of the New Rules

Under the proposed rules, the stock exchanges would have to file with the SEC proposed listing standards implementing the rule no later than 90 days after the final Rule 10D-1 is published in the federal register. Those new listing standards would need to be approved by the SEC and become effective no later than one year after the publication of the final new Rule 10D-1.

Issuers then would need to adopt clawback policies no later than 60 days after the exchanges' standards become effective. These clawback policies would need to apply to all incentive-based compensation received by current or former executive officers as a result of attainment of a financial reporting measure based on or derived from financial information for any fiscal period ending on or after the effective date of Rule 10D-1. The clawback policy would be expected to apply to such compensation even if the compensation is received under a pre-existing contract or arrangement.

Compliance with the new Item 402 disclosure rules would be required for all applicable filings with the SEC after the effective date of the exchanges' listing standards.

Recommended Actions for Listed Companies

- Review any existing clawback policies to determine what revisions would be needed if the proposed rules are adopted
- Review existing incentive-based compensation arrangements and any other plans or agreements that are affected by incentive compensation, such as deferred compensation plans or supplemental executive retirement plans, to determine whether there is an existing contractual right to recover compensation and consider whether to modify the arrangements to permit recovery in the future
- Consider commenting on the proposed rules during the 60-day comment period beginning after the proposed rules are published in the federal register.

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SEC Proposes Rules on Mandatory Pay for Performance Disclosure

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05 May 2015

Legal News: Employee Benefits & Executive Compensation

On April 29, 2015, the Securities and Exchange Commission (SEC) proposed rules that would require public companies to disclose the relationship between executive compensation and the company's financial performance. The rules would apply to public companies other than emerging growth companies, foreign private issuers, and registered investment companies, and the disclosure would be required in proxy statements or information statements in which disclosure of executive compensation currently must be included under Item 402 of Regulation S-K.

The rules were proposed in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act mandate that the SEC adopt rules requiring companies to disclose the relationship between their performance and executive compensation.

Summary of the Proposed Rules

The disclosure required under the proposed rules would consist of two elements: (1) a table covering the five most recently completed fiscal years (three years in the case of smaller reporting companies) that will include specified information, as explained below, and (2) a clear description, using the information in the table, of the relationship between executive compensation "actually" paid and the company's cumulative total shareholder return (TSR).

The New Table

The new table would use the following format, covering the five most recently completed fiscal years (three years in the case of smaller reporting companies):

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)

Summary Compensation Table Compensation. The summary compensation table total compensation column for the principal executive officer would be based on the same column in the existing summary compensation table. For the other named executive officers (NEOs), the column would be the average of the values in the summary compensation table.

Compensation Actually Paid. The "Compensation Actually Paid" column would be modified from summary compensation table total compensation as follows:

- The grant date fair value of equity awards would be removed, and the fair value of equity awards that vested during the relevant year would be added. Fair value for this purpose will be determined under the applicable accounting standards. If any previously vested equity awards have been materially modified, any incremental fair value resulting from the modification must be added as well.
- The change in pension value would be removed, and only the "service cost" of defined benefit and actuarial pension plans for the year will be added back. This is intended to exclude the effects of changes in interest rates, the executive's age, and other actuarial inputs and assumptions regarding benefits accrued in previous years. Smaller reporting companies are not currently required to provide the change in pension value in the summary compensation table and would not be required to include any change in pension value in this table.
- If more than one individual served as principal executive officer during the year, Compensation Actually Paid would be the aggregate of the compensation of all such individuals. In the case of a principal executive officer who receives severance or other termination-related benefits, or a new principal executive officer who receives a signing bonus, this aggregation approach may result in a large spike in principal executive officer compensation as compared to earlier and later years that is not related to the company's performance.

Total Shareholder Return. The company's TSR would need to be calculated on a basis similar to that used to calculate the performance graph required in the annual report under Item 201(e) of Regulation S-K. The peer group TSR would need to be calculated using either the peer group used for the performance graph or, at the company's election, its peer group as disclosed in the Compensation Discussion and Analysis section, if it has such a peer group. Smaller reporting companies would not be required to present a peer group TSR.

XBRL Formatting Required. Each amount in the table would need to be electronically formatted and tagged using eXtensible Business Reporting Language (XBRL). Currently, no other proxy statement disclosures are required to be formatted for XBRL.

Additional Description

In addition to the table described above, the proposed rules would require a "clear description," using the information in the table, of the relationship between executive compensation actually paid and the company's cumulative TSR for each of the last five years (three in the case of smaller reporting companies). For companies other than smaller reporting companies, the description would also need to include a comparison of the cumulative TSR of the company and the TSR of its peer group over the same period.

The proposed rules would not mandate that the description use any specific format, but the proposing release suggests that it could be presented in narrative, a graphic, or a combination of the two. The release also indicates that the presentation should be consistent with plain English principles.

The description would need to be block formatted for XBRL.

Neither the table nor the additional description would be incorporated by reference into any securities filings of the company unless the company specifically incorporated them.

Timing of Rules and Transition Relief

The comment period for the proposed rules will run for 60 days after the rules are published in the Federal Register.

The SEC has not indicated the expected timing of final rules. In particular, it has not yet ruled out the potential for final rules to be adopted in time for the disclosure to be required in 2016 proxy statements, so that remains a possibility.

The rules would provide for transition relief under which companies other than smaller reporting companies could initially provide disclosure for only three years, adding an additional year over the next two years until the full five years of disclosure is provided. For smaller reporting companies, only two years of disclosure would need to be included in the first year, followed by three years of disclosure in the second year. Smaller reporting companies also would not be required to comply with the XBRL tagging requirement until the third year.

New reporting companies would initially be required to provide only one year of disclosure and would add an additional year of disclosure each year until reaching the full five years of disclosure.

Recommended Actions for Publicly Traded Companies

- Consider providing comments on the proposed rules, particularly with respect to the scope of the rules, the format of the table and anticipated costs of compliance if the rules are adopted. The comment period for the proposed rules will run for 60 days after the rules are published in the *Federal Register*.
- Begin to evaluate what the tabular disclosure will look like for your current NEOs in light of your TSR and consider which peer group — the group used for your performance graph or the group used to benchmark compensation, if different — would be more appropriate for this disclosure.
- Consider potential formats for providing a description of the relationship of compensation and performance — whether a graph or narrative — and how the description might relate to any pay for performance disclosure you are currently providing in the proxy statement.

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