Securities Regulation Daily Wrap Up, TOP STORY—SEC adopts registration regime for muni advisers and proposes pay ratio rule, (Sep. 18, 2013)

Click to open document in a browser

By Jacquelyn Lumb

The SEC commissioners today unanimously approved a rule to establish a registration regime for municipal advisers and, in a three-to-two vote, approved the issuance of a proposal to require public companies to disclose the ratio of the compensation of their CEOs to the median compensation of all employees. The municipal adviser rule will take effect 60 days after publication in the Federal Register. The comment period for the pay ratio proposal will be open for 60 days. Both initiatives were required under the Dodd-Frank Act.

Municipal adviser registration. The municipal adviser registration requirement responds to the losses by municipalities during the financial crisis, some of which invested in complex derivative products based on advice from unregulated advisers which in some cases had undisclosed conflicts of interest. In 2010, the SEC adopted a temporary rule to require the registration of municipal advisers pending the adoption of a permanent rule. The SEC proposed a permanent rule shortly thereafter.

The SEC modified the proposal based on over 1,000 comment letters and numerous views that the proposal was too broad. The final rule clarifies who will be deemed a municipal adviser and provides guidance on when a person is providing advice under the municipal adviser definition.

The SEC narrowed the application of the term “investment strategies” to apply only to the investment of proceeds from the sale of municipal securities rather than to all public funds, and exempted employees and appointed officials from registration. Rather than require individuals who are associated with registered municipal advisory firms to register separately, the final rule requires the firms to furnish information about those individuals. The individuals will be subject to SEC censure, if necessary.

Exemptions. Brokers, dealers and municipal securities dealers that serve as underwriters will not have to register if their advisory activities involve the structure, timing, and terms of an issuance of municipal securities. The exemption does not apply to advice on investments of the proceeds of municipal securities. Registered investment advisers and associated persons will not have to register if they provide advice regarding the investment of the proceeds of municipal securities or municipal escrow investments. The rule also provides exemptions for registered commodity trading advisers, attorneys, engineers, banks, accountants, and swap dealers, under certain conditions.

Municipal advisory firms will file on the SEC’s EDGAR system. Form MA will be used to register as a municipal adviser and Form MA-I will be filed for individuals associated with firms that engage in municipal advisory activities.

Self-certification dropped. Commissioner Kara Stein expressed disappointment that the final rule did not include a self-certification with respect to standards of training and competence and the ability to carry out an adviser’s obligations. Self-certifications have proven to be effective tools, she said, and they reflect a means of doing more with less with respect to resources.

Piwowar’s approval and dissent. Commissioner Michael Piwowar said the two rules upon which the commissioners voted reflected the best of times and the worst of times and could not be in starker contrast. The municipal rule was an improvement over the initial proposal, he said, and he voted for its adoption, but he criticized the chair for not granting his request for additional time to consider the rule. With respect to the pay ratio rule, he said it had nothing to do with the SEC’s core mission, will harm investors, and will put large companies with global operations at a competitive disadvantage. He voted against the issuance of the proposal.

Pay ratio disclosure. The Dodd-Frank Act directed the SEC to amend its rules to require companies to disclose the median of the annual total compensation of all of their employees and the ratio of that median to the annual

total compensation of their CEO. The SEC's proposal does not specify a particular methodology for identifying the median employee in terms of total compensation for all employees. Companies may identify the median employee based on total compensation of its full employee population or may use a statistical sample of the population.

Companies would also be able to use reasonable estimates to calculate annual total compensation, any element of the total compensation, and in determining the annual total compensation of the median employee. They must disclose the methodology they used and any material assumptions, adjustments or estimates that were used to identify the median or to determine total compensation.

Under the proposal, employees would include full-time, part-time, seasonal, and non-U.S. employees, and those employed by the company and its subsidiaries. It would include those employed as of the last day of the prior fiscal year. Companies could supplement their disclosure with a narrative discussion, if they choose.

The disclosure would be included in registration statements, proxy and information statements, and annual reports that include executive compensation information under Item 402 of Regulation S-X. The rule would not apply to emerging growth companies, as provided by the JOBS Act, or to smaller reporting companies or foreign private issuers. The proposed compliance date would be the first fiscal year on or after the effective date of the final rule.

Aguilar's support. Commissioner Luis Aguilar noted that pay multiples between CEOs and the rank and file have risen steadily over the years and some estimates place it at 204 times today versus 20 times in the 1950s. He said it is not surprising that shareholders have questioned whether it is in a company's interest to have such a high ratio, particularly when there is no link to performance. Aguilar supported the proposal and hopes it will help counter the upward trend.

Gallagher's Dissent. Commissioner Daniel Gallagher said the proposal was yet another Dodd-Frank mandate that has nothing to do with the financial crisis and everything to do with politics. The proposal turns materiality-based disclosure on its head, he said, and even the release acknowledges the near impossibility of substantiating any economic benefits. Gallagher also noted that the proposal was not among the mandates with deadlines. He saw it as a misallocation of time and resources when other initiatives that address issues related to the financial crisis are still awaiting action.

Gallagher also criticized the scope of the proposal. He said it was unnecessary overkill and assured the most eye-poppingly high ratios by including global operations and temporary and seasonal employees. Gallagher said it was a rotten mandate and he urged commenters to provide detailed, data-heavy responses.

Chair Mary Jo White, who along with Aguilar and Stein voted to approve the proposal, noted that all Congressionally-mandated rules are a priority to complete and each will be considered as it is ready, as this one was today.

MainStory: TopStory SECNewsSpeeches DoddFrankAct DirectorsOfficers InvestmentAdvisers