
SEC Approves Amendments to Disclosure Requirements for Executive Compensation and Related Matters

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On July 26, 2006, the SEC approved amendments to its disclosure requirements for executive and director compensation, related party transactions, director independence, other corporate governance matters, and security ownership of officers and directors. The amendments were originally proposed in January 2006 and were the subject of a record number of comment letters.

In unanimously adopting the new rules, the commissioners stressed at several points their view that the purpose of the new rules is to enhance disclosure and better inform boards and stockholders about levels of compensation, and that it was not the SEC's job to judge what constitutes the right amount of executive compensation or to place limits on the amount of executive compensation.

Statements made at the SEC open meeting suggest that the rules were adopted substantially as proposed. Major changes from the proposals that were identified at the open meeting are discussed below. As expected, the final rules will also contain guidance and additional requirements focusing on option granting practices, particularly the timing of grants relative to whether a company is aware of material nonpublic information.

The following discussion of the new rules is based on comments made at the SEC's open meeting on July 26, 2006. The actual text of the new rules is expected to become available in one to two weeks. We will prepare a detailed analysis of the new rules after the full text of the adopting release becomes available.

A copy of the SEC's press release announcing the new rules is linked [here](#). The SEC's press release includes a general summary of the new rules.

New Provisions Relating to Option Granting Practices

The adopting release will include guidance and additional requirements focusing on option granting practices. These new provisions will affect both the new required narrative and tabular disclosures. Commissioner Atkins commented that these new provisions are still a work in progress, so further changes from what was discussed at the open meeting could occur.

As part of the new Compensation Discussion and Analysis (“CD&A”) section, companies will be expected to address situations where they acted with respect to options granted to executives in coordination with the release of material nonpublic information (positive or negative), either by delaying or accelerating the time of grant or the release of the information. Specifically, the new CD&A requirement will include a series of questions relating to the practice of granting (or not granting) options to executives in coordination with the release of material nonpublic information that companies should address where appropriate. CD&A discussion would be required concerning any general program, policy or practice of the company that coordinates the timing of option grants to executives with the release of material nonpublic information, and any instance during the past year in which the company acted regarding options in coordination with the release of material nonpublic information.

With respect to the setting of option exercise prices, if a company uses anything other than the closing price on the FAS123R-determined date of grant, the company will be required in CD&A to disclose that fact and to describe the pricing methodology used. Moreover, if the exercise price of options is less than the closing price on the FAS123R-determined date of grant, the tables will require separate disclosure of the closing price on the FAS123R-determined grant date. The new supplemental grant table will require disclosure of the FAS123R-determined grant date and, if different, the date the option was approved.

At the open meeting, Commissioner Campos noted that the new rules and guidance are forward-looking and are not intended to address whether any past actions were in violation of the federal securities laws.

Major Changes from the Proposal

- *Determination of NEOs.* The determination of the Named Executive Officers with respect to whom comprehensive compensation disclosure is required will be determined on the basis of total compensation, *excluding* the annual change in actuarial value of pension plans and earnings on deferred compensation.
- *CD&A Will Be Filed and Certified; New Compensation Committee Report Will Be Furnished.* The requirement to provide CD&A, a new overview section providing narrative disclosure intended to put the tabular and related disclosure into perspective for investors, was adopted substantially as proposed. The CD&A will be filed with the SEC and therefore covered by the CEO and CFO’s certifications of the Form 10-K. The adopting release will include guidance specifying that the CD&A is not intended to be a report on the deliberations or activities of the compensation committee, but rather is intended to be company disclosure regarding company policies and decisions. A requirement has been added to include a brief Compensation Committee Report, similar to that currently required from Audit Committees, which will be presented over the names of the members of the Compensation Committee and which will be furnished, not filed. This new Compensation Committee Report will disclose whether the Compensation Committee has reviewed the CD&A with management and recommended inclusion of the CD&A in the Form 10-K and

proxy statement. The adopting release will also make clear that the certifying officers may rely on the Compensation Committee Report in making their certifications.

- *Stock Performance Graph Retained, But Moved.* The Stock Performance Graph, which the proposed rules sought to eliminate, will be retained. However, the requirement to include the stock performance graph is removed from the executive compensation rules and is instead to become part of Item 201 of Regulation S-K regarding the market price of common equity and related matters, and will be required to be furnished to the SEC as part of the Annual Report to Shareholders.
- *Changes to Summary Compensation Table.* The proposed rules would have required disclosure in the Summary Compensation Table of all earnings on deferred compensation. As adopted, the rules will require disclosure in the Summary Compensation Table only with respect to above-market or preferential earnings. (Disclosure of all earnings will, however, be required in the Nonqualified Deferred Compensation Table.) The Option Awards column of the Summary Compensation Table, as proposed, would have required that options that are repriced or otherwise materially modified would be reported in this column based on the full grant date fair value of the award. In response to comments, the rule as adopted will require the incremental value of repriced or modified options only. The proposed requirement to include a Total Compensation column in the Summary Compensation Table has been retained, but the Total Compensation column will move all the way to the right side of the table.
- *Exclusion of Bonus Performance Goals to Be More Closely Scrutinized.* While companies will still be permitted to omit bonus factors or criteria involving commercial or business information, the disclosure of which would have an adverse effect on the company, the instructions will more clearly provide that the applicable standard is the same as applies when a company formally seeks confidential treatment of information. The SEC staff is expected to use the normal review and comment process to ensure that companies are not improperly omitting information that is not confidential or that does not otherwise meet the applicable standard for exclusion.
- *Changes to Other Tables.* Supplemental information about grants will be presented in a single Grants of Plan-Based Awards table, as opposed to the two supplemental grant tables originally proposed. The Outstanding Equity Awards at Fiscal Year-End table will include information about options on an individual (rather than aggregate) basis, and will include information about out-of-the-money options. The proposed Options Exercised and Stock Vested Table has been revised to remove the proposed column requiring reporting of the grant date fair value previously reported in the Summary Compensation Table.
- *Assumptions Added to Facilitate Post-Employment Disclosures.* The Retirement Plan Potential Annual Payments and Benefits Table is revised to require the disclosure of actuarial estimates payable at normal retirement, based on current levels of

compensation. For the required narrative disclosure regarding any written or unwritten arrangement providing termination or change in control compensation, the SEC has specified two assumptions to be used: that the triggering event took place on the last business day of the registrant's last completed fiscal year, and that the stock price on that date should be used for any estimates.

- *Disclosure Regarding Highly Compensated Non-Executives Re-proposed.* The SEC is modifying and re-proposing the requirement to include additional narrative disclosure of the total compensation and job description of up to three other employees who were not executive officers but who earned more in total compensation than any of the NEOs. As re-proposed, only large accelerated filers would be required to provide this additional narrative disclosure, and only employees with responsibility for significant policy decisions at the level of the parent company, a significant subsidiary, or a principal business unit, division or function would be covered. This guideline should exclude from disclosure the compensation of entertainment personalities, sales people, and traders or portfolio managers for example, as long as they do not also have management responsibilities. Among other things, the re-proposal will seek public comment on whether the anonymity of employees for whom disclosure is required to be provided should continue to be protected.

Effective Dates

The new compensation disclosure rules will apply to annual reports and proxy statements, beginning with the reports for fiscal years ending on or after December 15, 2006. For Form 8-K current reports, the new rules take effect for triggering events occurring 60 days after publication in the Federal Register.

As proposed, companies will not be required to restate executive compensation or related party transaction disclosures previously reported under the old rules.

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