

JENNER & BLOCK
When it's a Matter of ImportanceSM

Corporate Resource
Center

SEC News Alerts

July 27, 2006

Securities and Exchange Commission Adopts New Executive Compensation and Related-Party Transaction Disclosures

by Knapp, Tobias

Fogerty, Melissa

Perdue, Amanda

At an open meeting held July 26, 2006, the Securities and Exchange Commission voted to adopt changes to the disclosure rules regarding executive compensation, related-party transactions and independence of board members and board committees. The rule changes introduce detailed requirements for disclosure of executive compensation, including executive salary, bonuses, the dollar value of pension benefits, "above-market" earnings on deferred compensation and perquisites exceeding \$10,000 a year. The rules also include enhanced disclosure regarding option grant practices. The SEC did not adopt but re-proposed a modified version of its proposal requiring disclosure for each of the three most highly compensated employees whose total compensation is greater than any named executive officer.

The new rules take effect beginning December 15, 2006, requiring compliance in Annual Reports on Form 10-K for fiscal years ending on or after December 15, 2006, and proxy statements, information statements and registration statements filed on or after December 15, 2006. Compliance is required in Current Reports on Form 8-K for triggering events that occur 60 days or more after publication of the new rules in the Federal Register.

The full text of the new rules is not yet available. Accordingly, the description provided in this Client Alert is based on the statements made by the Commissioners and SEC staff at the open meeting.

Executive and Director Compensation

Summary Compensation Table

The Summary Compensation Table is the primary vehicle for executive compensation disclosure. The table will include a "total compensation" amount representing the sum of the amounts disclosed in each column. The SEC intends the "total compensation" column to allow investors more easily to compare compensation from one company to another. The table will include:

- a column reporting the amount of compensation under non-equity incentive plans;
- columns showing the dollar value for stock and options based on the grant date fair value of the award determined pursuant to FAS 123R (Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 123);
- a column reporting the annual change in the actuarial present value of accumulated pension benefits and above-market or preferential earnings on non-qualified deferred compensation;
- a column showing the aggregate amount of all other compensation not reported in the other columns of the table, including perquisites of an aggregate amount greater than \$10,000; and
- a column reporting total compensation.

Compensation Discussion and Analysis Section

The new Compensation Discussion and Analysis section ("CD&A") calls for a principles-based, plain English overview of executive compensation modeled after the MD&A. The CD&A was adopted substantially as proposed but will now require specific disclosure regarding the company's programs, plans and practices for the timing of stock option grants and the establishment of option exercise prices. The CD&A must be "filed" (and not "furnished") and will therefore

be subject to the CEO and CFO certifications required by Sarbanes-Oxley.

Compensation Committee Report

Although the CD&A is intended to replace the traditional Compensation Committee Report, a new Compensation Committee Report modeled on the Audit Committee Report must state whether the compensation committee has reviewed and discussed the CD&A with management and whether, based on this review, it recommends that the CD&A be included in the company's Annual Report on Form 10-K and proxy statement. The Compensation Committee Report will be "furnished" over the names of the compensation committee members but not "filed" with the SEC.

Performance Graph

The adopted rules retain the Performance Graph but move it to Item 201 of Regulation S-K, which currently covers the market price of common equity and related matters.

Option Grants Disclosure

In acknowledgement of the recent attention to stock option timing issues, the adopted rules require additional disclosure with respect to stock option grants. The Grants of Plan-Based Awards Table will require tabular disclosure of:

- grant date (as determined under FAS 123R);
- fair value on the grant date (as determined under FAS 123R);
- the closing market price on the grant date, if it is greater than the exercise price of the award; and
- the date the compensation committee or full board of directors took action to grant the award if different from the grant date.

In addition, the CD&A will require narrative disclosure about a company's option grant practices, including the timing of equity grants in coordination with the release of material non-public information and the selection of exercise prices that differ from the underlying stock price on the grant date.

Re-Issuance of Proposed Disclosure For Three Most Highly Paid Individuals With Compensation Exceeding Named Executive Officers

The SEC re-proposed a modified version of its proposal requiring disclosure for each of the three most highly compensated employees whose total compensation is greater than any named executive officer. This disclosure would be required only of large accelerated filers (companies with over \$700 million in market capitalization). In addition, the rule would only cover employees with responsibility for significant policy decisions within the parent company, a significant subsidiary or a principal business unit, division or function. This change is intended to exclude professional athletes, portfolio managers, news broadcasters, commissioned salespersons and others in highly-paid but non-management positions.

Disclosure of Outstanding Equity Interests

Disclosure regarding outstanding equity interests will be presented in two tables. The Outstanding Equity Awards at Fiscal-Year End Table will include the amount of securities underlying exercisable and unexercisable options, individual exercise prices and expiration dates for each outstanding option (rather than on an aggregate basis). The Option Exercises and Stock Vested Table will include amounts realized on equity compensation during the last fiscal year.

Disclosure of Retirement and Post-Employment Compensation

Retirement and post-employment compensation will be presented in the Pension Benefits Table and the Nonqualified Deferred Compensation Table. The rule changes revise the Pension Benefits Table to require disclosure of the actuarial present value of each named executive officer's accumulated pension benefit, computed using the same assumptions (except for the normal retirement age) used for financial reporting purposes. The Nonqualified Deferred Compensation Table will disclose executive contributions, company contributions, withdrawals, all earnings for the year and the year-end balance of deferred compensation plans. In addition, narrative disclosure is required regarding

payments or benefits payable upon a termination, a change in responsibilities or a change in control of the company.

Related-Party Transactions

The SEC adopted significant revisions to the related-person transaction disclosure requirements, including:

- increasing the dollar threshold for disclosure under Item 404(a) of Regulation S-K from \$60,000 to \$120,000;
- requiring new disclosure of a company's policies and procedures for the review, approval or ratification of related-person transactions;
- eliminating the distinction between indebtedness and other types of related-person transactions; and
- eliminating certain requirements for disclosure of specific types of director relationships.

Independence of Board Members and Board Committees

The SEC adopted new Item 407 of Regulation S-K to consolidate and update existing disclosure requirements regarding director independence and related corporate governance matters. This item requires:

- disclosure of whether each director and director nominee is independent;
- a description, by specific category or type, of any transactions, relationships or arrangements not disclosed as a related party transaction that were considered by the board of directors when determining if applicable independence standards were satisfied;
- disclosure of any audit, nominating and compensation committee members who are not independent; and
- disclosure about the compensation committee's processes and procedures for the consideration of executive and director compensation.

Security Ownership of Directors and Officers

The new rules will require disclosure of the number of shares, if any, that have been pledged by members of management. In addition, directors' qualifying shares must be included in disclosure of the total amount of securities owned.

Form 8-K

The changes to Form 8-K and the security ownership disclosure requirements for directors and named executive officers of Item 403 were adopted as proposed. These changes capture various employment arrangements and material amendments for named executive officers, and also consolidate Form 8-K disclosures regarding employment arrangements under one Form 8-K item.