

# Client Alert

August 24, 2006

## **SEC Issues Final Rules on Executive and Director Compensation Disclosure**

### **Overview**

On August 11, the Securities and Exchange Commission (the SEC) released the final text of sweeping new rules for the disclosure of executive and director compensation in public company proxy statements and other securities filings. These new rules are generally effective for fiscal years ending on or after December 15, 2006. Related changes to Form 8-K disclosure are for triggering events that occur 60 days or more after publication of the regulations in the Federal Register.

Among other issues, the new rules significantly expand the disclosure of practices and policies related to stock option grants, a response by the SEC to recent concerns about option timing and pricing issues. The rules also address corporate governance considerations including related party transactions, Board independence and stock ownership by Directors and officers.

Additionally, the SEC has not formally adopted and is seeking additional comments on the proposed rules related to compensation disclosure of three additional highly compensated employees.

This Client Alert summarizes the most significant considerations raised by the new rules and highlights changes from the earlier proposal.

The disclosure rules dramatically change the form and substance of executive compensation disclosure. Given the far greater time and effort that will be needed to comply with the additional disclosures, we strongly encourage our clients and friends to begin compiling the data, drafting the CD&A and preparing the tables and associated narratives as soon as practicable.

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## Major Highlights – New Rules

**New CD&A:** The current “Compensation Committee Report” and “Company Performance Graph” are replaced by a new **Compensation Discussion and Analysis** (CD&A), similar in design to the Management Discussion and Analysis required in 10-K filings. The new CD&A includes increased disclosure of compensation governance practices. The Company Performance Graph was moved to the annual report.

**CCR:** A new **Compensation Committee Report** (CCR), similar to the Audit Committee Report, will continue to be treated as “furnished” and the Committee members must be listed by name at the bottom of the Report.

**Increased Liability Exposure:** The CD&A will be treated as “filed” with the SEC, potentially increasing liability related to compensation disclosures and making it subject to a company’s disclosure controls and procedures. The CEO and CFO certification requirements under Sarbanes-Oxley are extended to CD&A narrative disclosures.

**More Tables:** There is increased tabular disclosure for all elements of executive and Directors compensation.

**Increased Disclosure of Stock Option Grant Practices:** Responding to perceived corporate governance failures, additional information is required regarding grant date, stock price on date of grant, exercise price, option terms and policies regarding the determination of the grant date and exercise price.

**Bottom Line Number:** Companies must provide a single total compensation value for each reported individual.

**Principal Financial Officer as NEO:** The Principal Financial Officer is included as a NEO in the **Summary Compensation Table** (SCT), regardless of the level of compensation.

**Perquisites:** Total annual perquisites in excess of \$10,000 must be disclosed, with separate disclosure of any perquisite valued at greater than \$25,000 or 10% of total perquisites.

**Post-Employment Compensation:** Companies must provide details of retirement, deferred and other post-employment compensation, including severance and change-in-control compensation and benefits.

**Plain English:** Companies must provide disclosure information under the same SEC “Plain English” writing standard that applies to prospectuses.

**Increased Disclosure of Compensation Governance Practices:** More stringent disclosure of interlocks and beneficial ownership is required. The new rules also require tabular disclosure of Director compensation and amend the disclosure of management’s beneficial ownership to include pledged shares. In addition, the new rules outline required disclosures related to Form 8-K and compensation governance practices.

**More Individuals Covered:** The SEC has proposed that total compensation be disclosed for up to three individual employees who earn more than any one of the named executive officers (NEOs) and who have policy making responsibilities. We expect this additional disclosure to be adopted.

## Major Highlights – Changes From Proposed Rules to Final Rules

The proposed executive compensation disclosure rules released by the SEC in January of 2006 elicited over 20,000 comment letters. While the new rules have been adopted substantially as proposed, the agency made a number of modifications including:

- Disclosure of option grant practice was greatly expanded in response to controversy over the pricing and dating of stock options that developed subsequent to release of the SEC's originally proposed rules. In addition to the earlier proposal to report grant date fair value, companies will now need to disclose:
  - *FAS 123R grant date.*
  - *Closing market price* on the grant date, if greater than the award exercise price.
  - *Date of Committee action*, if the grant date differs from the date the Committee approved the grant.
  - *Narrative description of the methodology* used to determine the exercise price, if other than the closing price on the date of grant.
  - *Additional narrative disclosure* regarding the scheduling of annual option awards, any grants made outside of normal practices and the methodology used to determine option exercise prices.
- Earnings on non-qualified deferred compensation (NQDC) and annual increases in actuarial pension value will *not* be included as compensation for the purpose of determining which employees are listed as NEOs.
- The SCT must disclose only *above market* earnings on deferred compensation, as opposed to *all* earnings on deferred compensation, as originally proposed. Above market interest is based on the IRS's published Applicable Federal Rates.
- Amounts earned under "traditional" performance-based annual incentive plans will be reported in the Non-Equity Incentive Plan Compensation column, rather than the Bonus column, as is currently the case.
- The proposed Grants of Performance-Based Awards and Grants of All Other Equity Awards tables are *combined* into a single **Grants of Plan Based Awards Table**. Extensive narrative disclosure may be required to explain the data.

- The CCR is retained in an alternative, simplified format similar to the Audit Committee Report. It must state whether the Compensation Committee reviewed and discussed the CD&A with management and recommends its inclusion on Form 10-K.
- The SEC clarified the assumptions to be used for calculating termination payments, change-in-control payments and pension benefits.
- A question in the CD&A presented in the original proposal requiring discussion regarding what compensation plans are designed *not* to reward has been eliminated, better focusing disclosure on what pay plans *are* intended to reward.
- Option modifications will *not* be treated as new grants and only the incremental cost as measured by FAS 123R will need to be reported as compensation in the SCT. However, grants of reload options must be reported based on the total grant date fair value.
- The Outstanding Equity Awards at Fiscal Year-End table must provide information on individual grants. The information required for the table and related footnotes/narrative may be extensive.
- The SEC proposed a more narrow definition for “Top 3 Other Employees” that would limit disclosure to “large accelerated filers” (about 1,700 companies in total) and apply only to employees with significant policy-making powers. Investment bankers, traders, salespeople, entertainment personalities or professional athletes who lack such a policy making role would be specifically excluded. The SEC’s original proposal would have required disclosure of up to *any* three non-executive employees whose total pay exceeded any of the NEOs’ compensation.

## General Outline

Under the new rules, compensation disclosure begins with the **Compensation Discussion and Analysis** (CD&A), which is intended to provide a discussion and analysis of the material factors underlying compensation policies and decisions reflected elsewhere in the proxy statement. To the extent companies are concerned that new and additional tabular disclosures do not accurately reflect executive compensation, the SEC has identified the CD&A or additional narrative following each table as appropriate places to provide additional information. The new rules also require companies to integrate additional information on option grant practices into the tabular disclosure and accompanying narrative.

Detailed disclosure of executive compensation is organized into three categories:

- *Annual Compensation:* Compensation for the last three fiscal years is presented in a revised SCT, as discussed below, supplemented by additional narrative disclosure and a new **Grants of Plan-Based Awards Table**.
- *Equity Holdings:* Equity held by NEOs related to actual or potential compensation is presented primarily in two new tables:
  - **Outstanding Equity Awards at Fiscal Year-End Table.**
  - **Option Exercises and Stock Vested Table.**
- *Post-Employment Payments:* Retirement and other post-employment benefits, presented in two new tables and a narrative description covering potential severance and change-in-control payouts. The new tables are:
  - **Pension Benefits Table.**
  - **Nonqualified Deferred Compensation Table.**

The new rules also require tabular disclosure of Director compensation and amend the disclosure of management's beneficial ownership to include pledged shares. In addition, the new rules outline required disclosures related to Form 8-K and compensation governance practices.

## I. COMPENSATION DISCUSSION AND ANALYSIS

The SEC intends the new CD&A to be a “principles-based” disclosure, without the use of boilerplate language, that provides material information relevant to understanding the objectives, policies and philosophy behind the company’s executive compensation programs. The CD&A must specifically address each of the following questions:

- What are the objectives of the company’s compensation program(s)?
- What are the compensation program(s) designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and, where applicable, the formula) for each element?
- How does each element and the company’s decision regarding that element fit into the company’s overall compensation objectives and affect decisions regarding other elements?

The SEC also identified questions that based on a company’s facts and circumstances, may be “potentially” appropriate to address in the CD&A. Among the breadth of issues that may be covered:

- Policies for allocating between long-term and current compensation.
- Policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation.
- The basis for allocating among multiple types of long-term compensation.
- How the timing of awards is determined, including awards of equity-based compensation such as options.
- Specific items of corporate performance considered in setting compensation policies and making compensation decisions.
- How specific elements of compensation are structured and implemented to reflect each NEO’s individual performance. The new rules added a requirement that companies disclose how plans are implemented. This would require disclosure of not just whether discretion may be exercised (either to award compensation absent attainment of a performance measure, or to reduce or increase the size of any award or payment), but also whether such discretion has been exercised.

- How specific forms of compensation are structured to reflect items of a company's performance, including whether discretion may be exercised either to award compensation absent attainment of the relevant performance goal(s) or to reduce or increase the size of an award.
- Factors considered in material increases or decreases to compensation.
- How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g., how gains from option or stock awards are considered in setting retirement benefits).
- Impact of accounting and tax treatments of the form of compensation. Interestingly, the SEC has dropped the requirement for specific reference to the company's Section 162 (m) policy (dealing with the \$1 million compensation limit). Rather, pursuant to the principles-based approach, the new rules are to be interpreted more broadly to require commentary on any tax or accounting treatment, including Section 162(m).
- Ownership guidelines and policies regarding hedging.
- Beneficial ownership requirements.
- Description of any compensation benchmarking activity, including peer companies.
- Role of executive officers in determining executive compensation (see also the discussion below regarding Corporate Governance).
- Company policies and decisions regarding the adjustment or recovery of awards or payments if the relevant company performance measure(s) upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of the award or payment.
- The basis for selecting particular events as triggering payment with respect to post termination agreements. For example, why did the company provide a single trigger for payment in the event of a change-in-control?

Generally, and consistent with the current rules, public companies are not required to disclose specific target levels or any other information involving confidential commercial or business information that would cause competitive harm to the company.

In addition, a company's policies, programs and practices regarding the award of stock options and other equity-based instruments may require disclosure and discussion in the CD&A. The new rules specifically require disclosure of practices regarding the granting of stock options in conjunction with the release of material non-public information.

## II. COMPENSATION COMMITTEE REPORT

The new CCR will be similar to the current Audit Committee Report and is considered a “furnished” document, as opposed to the “filed” CD&A (see below). Its only requirements are:

- A statement providing whether the Compensation Committee has reviewed and discussed the CD&A with management.
- A statement providing whether, based on the review and discussion, the Compensation Committee recommended to the Board that the CD&A be included in the company’s annual report on Form 10-K, and, as applicable, the company’s proxy or information statement.
- A list of the Committee members below the disclosure.

## III. “FILED” vs. “FURNISHED”

Unlike the CCR, the CD&A will be “filed” with the SEC rather than “furnished.” As such, it is subject to the CEO and CFO certification requirements mandated by the Sarbanes-Oxley Act of 2002 and creates the potential for greater legal exposure under federal securities laws. Among other things, certification requires a statement by the CEO and CFO that the CD&A contains no known material misstatement or omission and that there are adequate disclosure controls and procedures for the statements in the filings, including the CD&A.

The SEC received numerous comments that this rule requires the CEO and CFO to certify disclosures related to the process for setting their own compensation, even though they may not have been privy to all relevant discussions. The SEC responded that it is their belief that the CD&A is intended to discuss company policies and decisions, rather than the deliberations of the Compensation Committee. However, company policies and the deliberations of the Compensation Committee with regard to executive compensation are often integrally related. Therefore, we note that it remains the case that the CEO and CFO may not be privy to the information necessary to complete the CD&A, because they were not present at discussions regarding their own compensation. For example, we query whether, and to what extent, the CEO or CFO will be aware of the factors considered with respect to any material increases or decreases to their own compensation, which must be discussed in the CD&A and certified. Committees and management will need to define a process by which the CEO and CFO will be comfortable certifying the disclosure.

#### IV. SUMMARY COMPENSATION TABLE

The newly formatted SCT is the principal disclosure vehicle for executive compensation under the new rules. It shows the NEOs' compensation for the last three years, each year adding up to the desired "one number" for each executive's total compensation.

Full compliance with the new rules is required on a prospective basis, with implementation to be phased in over a three-year period. During this transition period, companies will not be required to present prior year compensation disclosure. For a calendar year company, that means fiscal year 2006 disclosure will contain just one year of data, 2007 disclosure will contain two years, and 2008 and beyond will contain three years.

SUMMARY COMPENSATION TABLE									
Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO	_____ _____ _____								
PFO	_____ _____ _____								
A	_____ _____ _____								
B	_____ _____ _____								
C	_____ _____ _____								

Instructions to each column of the SCT require the following:

**Name and Principal Position Column:** All NEOs are listed, as is currently required, but the new rules change the definition of an NEO to include the company's principal executive officer (PEO), principal financial officer (PFO) and the three most highly compensated executive officers on a total compensation basis (rather than on the basis of salary and bonus only, as per the current rules). Total compensation for purposes of determining the NEOs does not include earnings on non-qualified deferred compensation or increases in pension value.

The SCT must include any individual who served as a PEO or PFO during the year and up to two additional individuals for whom disclosure would have been required, but for the fact that they were not serving as executive officers at the end of the last fiscal year.

To remove any incentive to manipulate NEO status by re-characterizing compensation, the new rules also prohibit companies from excluding employees as NEOs by characterizing certain elements of their compensation as “nonrecurring and unlikely to continue” (with the exception of special payments related to an overseas assignment).

The SEC has modified and is again seeking comments on its proposed rule for disclosure of compensation of up to an additional three most highly compensated employees who are not executive officers or directors, but who earn more than the NEOs.

The revised requirement would apply only to large accelerated filers (those with market caps of \$750 million or more, or about 1,700 companies). Disclosure of total compensation for the most recent fiscal year and a job description would be provided for each of the three most highly compensated employees whose total compensation is greater than any one of the named executive officers, whether or not that person is an executive officer. However, the SEC narrowed that definition to apply only to employees with responsibility for significant policy decisions within the company, a significant subsidiary, principal business unit or functional area. Moreover, the SEC specifically stated that the new requirement would exclude investment bankers, traders, salespeople, entertainment personalities or professional athletes who lack such a policy-making role.

**Salary and Bonus Columns:** These columns are substantially unchanged from their current form, except as described below. To address the potential for double counting, footnote disclosure will be required for any currently payable compensation that is tax-deferred (other than in the form of equity or other non-cash property) and reported in the appropriate column. If salary or bonus cannot be calculated by the required filing date, the company must state such in a footnote and provide the expected date of determination (at which time a Form 8-K would be required).

The SEC did make a change in the type of compensation reportable in the Bonus column. Under prior rules, registrants generally reported almost all cash-based annual performance plan bonuses in the Bonus column. Under the new rules, the Bonus column will generally include only discretionary bonuses made by the Committee. Payments made in accordance with pre-established performance targets will now be reportable in the SCT under the Non-Equity Incentive Plan column.

**Stock Awards Column:** This column discloses equity-related awards that do not have option-like features, such as restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units and stock awards subject to performance-based conditions. Dividends, when paid, need not be included if the right to receive dividends was factored into the grant date fair value of the awards.

- Valuation is based on the grant date fair value as determined by FAS 123R for financial reporting purposes.
- The full grant date fair value is reported even if the award is recognized over the vesting period for financial reporting purposes.

**Option Awards Column:** The new rules require that this column disclose the grant date fair value of stock options, SARs, and similar stock-based compensation instruments with option-like features, rather than the number of such awards. Similar to the Stock Awards Column, the Option Awards Column will present the aggregate grant date fair value computed in accordance with FAS 123R, even if the award is subject to subsequent vesting and recognized for financial reporting purposes over several years. Assumptions used to calculate values must be reported in a footnote that refers to the actual assumptions reported in the company's financial statements or MD&A. If options are repriced, exchanged or otherwise modified, only the incremental value of the new grant is reported in this column in the year of the modification. However, the full value of reload or restorative option grants must be reported.

The SEC, in an attempt to address concerns over the timing of option grants, amplified disclosure requirements for option awards. However, this column will report only the accounting value of the grants, with additional option disclosure reported in the **Grants of Plan-Based Awards Table** and accompanying narrative.

**Non-Equity Incentive Plan Compensation Column:** This column discloses the dollar value of non-equity incentive plans, including earnings on all other incentive plan awards not included in the stock-based awards and options columns.

- Disclosure must be made when the relevant performance criteria are met and the compensation is earned, whether or not payment is made that year. However, the award is disclosed in the supplemental **Grants of Plan-Based Awards Table** (discussed below) in the year it is granted.
- There is a significant reporting difference between cash-settled awards, which are reported in this column, and equity-settled awards, which are reported in the Stock Awards and Options Awards columns. Paralleling FAS 123R treatment, an equity-based award is measured and reported *at grant*, while a cash-based award (similar to a liability award) is reported when *earned*, typically at the end of a performance period. The SEC has defined "earned" for this purpose as when the performance criteria are met, even if the compensation is subject to an additional time-based vesting schedule.

**Changes in Pension Value and Nonqualified Deferred Compensation Earnings**

**Column:** This new column provides the aggregate increase in actuarial value to NEOs of all defined benefit and actuarial plans (including supplemental plans) accrued during the year and any above market earnings on nonqualified deferred compensation balances. This is a change from the SEC's original proposal, which would have included all earnings on deferred compensation. Footnote identification and quantification of the full amount of each element is required. Negative numbers are also disclosed in a footnote, rather than shown in the column. This column is not included for the purposes of determining who constitutes an NEO for that year.

**All Other Compensation Column:** This final column leading up to the Total column discloses compensation not reported in any other column, essentially consolidating the current "Other Annual Compensation" and the "All Other Compensation" columns. In a change from current requirements, the column must include any compensation provided under relocation plans, even if such plans are generally available to all salaried employees. Among other items that would be included:

- Annual company contributions or other allocations to vested and unvested defined contribution plans.
- Amounts paid or accrued in connection with any termination of employment or change-in-control.
- The dollar value of any life insurance premiums paid by the company for the benefit of an NEO.
- "Gross-Ups" or other amounts reimbursed during the fiscal year for the payment of taxes, even for perquisites that are themselves exempt from disclosure.
- The value of compensation under FAS 123R for any purchases of company stock at a discount, unless the discount is available generally to all stockholders or all salaried employees (e.g., through an employee stock purchase plan).
- Dividends or other earnings paid on stock or option awards, if those amounts were not factored into the grant date fair value.
- The value of all perquisites provided to an NEO if the total exceeds \$10,000. In addition, the dollar value of any one perquisite must be disclosed if it exceeds the greater of \$25,000 or 10% of total perquisites and other personal benefits. The previous threshold for perquisite disclosure was the lesser of \$50,000 or 10% of the total of annual salary and bonus. All perquisites included in the All Other Compensation column must be identified in a footnote.

Where perquisites are subject to disclosure, they must be described in a manner that identifies the particular nature of the benefit received. For example, the SEC noted that it is not sufficient to report theater tickets or housekeeping services simply as “travel and entertainment.”

- **Description of a Perquisite:** The SEC’s new interpretive guidance defines a perquisite as any payment that is not “*integrally and directly related*” to the performance of the executive’s duties, and further describes that concept as “narrow.” An item is considered a perquisite if it directly or indirectly provides *any* aspect of personal benefit to the executive, even if it also serves a business purpose, unless it is generally available on a non-discriminatory basis to all employees.

It is important to note that the rules do not attempt to establish a “bright line” definition of a perquisite. Consistent with the principles-based nature of the rules, companies are encouraged to take an expansive and thoughtful view of how they define a perquisite.

We suggest companies re-evaluate prior disclosure of perquisites in light of this new guidance.

- Among the examples listed in the new rules as discloseable perquisites: club memberships not used exclusively for business entertainment purposes; personal financial or tax advice; personal travel using vehicles owned or leased by the company; personal use of other property owned or leased by the company; housing and other living expenses (including but not limited to relocation assistance); security provided at a personal residence or during personal travel; commuting expenses; and discounts on the company’s products or services that are not generally available to employees on a non-discriminatory basis.

**Total Column:** This new column will include the total compensation for each NEO, defined as the sum of the amounts disclosed in the other columns.

### **Grants of Plan-Based Awards Table**

In place of its original proposal for two supplemental tables to explain information in the SCT, the SEC has decided to require a single new **Grants of Plan-Based Awards Table**. This table is intended to provide more detailed disclosure of all equity or cash-based awards made during the last-completed fiscal year, essentially replacing the previous “Long-Term Incentive Awards Table.”

GRANTS OF PLAN-BASED AWARDS										
Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Sh)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
PEO										
PFO										
A										
B										
C										

Instructions to this table provide the following guidance:

- Grants must be disclosed individually and generally may not be aggregated.
- A separate column must be added showing the market price on the grant date if the per-share exercise or base price of the options, stock appreciation rights or similar option like instruments is less than the closing market price of the underlying security on the grant date.
- A column must be added to disclose the date the Committee took action or is deemed to have taken action to approve a grant if it differs from the actual grant date.
- Threshold, target and maximum payout information must be provided for incentive awards. If the award provides for only a single estimated payout, that amount must be reported as the target.
- Modifications and repricings are not reported in this table. Since the SCT adopts an FAS 123R approach, only the incremental value of the modification or repricing is reported in the SCT, although narrative regarding these transactions is required.

## Narrative Disclosure to the SCT and Grants of Plan-Based Awards Table

The new rules call for companies to provide a narrative description of the material factors necessary to understand the SCT and **Grants of Plan-Based Awards Table**. The narrative should focus on an explanation of quantitative disclosures, as opposed to the CD&A's emphasis on policies and objectives. Examples of such disclosures include:

- The terms of any written or unwritten NEO employment agreement necessary to understanding the tabular disclosure.
- Description of the methodology used to determine the exercise price, if it is other than the closing value on the date of grant.
- Additional narrative disclosure regarding: the scheduling of annual option awards; any grants made outside of normal practices; and the methodology used to determine option exercise prices.
- A description of repricing or other material modifications of outstanding options or stock-based awards during the last fiscal year. This replaces the "Ten-Year Option/SAR Repricings Table."
- Descriptions of the terms of awards in the **Grants of Plan-Based Awards Table**, to the extent needed to understand the tabular disclosure.
- Any material waiver or modification made to a performance condition for payout under any reported incentive plan.

Companies are not required to disclose any factor, criteria or other condition related to payout or vesting of a particular award that involves confidential trade secrets or confidential commercial or financial information, disclosure of which would result in competitive harm to the company.

## V. TABULAR DISCLOSURE OF EXERCISES, STOCK VESTING AND HOLDINGS OF PREVIOUSLY AWARDED EQUITY

New tabular disclosure of outstanding equity awards is provided in the new **Outstanding Equity Awards at Fiscal Year-End Table**. It essentially replaces the previous table of “Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year End Option/SAR Values.”

The table will disclose outstanding grants whose ultimate value is unknown and has not been realized (i.e., dependent on future results of certain measures). Included would be information regarding outstanding awards under stock option or SAR plans (for both unvested and vested awards); restricted stock plans; other equity-based incentive plans; and similar plans. Also disclosed would be the market-based values of the options (i.e., in-the-money value), rights, shares or units in question as of the company’s most recent fiscal year end. In addition:

- Information must be provided about individual grant exercise prices and expiration dates (which may result in a very lengthy table).
- The number of shares reported in the appropriate columns for equity incentive plan awards is based on threshold performance goals, unless the previous fiscal year’s performance exceeds the threshold. In that case, the next higher performance measure (target or maximum) that exceeds the previous year’s performance is reported. If the target amount cannot be determined, a representative amount based on the previous fiscal year’s performance should be reported.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END									
Name	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
PFO									
A									
B									
C									

The **Option Exercises and Stock Vested Table** is intended to enable investors to understand the value of equity realized by an NEO upon exercise of options or the vesting of stock during the most recent fiscal year. The valuation of restricted shares as of the date of vesting is a new disclosure requirement under this table.

OPTION EXERCISES AND STOCK VESTED				
Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized Upon Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
(a)	(b)	(c)	(d)	(e)
PEO				
PFO				
A				
B				
C				

## VI. POST-EMPLOYMENT COMPENSATION

This portion of the disclosure is organized in three sections: the **Pension Benefits Table**, the **Nonqualified Deferred Compensation Table**, and **Other Potential Post-Employment Payments Table**.

PENSION BENEFITS				
Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit (\$)	Payments During Last Fiscal Year (\$)
(a)	(b)	(c)	(d)	(e)
PEO				
PFO				
A				
B				
C				

The **Pension Benefits Table** is concerned with the estimated value of retirement benefits under defined benefit plans. This table replaces the current “Pension Plan Table” used to estimate benefits for an assumed compensation level and years of service, which does not currently require any such information on an individual basis.

Disclosure is based on the actuarial present value of the NEO’s accumulated benefit under the plan and the number of years of service credited to the NEO under each plan reported. Each value is calculated as of the pension plan measurement date for financial reporting purposes for the company’s last completed fiscal year and assuming normal retirement age and the executive’s current compensation. Each plan under which an NEO is eligible for payout is shown on a separate line. Allocation between qualified and non-qualified plans is made on the basis of current IRS compensation limits. A narrative disclosure following this table must discuss material factors necessary to understand the table, such as:

- The plan’s retirement benefit formula, eligibility standards and any early retirement arrangements.
- The specific elements of compensation included in the benefit formula.
- The purposes of each plan, in the case of multiple plans.
- Company policies regarding the award of additional years of service, such as multiple years of service for employment during a 12-month period.

<b>NONQUALIFIED DEFERRED COMPENSATION</b>					
<b>Name</b>	<b>Executive Contributions in Last FY (\$)</b>	<b>Registrant Contributions in Last FY (\$)</b>	<b>Aggregate Earnings in Last FY (\$)</b>	<b>Aggregate Withdrawals/ Distributions (\$)</b>	<b>Aggregate Balance at Last FYE (\$)</b>
<b>(a)</b>	<b>(b)</b>	<b>(c)</b>	<b>(d)</b>	<b>(e)</b>	<b>(f)</b>
PEO					
PFO					
A					
B					
C					

In contrast to previous rules that required reporting only of above-market earnings on deferred compensation, the **Non-Qualified Deferred Compensation Table** discloses all earnings as well as both NEO and company contributions; withdrawals and distributions; and each NEO's plan balances at fiscal year end. Only deferred compensation that is not tax-qualified is included.

To avoid double counting, the new rules require footnote disclosure to quantify contributions and earnings reported in the current SCT and those reported in earlier years. A narrative description following this table might include:

- The type(s) of compensation permitted to be deferred and any limitations on deferrals.
- The measures used to calculate interest or other plan earnings, including whether such measures are selected by the NEO, and the frequency and manner in which selections may be changed.
- Material plan terms for payouts, withdrawals and other distributions.

#### **Other Potential Post-Employment Payments**

Disclosure is now required with respect to “specific aspects” of any written or unwritten post-employment arrangements for each NEO, including resignation, severance, retirement and change-in-control arrangements. When the amounts payable in any given circumstance are uncertain, companies must provide a reasonable estimate or range, including the material assumptions used in the calculation. Narrative disclosure of termination and change-in-control provisions must include:

- The specific circumstances, such as a change-in-control, that would trigger compensation or benefits (including perquisite and health care benefits).
- The estimated payments and benefits provided in each termination circumstance; whether they would or could be lump-sum or paid over time; payment duration; and the entity providing the payments.
- The specific factors used to determine payment, benefit or perquisite levels under various triggering circumstances.
- Any agreements or provisions that would affect payments or benefits, such as non-compete, non-solicitation, non-disparagement or confidentiality covenants, including their duration and any provisions for waiver or breach of such agreements.
- Any other material features necessary to understand the programs and plans.

The new rules also clarify that amounts should be calculated assuming:

- The triggering event took place on the last business day of the company's last completed fiscal year.
- The share price of the company's securities is the closing market price as of that date.

Companies need not disclose payments or benefits under this requirement if they do not discriminate in scope, terms or operation, in favor of a company's executive officers and are available generally to all salaried employees. However, plans that include only top executives are reportable.

## VII. DISCLOSURE OF DIRECTOR COMPENSATION

In a major change from current disclosure rules, Director compensation will be quantified in a tabular format similar to the SCT, but will be limited to the past fiscal year.

DIRECTOR COMPENSATION							
Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
A							
B							
C							
D							
E							

No supplemental tables are required for Director compensation, but a narrative description is required of any material facts necessary to understand the table, such as a breakdown of fees. Fees paid in stock and in cash must be reported separately. Companies also must report in a footnote the aggregate numbers of stock awards and stock options outstanding at year end.

Under the All Other Compensation column, companies must disclose any additional Director compensation not reported in the other columns, generally under the same instructions provided for the SCT. This would include consulting fees, retirement plan contributions or accruals, insurance premiums, awards under director legacy or charitable awards programs, and any perquisites with a value of over \$10,000.

## VIII. BENEFICIAL OWNERSHIP DISCLOSURE

The new rules require supplemental footnotes to the existing beneficial ownership table that disclose any shares pledged as collateral for any loans taken by a Director or NEO, and all Directors and executive officers as a group.

## IX. CORPORATE GOVERNANCE DISCLOSURE

The SEC has amended existing rules to require additional disclosure of Compensation Committee governance, similar to that already provided by Audit Committees. Generally, companies must describe the processes and procedures in place for the consideration and determination of executive and Director compensation, including:

- The scope of authority of the Compensation Committee, or the persons performing the equivalent function.
- To whom and to what extent the Compensation Committee can delegate any authority.
- Any role of executive officers in determining or recommending the amount or form of executive and director compensation.

Companies must also describe any role of compensation consultants in determining or recommending the amount or form of executive and director compensation. The disclosure must include the identity of the consultants; whether they were engaged directly by the Compensation Committee or by another person; the nature and scope of their assignment; and the material elements of the instructions or directions given to the consultants with respect to the engagement.

## X. CHANGES TO FORM 8-K

The rules regarding compensation-related Form 8-K filings have been narrowed - a change that should result in substantially fewer such filings.

## XI. PLAIN ENGLISH REQUIREMENT

Proxy statements will now need to be written in “plain English” under the same language standards currently applied to the cover page, summary and risk factors sections of prospectuses. Public companies will need to re-evaluate the quality of their narrative presentation of executive and director compensation, with the SEC likely to comment on disclosure not considered consistent with the new plain English standard.

## XII. CONCLUSION

The disclosure rules dramatically change the form and substance of executive compensation disclosure. Given the far greater time and effort that will be needed to comply with the additional disclosures, we strongly encourage our clients and friends to begin compiling the data, drafting the CD&A and preparing the tables and associated narratives as soon as practicable.

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