Highlights of the New Executive Compensation Disclosure Rules and Related Rule Changes

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The SEC recently issued Release No. 33-8732, in which it significantly revised the compensation disclosure rules set forth in Item 402 of Regulation S-K and related requirements of Form 8-K. In its adopting release and other public statements, the SEC has emphasized that companies need to take a “principles-based approach,” with a view to providing investors with a complete picture of their compensation programs rather than disclosing only what would be required under a literal reading of the rules. The new rules also revise the requirements regarding related party transactions (now referred to as “related person transactions”), set forth in Item 404, and update various corporate governance-related disclosure requirements, consolidating them into a new Item 407 of Regulation S-K.

Most companies will need to implement the new rules during the 2007 proxy season. Preparation of the new disclosures will require substantial time and energy, and we urge you to begin the process as soon as possible. This Alert is intended to highlight the basic issues you will face under the new rules. We welcome your inquiries and would be happy to assist you as you work through your revised disclosures.

**Significant Changes Reflected in the Revised Rules**

- A new Compensation Discussion and Analysis (CD&A) must provide a narrative discussion regarding all material elements of compensation of Named Executive Officers (NEOs). The CD&A will be subject to the CEO/CFO certifications.

- The revised rules permit companies to omit confidential performance targets in their disclosures; however, if they do so, they must explain how difficult or likely it would be for the company or executive to reach those targets.

- The CFO, like the CEO, is always included as an NEO, regardless of compensation. Other NEOs are determined based on total compensation (excluding certain items), not just salary and bonus.

- Companies are required to disclose full FAS 123R grant-date fair values of stock and option awards.

- The Summary Compensation Table includes a new “total compensation” column.

- The threshold for perks disclosure has been reduced to $10,000.

- Certain option grant practices may trigger additional disclosure.

- Director compensation must be disclosed in a table similar to the Summary Compensation Table.

- The threshold for disclosure of related party transactions has been increased to $120,000.

- Companies must provide narrative disclosure describing policies and procedures for approving compensation and related person transactions.

- Companies must disclose, by category or type, relationships considered in assessing director independence.
Actions to Take Before Year-End

- Re-evaluate your disclosure controls and procedures in light of the amended disclosure requirements. In particular, be sure that the disclosure process involves persons who are also sufficiently involved in the compensation process that they can guide the drafting of the CD&A. Your disclosure committee should include a representative of HR and, if possible, a lawyer who is well versed in the compensation disclosure rules.

- Involve the compensation committee in the disclosure process, including the drafting of the CD&A. Make sure the members of the committee understand what disclosures are likely to flow from the committee’s decisions and the processes it follows.

- Consider whether you have sufficient staffing on the team that is responsible for collecting and analyzing executive and director compensation and assisting with the drafting of new disclosures.

- Carefully review payroll and other relevant records as well as compensation plans and employment agreements to get complete and accurate data on all compensation paid to executives and directors.

- Get a head start in preparing the new compensation disclosures, particularly those regarding potential benefits upon retirement, termination or change in control, which will require coordination with several functional areas, including HR and accounting.

- Conduct a run-through on all compensation tables and related calculations to identify additional information that may be needed to prepare your proxy statement, as well as any interpretive questions that may arise, as early as possible.

- Start early in drafting your CD&A. Do not wait until the compensation tables are completed.

- Remember that the new rules will apply retroactively to most companies. You should review all matters relating to compensation or related party transactions – particularly actions and deliberations of the compensation committee – that occurred before the new rules were adopted but may be subject to disclosure in your 2007 proxy statement. Review and document the processes and procedures followed by the compensation committee to the extent you have not already done so.

Additional Practical Tips are provided throughout the body of this Alert.
General Considerations

Effective Dates

Subject to the staggered transition described below, the new disclosure rules relating to compensation, related party transactions, corporate governance, and beneficial ownership will apply to:

<table>
<thead>
<tr>
<th>Forms 10-K/10-KSB . . .</th>
<th>. . . if they report fiscal years ending on or after December 15, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proxy, Information and Registration Statements . . .</td>
<td>. . . if they (1) are filed on or after December 15, 2006 and (2) require disclosure under Items 402 (executive compensation) and 404 (related party transactions) for fiscal years ending on or after December 15, 2006</td>
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</tbody>
</table>

Different effective dates apply to registered investment companies. It is important to note that the new rules will apply retroactively to most issuers (particularly those with December 31 or March 31 fiscal year-ends) in that their proxy disclosures in 2007 will cover periods that began before the rules were issued.

The amendments to Form 8-K will apply to triggering events that occur on or after November 7, 2006.

Staggered Transition for Prior-Year Disclosures

Companies will not be required to restate compensation or related person transaction information previously disclosed under the old rules. During the first compliance year, disclosure will address only the most recently-completed fiscal year. Filings for the second compliance year must include disclosure for the two most recently-completed fiscal years, and filings in all subsequent years will require disclosure for the three most recently-completed fiscal years.

For example, a calendar-year company will be subject to the following staggered transition:

<table>
<thead>
<tr>
<th>Proxy Statement filed in . . .</th>
<th>Summary Compensation Table must cover . . .</th>
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<tbody>
<tr>
<td>2007</td>
<td>2006</td>
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<tr>
<td>2008</td>
<td>2006 and 2007</td>
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<tr>
<td>2010 and later</td>
<td>Three most recent fiscal years</td>
</tr>
</tbody>
</table>

Plain English Required

Disclosures regarding executive and director compensation, beneficial ownership, related person transactions and corporate governance matters that are included in or incorporated by reference into an Exchange Act filing must be presented in plain English. This means, among other things, that the disclosures must:

- be presented in a clear, concise, and understandable manner, with descriptive headings;
- use the active voice, short sentences, and clear, concise sections, paragraphs and sentences; and
• use definite, concrete, everyday words rather than jargon and technical language.

Reproposa of “Katie Couric” Rule

The SEC has not adopted the requirement, included in the original rule proposal, that companies disclose compensation earned by up to three non-executive employees whose total compensation exceeded that of any of the NEOs. However, it has solicited additional comments regarding this requirement and may ultimately include it in time for the upcoming proxy season.

Executive Summary

This executive summary highlights several important features of the new rules. By clicking on the hyperlinked subject headings, you can jump directly to the corresponding discussion in the body of this Alert.

Disclosures Regarding Stock Option Practices

While the SEC stated that it neither encourages nor discourages the use of stock options, it does require full and fair disclosure of option compensation information. The adopting release includes several specific disclosure requirements regarding the grant date and exercise price of stock options.

Executive and Director Compensation Disclosure

Compensation Discussion and Analysis

The new Compensation Discussion and Analysis (CD&A) must explain material factors underlying the company’s NEO compensation policies and decisions and provide context to the detailed tabular disclosures. Each company must specifically tailor the CD&A to its compensation program.

Named Executive Officers

The principal financial officer, in addition to the principal executive officer, will now automatically be part of the NEO group. The other members of the NEO group will be determined based on total compensation less certain pension and deferred compensation.

Compensation Committee Report

Similar to the existing Audit Committee Report, a new Compensation Committee Report will state whether the compensation committee has reviewed and discussed the CD&A with management and recommended its inclusion in the company’s filings.

Summary Compensation Table

The Summary Compensation Table has been revised in several significant respects. Most notable: Stock and option awards must be disclosed at their grant-date fair value under FAS 123R; and the threshold for disclosure of perquisites and other personal benefits (perks) has been reduced to $10,000.
**Is It a Perk?**

Although the SEC does not define “perquisites and other personal benefits,” the adopting release does provide guidance for assessing whether an item is a perk. The outlines of the SEC’s guidance are presented in this flowchart:

- Is it integrally and directly related to the performance of the executive’s duties?
  - YES → Not a perk.
  - NO →
- Does it confer a benefit that has a personal aspect (regardless of whether it is provided for some business reason or for the convenience of the company)?
  - YES → It is a perk unless it is generally available on a non-discriminatory basis to all employees.
  - NO →

**Grants of Plan-Based Awards Table**

This new table requires disclosure regarding grants made to NEOs in the most recent fiscal year. Additional disclosure will be required if options have a grant date different than the date the board took action or an exercise price less than the market price of the underlying security on the date of grant.

**Additional Equity Compensation Disclosure**

- Outstanding Equity Awards at Fiscal Year-End table: Discloses information regarding options and restricted stock held by NEOs at fiscal year-end.
- Option Exercises and Stock Vested table: Discloses amounts received by NEOs upon exercise, vesting, or transfer of equity instruments during the last fiscal year.

**Post-Service and Change of Control Payments**

- Pension Benefits table and Nonqualified Deferred Compensation table: Disclose the actuarial present value of the accumulated benefit under retirement plans and earnings on and contributions to nonqualified deferred compensation.
- Potential Payments upon Termination or Change in Control: Discloses, in narrative form, arrangements that provide for payments to NEOs at or in connection with resignation, severance, retirement, or other termination; a change in responsibilities; or a change in control of the company. The $100,000 disclosure “floor” has been removed, so all such arrangements must be described.

**Director Compensation**

Tabular and narrative disclosure must describe all director compensation for the last fiscal year, except for perks aggregating less than $10,000.
**Performance Graph**

The performance graph has been retained, despite the SEC’s original proposal to eliminate it, but it has been moved to the annual report.

**Transactions with Related Persons**

The revised rules shift the emphasis of Item 404 from bright-line tests to a broader materiality analysis. The SEC also adopted a few specific changes, most significantly an increase in the disclosure threshold from $60,000 to $120,000. In addition, a company must now provide narrative disclosure of its policies and procedures regarding review and approval of such transactions and must specifically identify any related person transactions that were not approved pursuant to such procedures.

**Corporate Governance Disclosure**

The disclosure requirements regarding director independence, board committees and similar corporate governance matters have been updated and consolidated into a new Item 407 of Regulation S-K. A company must identify its independent directors and any members of its key committees who are not independent. For each director identified as independent, the company must describe, by category or type, any transactions (other than transactions disclosed separately under Item 404) that were considered by the board in connection with its determination of whether the applicable independence standards were met.

The disclosure requirements regarding audit, nominating, and compensation committees have been revised to provide greater consistency. The company is required to make disclosures regarding its compensation committee similar to the required disclosures regarding the nominating committee. Among other things, the company must describe its processes and procedures for determining executive and director compensation, including the scope of authority of the compensation committee and any role that executive officers and consultants had in determining or recommending executive or director compensation.

**Amendments to Form 8-K**

Form 8-K has been amended to exclude most forms of executive compensation from Item 1.01, which previously required many companies to report many routine compensatory matters regardless of materiality. This reporting requirement has been replaced by an expanded Item 5.02, under which companies must report material compensatory transactions or arrangements as well as transactions or arrangements that are entered into in connection with certain triggering events such as hiring or promotion of specified officers.

**Beneficial Ownership Table**

The beneficial ownership disclosure requirement under Item 403 of Regulation S-K has been amended to require footnote disclosure of the number of shares pledged as security by NEOs, directors and director nominees.

**Small Business Issuers and Foreign Private Issuers**

Some of the rules discussed below are relaxed for small business issuers and foreign private issuers.
Disclosures Regarding Stock Option Practices

Since the issuance of the original rule proposal in January, considerable interest has arisen among regulators, the media, and investors about potential abuses associated with various companies’ practices involving the granting of stock options. The SEC has modified the final rules somewhat to better address this issue. In the adopting release, the SEC stated that while it does not seek to encourage or discourage the use of stock options or any other particular form of executive compensation, it does believe that the federal securities laws require full and fair disclosure of compensation information to the extent material or required by SEC rule. To provide greater transparency concerning executive stock option grants, the SEC has expanded the scope of disclosure regarding option compensation and option grant policies.

The most significant change in option-related disclosure contemplated by the revised rules is a requirement, included in the original rule proposal, that companies disclose the fair value of each option on the date of grant as determined under Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (FAS 123R). Moreover, if the exercise price of an option is less than the closing market price of the underlying security on the date of grant, the new Grants of Plan-Based Awards table requires an additional column to show the grant-date closing price (similar to the old Option/SAR Grants in Last Fiscal Year table). Additionally, if the grant date is different from the date the compensation committee or full board of directors takes action to grant an option, the new rules require an additional separate adjoining column showing the date the compensation committee or full board took the action. Finally, if the exercise price of an option differs from the closing market price on the grant date, the new rules require a separate description of the methodology for determining the exercise price.

Timing of Option Grants

The new rules require disclosure about any linkage between the timing of option grants and the release of material nonpublic information. If the company has had since the beginning of the last fiscal year, or intends to have during the current fiscal year, a plan or practice to select option grant dates for executive officers in coordination with the release of material nonpublic information, the company must disclose that plan or practice in the CD&A. The rules address both accelerated release of negative information and delays in the release of favorable information in conjunction with stock option grants. It is important to note that the SEC explicitly declined to express any view as to whether or not a company could have appropriate reasons for timing of option grants, consistent with the company’s own business purposes. However, the SEC indicated that the existence of such a plan or practice would be material to investors and thus should be fully disclosed. The SEC specifically identified the following aspects of option timing for companies to consider when drafting this disclosure:

- Does the company have any plan or practice to time option grants in coordination with the release of material nonpublic information?
- How does any plan or practice to time option grants to executives fit into the context of the company’s plans or practices with regard to option grants to the broader pool of employees?
- What was the role of the compensation committee in approving and administering such a plan or practice? How did the committee take such information into account when determining whether and in what amount to make those grants? Did the committee delegate any aspect of the actual administration of the program to any other persons?
• What was the role of executive officers relating to the company’s plan or practice of option timing?

• Does the company set the grant date of its stock option grants to new executives in coordination with the release of material nonpublic information?

• Does the company plan to time or has it timed its release of material nonpublic information for purposes of affecting the value of executive compensation?

Finally, if a company has a plan or practice of awarding options and setting the exercise price based upon the stock price on a date other than the actual grant date, it is required to disclose this plan or practice. Additional disclosures regarding option granting practices may be required in the CD&A (discussed below).

**Practical Tips**

• Review option plans and compensation committee practices regarding option grants with a view to understanding whether exercise prices have been determined by a measure other than the closing market price on the grant date or whether any grant dates have varied from the date of board or committee action.

• Review option grants made since the beginning of the last fiscal year and consider whether there has been any coordination between the timing of option grants and the disclosure of material information, such as delaying a grant or delaying the release of positive news.

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**Executive and Director Compensation Disclosure**

The SEC has significantly revised Item 402 of Regulation S-K, which sets forth the disclosure requirements regarding executive and director compensation. It has introduced new narrative and tabular disclosures and revised and in some cases combined existing tables. The Board Compensation Committee Report on Executive Compensation has been replaced by the CD&A. The 10-Year Option/SAR Repricings table has been eliminated in favor of narrative disclosure.
New: Compensation Discussion and Analysis (CD&A)

**Key Changes**

- This new report requires a discussion of all material elements of NEO compensation.
- The CD&A in effect replaces the Board Compensation Committee Report on Executive Compensation, but differs in several significant ways:
  - The CD&A will be “filed,” not “furnished,” meaning, among other things, that it will be covered by the CEO and CFO certifications.
  - The old Compensation Committee Report was expected to discuss the company’s executive compensation program but was not required to specifically address the compensation of any individual other than the CEO, whereas the CD&A is required to address the compensation earned by all NEOs.
  - The old Compensation Committee Report was required to address specifically the connection between executive compensation and corporate performance, whereas the CD&A must discuss all material goals of the compensation program.
  - If confidential performance targets are omitted, the CD&A must discuss how difficult it will be for the executive, or how likely it will be for the company, to meet those targets.

The new Compensation Discussion and Analysis is designed to enable an investor to understand the company’s objectives, policies and decisions regarding compensation earned by or paid to NEOs. The CD&A must describe the factors most critical to analyzing the company’s NEO compensation principles and provide context to enhance a reader’s understanding of the tabular information. The CD&A should not merely recite statistics but should present thoughtful analysis. It must cover the last fiscal year and should also cover actions taken after the fiscal year-end that affect executive compensation. It may also be necessary to discuss prior years and/or post-termination compensation arrangements and policies that will be applied on a going-forward basis.

**Required Elements**

The CD&A must explain all material elements of NEO compensation by describing:

- the objectives of the company’s compensation programs;
- what the compensation program is designed to reward;
- each element of compensation;
- why the company chooses to pay each element;
- how the company determines the amount (and, where applicable, the formula) for each element; and
- how each element and the company’s decisions regarding it fit into the company’s overall compensation objectives and affect decisions regarding other elements.
**Illustrative Examples**

Examples of additional information that a company may be required to disclose are:

- policies for allocating between or among:
  - long-term and currently paid-out compensation;
  - cash and non-cash compensation;
  - different forms of non-cash compensation; and
  - different forms of long-term compensation awards;
- how the company determines when options and other awards are granted;
- what specific items of corporate performance are considered and how different forms of compensation are structured and implemented to reflect the specified performance items, including whether discretion can be or has been exercised, and the NEO’s performance or contribution, describing the elements of performance or contribution that are considered;
- policies and decisions regarding the adjustment or recovery of awards if the relevant performance measures are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;
- factors considered in decisions to materially alter compensation;
- how prior compensation or amounts realizable from prior compensation are considered in setting other elements of compensation;
- the impact (to the NEO or the company) of accounting and tax treatments of a particular form of compensation, including Section 162(m) of the Internal Revenue Code;
- the company’s security ownership requirements or guidelines and policies regarding hedging the economic risk of such ownership;
- whether the company engaged in any benchmarking of total compensation or any material element of compensation, identifying the benchmark and, if applicable, its components;
- the role of executive officers in the compensation process; and
- the basis for selecting particular triggering events for post-termination payments.

These topics are for illustrative purposes only. Each company must think holistically about its NEO compensation programs and why certain elements are used and clearly explain all elements of compensation and their purpose.

**Disclosure of Performance Targets**

Under the old rules, companies were not required to disclose target levels where disclosure would have an “adverse effect.” Although the new rules retain provisions allowing omission of target information, they apply a stricter standard and require additional disclosures in place of the omitted information. Under the new rules, companies will not be required to disclose performance targets involving confidential information if disclosure would result in competitive harm. The standard for exclusion is the same as for a confidential treatment request. Although it will not be necessary to submit a formal confidential treatment request, the SEC may require the company to substantiate its position regarding confidential treatment. In addition, if the company determines that the specific targets can be excluded, the CD&A must discuss how
difficult it will be for the executive, or how likely it will be for the company, to achieve the undisclosed target levels.

**CEO/CFO Certifications**

The CD&A will be considered soliciting material and will be deemed to be filed. To the extent the CD&A and any other disclosure regarding executive or director compensation is included or incorporated by reference into a periodic report such as the Form 10-K, the disclosure would be covered by the CEO/CFO certifications required by the Sarbanes-Oxley Act. The SEC has noted, however, that, in providing such certifications, the CEO and CFO will be able to look to the new Compensation Committee Report required by the revised rules, discussed below, in which the compensation committee will discuss its recommendation that the CD&A be included in the Form 10-K and proxy statement.

**Option Disclosures**

The CD&A should discuss any program, plan, or practice to select option grant dates in coordination with the release of material nonpublic information that has existed since the beginning of the last fiscal year or that will be implemented during the current fiscal year, as discussed above under “Disclosures Regarding Stock Option Practices.”

**Practical Tips**

- Approach the project organically by documenting how and why NEO compensation is set rather than recycling previous disclosures. Permit sufficient time for several drafts to be reviewed by HR, management, and compensation committee members, as well as outside advisors. *Do not wait until the compensation tables are completed before starting this process.*
- To support the disclosures that will be required in the CD&A, be sure that the deliberations of the compensation committee are adequately documented in the minutes, including deliberations made in executive session.

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Who Is a Named Executive Officer (NEO)?

**Key Changes**

- The CFO, like the CEO, is always included as an NEO, regardless of compensation.
- Other NEOs are determined based on total compensation (excluding certain items such as increase in pension values) not just salary and bonus, meaning that a large one-time payment such as a signing bonus or severance payment can affect NEO status.

Extensive tabular and narrative disclosure is required regarding the compensation of a company’s Named Executive Officers. As revised, the term “Named Executive Officers” will include:

- every person who served as principal executive officer (PEO) at any time during the last fiscal year, regardless of compensation;
- every person who served as principal financial officer (PFO) at any time during the last fiscal year, regardless of compensation;
- the three most highly compensated executive officers other than the PEO and the PFO; and
- up to two additional executives who would have been NEOs based on actual compensation earned, but for the fact that they were no longer serving as executives at the end of the year.

The most highly compensated executives are determined based on total compensation excluding (a) increases in pension values and (b) above-market or preferential earnings on nonqualified deferred compensation. An executive officer (other than the PEO or PFO) whose compensation calculated in this way does not exceed $100,000 will not be deemed an NEO. The instruction permitting the determination of the most highly-paid executives to exclude non-recurring cash compensation such as relocation bonuses has been omitted in the new rules.

**Practical Tip**

Because the factors in identifying NEOs are no longer limited to salary and bonus, it is more difficult to predict ahead of time who your NEOs will be as of the end of the fiscal year, and therefore, you should carefully monitor executive compensation throughout the year.

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**New: Compensation Committee Report**

In this new Compensation Committee Report, the compensation committee (or other board committee performing similar functions or, if there is no such committee, the entire board) must state whether it:

- reviewed and discussed the CD&A with management; and
- based on that review and discussion, recommended to the board that the CD&A be included in the Form 10-K and the proxy or information statement.

The names of each committee member must appear immediately following this report. The report will not be deemed to be soliciting material or filed, except to the extent that the company specifically requests such treatment or specifically incorporates it by reference into another document.

Note that this report bears no relation to the similarly-named report required under the old rules, which has been replaced by the CD&A, as discussed above.

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Summary Compensation Table

<table>
<thead>
<tr>
<th>Name and Principal Position</th>
<th>Year</th>
<th>Salary ($)</th>
<th>Bonus ($)</th>
<th>Stock Awards ($)</th>
<th>Option Awards ($)</th>
<th>Non-Equity Incentive Plan Compensation ($)</th>
<th>Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)</th>
<th>All Other Compensation ($)</th>
<th>Total ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NEOs</td>
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**Key Changes**

- A new “total compensation” column is required.
- The table must disclose of full FAS 123R grant-date fair value for stock and option awards and the change in value of accumulated benefit under defined benefit and actuarial pension plans.
- The threshold for disclosure of perquisites and other personal benefits (perks) has been reduced to $10,000.
- Relocation plans are no longer exempted from disclosure, even if they do not discriminate in favor of executives and are generally available to all salaried employees.
- The distinction between “annual” and “long-term” compensation has been removed.
- All deferred compensation must be reported, even if deferred at the company’s election.
- Compensation that cannot be calculated as of the date of filing must be disclosed on Form 8-K as soon as it can be calculated.

As under the old rules, revised new Summary Compensation Table requires disclosure of NEO compensation earned for each of the last three fiscal years (other than during the first two years of the phase-in period as discussed above).

All elements of compensation must be included in the table, with only two exceptions:

- Perquisites and other personal benefits provided to an NEO can be omitted if they aggregate less than $10,000 for the fiscal year.
- Information regarding group life, health, hospitalization, and medical reimbursement plans can be omitted if the plans do not discriminate in scope, terms or operation in favor of executive officers or directors and are available generally to all salaried employees. Unlike the old rules, the new rules will require disclosure of relocation plans even if they are available generally to other employees.

Compensation that was earned in the period, but for which payment has been deferred by the NEO or the company, must be included in the appropriate column of the table. This is a departure from prior practice, under which salary and bonus deferrals were reported only if deferred at the NEO’s election. If salary or bonus cannot be calculated as of the time of disclosure, the item may be omitted, but the company must include a footnote indicating the date when the salary or bonus is expected to be determined and, as soon as the amount has been determined, the company must report the compensation under Item 5.02 of Form 8-K.
**Practical Tip**

The lower disclosure threshold makes it significantly more likely that companies will be required to disclose perks. Companies should review their disclosure controls and procedures to make sure they are adequate for tracking usage of perks and their incremental cost.

**Bonus Compensation**

Bonus compensation consists of a cash award based on satisfaction of a performance target that was not pre-established and communicated to the NEO, or the outcome of which was not substantially uncertain. If the outcome was substantially uncertain and the target was communicated to the executive, the compensation is not considered bonus compensation but instead should be disclosed in the Non-Equity Incentive Plan Compensation column as well as the Grants of Plan-Based Awards table. Many companies may find that, under the new rules, compensation that had previously been treated as bonus compensation will now be deemed incentive plan compensation.

**Stock and Option Awards**

The new rules require disclosure of the full FAS 123R grant-date fair value of stock and option awards. The reported amount will often differ from the amount expensed on the income statement since the entire grant-date value must be disclosed for the year of grant rather than being amortized over the vesting period. For all stock and option awards, the company must provide a footnote disclosing all assumptions made for purposes of the FAS 123R valuation by reference to the company’s financial statements, notes to the financial statements or MD&A.

**Non-Equity Incentive Plan Compensation**

In this column, the company must disclose the dollar value of all amounts earned during the fiscal year pursuant to non-equity incentive plans, including earnings on outstanding awards. The new rules remove the old distinction between long-term and other incentive plans, instead relying on a single definition of incentive plan, of which equity incentive plans and non-equity incentive plans are treated differently. An “incentive plan” is one that provides compensation intended to serve as incentive for performance occurring over a specified period, whether performance is measured by reference to financial performance, stock price or otherwise. An “equity incentive plan” is an incentive plan involving awards that fall within the scope of FAS 123R as stock-based compensation; any other incentive plan is considered a “non-equity incentive plan.”

Disclosure is required in the year when the criteria are satisfied and compensation is earned, regardless of when it is paid and even if the award remains subject to forfeiture conditions. Any earnings on such compensation must be identified and quantified in a footnote.

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

This column must reflect the sum of:

- the aggregate change in the actuarial present value of the accumulated benefit under all defined benefit and actuarial pension plans; and
• all above-market or preferential earnings on nonqualified deferred compensation.

The full amount of each element must be identified and quantified in a footnote.

**All Other Compensation**

This column must reflect all compensation that could not properly be included in any other column. The "Other Annual Compensation" column that was used under the prior rules has been merged into this column is no longer presented separately. Each item for the last fiscal year (other than perks) that exceeds $10,000 must be separately identified and quantified in a footnote.

Items to be disclosed in the All Other Compensation column include:

• perquisites and other personal benefits, if the aggregate value is $10,000 or more in a fiscal year;
• amounts paid or accrued pursuant to a plan or arrangement in connection with any termination of employment or a change in control;
• company contributions or other allocations to defined contribution plans;
• the dollar value of any insurance premiums paid by the company with respect to life insurance for the benefit of the NEO;
• “gross-ups” or other amounts reimbursed during the fiscal year for the payment of taxes (even if they relate to perks that do not themselves need to be disclosed);
• the FAS 123R compensation cost of any company security purchased from the company at a discount from the market price, unless that discount is available generally to all security holders or to all salaried employees; and
• the value of any dividends or other earnings on stock-based compensation if not factored into the grant-date fair value of the award reported in another column of the Summary Compensation Table.

**Special Footnote Disclosures**

• Any required perks disclosure for the most recent fiscal year must be accompanied by a footnote identifying each perk by type (in sufficient detail to explain the nature of the benefit received). For each perk whose incremental cost to the company exceeds the greater of $25,000 or 10 percent of total perks, the company must disclose its aggregate incremental cost and the method used to calculate that cost.
• “Gross-ups” or other amounts reimbursed during the fiscal year for the payment of taxes must be separately quantified and identified in a footnote.

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Identifying Perks

Although the SEC has declined to define the term “perquisites or other personal benefits,” it has provided a two-step analysis to assist in identifying perks:

**Step 1**: Is the item integrally and directly related to the performance of the executive’s duties?

- The SEC narrowly construes “integrally and directly related,” distinguishing between an item provided because it is required to do the job and an item provided for some other reason that happens to also have a business purpose.
- It is irrelevant whether the company considers an expense “ordinary” or “necessary” for tax or other purposes or whether an expense is for the benefit or convenience of the company.

If the answer is “no,” go to **Step 2**.

If the answer is “yes”:

- the item is *not* a perk and no compensation disclosure is required;
- there is no requirement to disclose any incremental cost over a less expensive alternative, such as the price difference between flying first-class and coach; and
- it is irrelevant whether there is also a personal benefit or the item is not generally available to other employees.

**Step 2**: Does the item confer a direct or indirect benefit that has a personal aspect?

- The possibility that there may also be a business purpose does not affect whether an item is a perk.

If the answer is “no,” the item is most likely *not* a perk.

If the answer is “yes,” the item is a perk *unless* it is generally available to all employees on a non-discriminatory basis – *i.e.*, it is available to all employees to whom it may lawfully be provided.

The foregoing analysis is represented in the flowchart included above in the Executive Summary.

The SEC provides the following non-exhaustive list of items that constitute perks:

- club memberships not used exclusively for business entertainment purposes;
- personal financial or tax advice;
- personal travel at the company’s expense or using vehicles owned or leased by the company;
- personal use of other property owned or leased by the company;
- reimbursement for housing and other living expenses (including relocation assistance);
security provided at a personal residence or during personal travel;
reimbursement for commuting expenses (whether or not for the company’s convenience or benefit); and
discouts on the company’s products or services not available to employees on a non-discriminatory basis.

Companies should re-assess all items that could be classified as perks in light of this guidance. **It is important to note, however, that companies should not apply the SEC’s guidance mechanically but should use their own independent judgment regarding whether an item is truly excludable as a perk, consistent with a principles-based approach.**

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New: Grants of Plan-Based Awards Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Grant Date</th>
<th>Estimated Future Payouts Under Non-Equity Incentive Plan Awards</th>
<th>Estimated Future Payouts Under Equity Incentive Plan Awards</th>
<th>All Other Stock Awards: Number of Shares of Stock or Units (#)</th>
<th>All Other Option Awards: Number of Securities Underlying Options (#)</th>
<th>Exercise or Base Price of Option Awards ($/Sh)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Threshold ($), Target ($), Maximum ($)</td>
<td>Threshold (#), Target (#), Maximum (#)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NEOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Key Changes**

- Replaces the old Option/SAR Grants in Last Fiscal Year and Long-Term Incentive Plans – Awards in Last Fiscal Year tables.
- Additional columns may be required to explain particular option granting practices.
- Whenever the exercise price differs from the closing market price on the date of grant, the company must disclose the methodology used in setting the exercise price.

This new table requires disclosure regarding grants of plan-based awards to NEOs during the most recent fiscal year. Each award must be reported separately in the year it is granted, and, if more than one plan is used, each grant must be identified by plan. For incentive plan awards, the company must disclose threshold, target, and maximum payout information, similar to the Long-Term Incentive Plans table required under the old rules. Grants made in connection with a repricing are not reported in this table.

The following circumstances will require the inclusion of additional columns in the table:

- If the exercise price is less than the closing market price of the underlying security on the grant date, then the company must include a separate column showing the closing market price on the date of grant.
- If the grant date is different than the date the board or committee takes action, then the company must include a separate column showing the date on which action was taken.
• If a non-equity incentive plan award is denominated in units or other rights, then the company must include a separate column disclosing the units or other rights awarded.

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New: Narrative Discussion for Summary Compensation and Grants of Plan-Based Awards Tables

The new disclosures include a narrative description of any material factors necessary to an understanding of the Summary Compensation Table and the Grants of Plan-Based Awards table, in order to provide context to the quantitative disclosure. This discussion might include, among other things:

• material terms of NEO employment agreements;
• material terms of any awards disclosed in the Grants of Plan-Based Awards table;
• repricings or other material modifications of outstanding awards during the last fiscal year; and
• an explanation of the amount of salary and bonus in proportion to total compensation.

As with the CD&A, any discussion of performance-based conditions may omit confidential information if disclosure would result in competitive harm.

New: Outstanding Equity Awards at Fiscal Year-End Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Option Awards</th>
<th>Stock Awards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of Securities Underlying Unexercised Options (#) Exercisable</td>
<td>Number of Securities Underlying Unexercised Options (#) Unexercisable</td>
</tr>
<tr>
<td>NEOs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This table, which, together with the Option Exercises and Stock Vested table (discussed below) replaces the old Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option/SAR Value table, requires disclosure regarding outstanding awards at fiscal year-end under option, restricted stock, and other equity incentive plans, including awards that have been transferred other than for value. (An award transferred for value should be disclosed in the Option Exercises and Stock Vested table.) For performance awards, disclosure is based on achieving threshold performance goals, except that if performance for the previous fiscal year has exceeded the threshold, disclosure will be based on the next highest performance measure. If the target amount is not determinable, the company must provide an estimate based on performance during the previous fiscal year.
New: Option Exercises and Stock Vested Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Number of Shares Acquired on Exercise (#)</th>
<th>Value Realized on Exercise ($)</th>
<th>Number of Shares Acquired on Vesting (#)</th>
<th>Value Realized on Vesting ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NEOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This table discloses the net amounts realized upon exercise or transfer of options and similar instruments and upon the vesting of stock or similar instruments during the last fiscal year on an aggregated basis.

[Return to Executive Summary]

New: Pension Benefits Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Plan Name</th>
<th>Number of Years Credited Service (#)</th>
<th>Present Value of Accumulated Benefit ($)</th>
<th>Payments During Last Fiscal Year ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NEOs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Key Changes**

- This table replaces the old Pension Plan table.
- Separate disclosure is required for each NEO, unlike the old rules, which permitted aggregate disclosure.
- The company must disclose the present value of accumulated benefits rather than estimated future payment amounts at assumed levels of compensation and service.

This table requires disclosure of the actuarial present value of each NEO’s accumulated benefit, and the number of credited years of service, under any plan that provides for payments or other benefits at, after, or relating to retirement. Both values must be calculated as of the pension plan measurement date used with respect to the audited financial statements for the last completed fiscal year, using the same assumptions (such as interest rates) used for GAAP purposes, except that retirement age is assumed to be normal retirement age as defined in the plan or, if not so defined, the earliest retirement date permitted without benefit reduction. The estimate should be based on the NEO’s current compensation.

This table must be followed by a narrative description of material factors necessary to an understanding of the table, including the valuation method and all material assumptions or a reference to such description in the MD&A or financial statements. The narrative may need to address:

- the material terms and conditions of payments and benefits available under the plan, including the normal retirement payment and benefit formula and eligibility standards, and the effect of the form of benefit elected on the amount of annual benefits;
• if any NEO is currently eligible for early retirement, the identity of the NEO and a description of the plan’s early retirement payment and benefit formula and eligibility standards;
• the specific elements of compensation, such as salary and bonus, included in applying the benefit formula, identifying each such element;
• the different purposes for multiple plans; and
• company policies regarding such matters as granting extra years of credited service.

New: Nonqualified Deferred Compensation Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Executive Contributions in Last FY ($)</th>
<th>Registrant Contributions in Last FY ($)</th>
<th>Aggregate Earnings in Last FY ($)</th>
<th>Aggregate Withdrawals/ Distributions ($)</th>
<th>Aggregate Balance at Last FYE ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>NE Os</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

This new table must disclose information regarding nonqualified deferred compensation, including contributions, distributions, and earnings (not limited to preferential earnings). In footnotes, the company must disclose the extent to which (a) amounts in the contributions and earnings columns are reported as compensation in the last completed fiscal year of the Summary Compensation Table and (b) amounts reported in the aggregate balance at the last fiscal year-end column were reported previously in the Summary Compensation Table for prior years.

The company must also provide narrative disclosure regarding the material factors necessary to an understanding of the disclosure in the table, such as:

• the type(s) of compensation permitted to be deferred and any limitations on deferral;
• the measures for calculating interest or other plan earnings (including whether such measures are selected by the NEO or the company and the frequency and manner in which such selections may be changed), quantifying interest rates and other earnings measures applicable during the company’s fiscal year; and
• material terms with respect to payouts, withdrawals, and other distributions.

Potential Payments upon Termination or Change In Control

Key Changes

• The new rules require more detailed disclosure, including quantitative disclosure of potential payments under given circumstances.
• The $100,000 threshold for disclosure of severance or change-in-control arrangements has been eliminated.

Companies must disclose arrangements that provide for payments to an NEO at, following, or in connection with resignation, severance, retirement, or other termination; a change in the NEO’s responsibilities (whether or not in connection with a change in control); or a change in control of the company. Disclosure regarding severance or change-in-control arrangements is no longer limited to arrangements involving payments in excess of $100,000.
Disclosure must include:

- the specific circumstances that would trigger payment or the provision of other benefits;
- the estimated payments and benefits that would be provided in each circumstance and whether they would or could be lump sum or annual, disclosing the duration and by whom they would be provided;
- how the appropriate payment and benefit levels are determined under the various circumstances that would trigger payments or provision of benefits;
- any material conditions or obligations applicable to the receipt of payments or benefits, including non-compete, non-solicitation, non-disparagement, and confidentiality covenants; and
- any other material factors regarding each such arrangement.

Nondiscriminatory benefits need not be discussed. Post-termination perks must be disclosed, subject to the same disclosure and itemization thresholds described above for the Summary Compensation Table.

The company is also required to provide quantitative disclosure regarding the benefits to be received under each arrangement, assuming that:

- the triggering event occurred on the last business day of the company’s last completed fiscal year; and
- the price per share of the company’s securities is the closing market price as of that date.

When uncertainties exist regarding amounts payable, the company must provide a reasonable estimate (or a range of reasonable estimates) and disclose material assumptions underlying such estimates.

If a triggering event has occurred for an NEO who was not serving as an NEO at the end of the last completed fiscal year, disclosure is required only with respect to the actual triggering event.

Practical Tip

When preparing to draft this disclosure under the revised rules, carefully review all agreements regarding the employment and termination of executives, in order to fully understand the factors affecting potential separation payments.
New: Director Compensation Table

<table>
<thead>
<tr>
<th>Name</th>
<th>Fees Earned or Paid in Cash ($)</th>
<th>Stock Awards ($)</th>
<th>Option Awards ($)</th>
<th>Non-Equity Incentive Plan Compensation ($)</th>
<th>Change in Pension Value and Nonqualified Deferred Compensation Earnings</th>
<th>All Other Compensation ($)</th>
<th>Total ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Directors</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Key Changes**

- Director compensation must be quantified in a table similar to the Summary Compensation Table.
- Disclosure of a director’s perquisites is not required if they totaled less than $10,000 for the fiscal year.

Under the revised rules, director compensation must be reported on a table similar to the Summary Compensation Table. All director compensation for the last fiscal year must be disclosed, except that if perquisites total less than $10,000, they do not need to be disclosed. All directors who received identical compensation may be presented in a single row. The aggregate numbers of stock awards and option awards outstanding at fiscal year-end must be disclosed in footnotes. The All Other Compensation column involves substantially the same disclosure requirements as the comparable column in the Summary Compensation Table.

The table must be followed by a narrative discussion that discloses any material factors necessary to an understanding of the table, such as a breakdown in types of fees, and option timing or dating practices.

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**Third-Party Arrangements**

Item 402 requires disclosure of all transactions between the company and a third party, the principal purpose of which is to furnish compensation to an NEO or director. Item 402 no longer includes an instruction allowing omission of information already disclosed under Item 404. Thus, in some cases, compensation information may be required under Item 402, while disclosure of the related person transaction giving rise to the compensation will also be required under Item 404.

**Performance Graph**

Although the SEC originally proposed to eliminate the performance graph, the final rules instead move it to Item 201 of Regulation S-K, to be included in the annual report. Under the revised requirements, companies that use performance measures other than total return will no longer be required to explain the link between that measure and executive compensation, but will need to ensure that the meaning of any such measure is made clear.

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Transactions with Related Persons

Item 404 of Regulation S-K has been revised to streamline and modernize the disclosure requirements pertaining to financial relationships and transactions with directors, executive officers and significant shareholders (now referred to as “related person transactions”). The revisions retain long-standing principles for disclosure of related person transactions that are currently followed by Item 404, but omit some of the bright-line tests for determining what transactions are reportable or excludable in favor of a broader materiality analysis.

Key Changes

- The disclosure threshold has been increased from $60,000 to $120,000.
- A company may be required to disclose a transaction in which it is a “participant,” though not technically a “party.”
- Item 404(b), which covered specific types of business relationships with outside directors, such as affiliation with a company whose sales to the issuer exceed five percent of either party’s gross revenues for the past fiscal year, has been eliminated.
- A new Item 404(b) requires disclosure regarding the company’s policies and procedures relating to approval of related person transactions.

Broad Principle of Disclosure

Consistent with its principles-based approach, the SEC has eliminated some of the specific disclosure requirements and safe harbors previously included in Item 404 in favor of a general disclosure requirement set forth in Item 404(a). Under this item, a company must provide disclosure regarding any transaction since the beginning of its last fiscal year, or any proposed transaction, in which:

- the company was or is to be a participant;
- the amount involved exceeds $120,000; and
- any related person had or will have a direct or indirect material interest.

The materiality of such interest is determined based on the significance of the information to investors in light of the circumstances. Among the factors to be considered in evaluating materiality are the relationship of the related person to the transaction and to other related persons (if any) involved in the transaction, the importance of the interest to the related person and the amount involved in the transaction.

The reference to the company as a “participant,” as opposed to the previous term “party,” is intended to make it clear that disclosure may be required when the transaction affects the company even if the company is not technically a party to the transaction.

Definitions

Revised Item 404(a) relies on a number of defined terms.
“Transaction”

The term "transaction" is intended to be interpreted broadly. It includes, but is not limited to, any financial transaction, arrangement, or relationship (including any indebtedness or guarantee of indebtedness), or any series of similar transactions, arrangements, or relationships.

“Related Person”; “Immediate Family Member”

<table>
<thead>
<tr>
<th>Key Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The rule makes it clear that a transaction involving a director or executive officer may trigger disclosure even if the individual is no longer serving in that position or was not serving in that position at the time of the transaction.</td>
</tr>
<tr>
<td>• Immediate family members now specifically include stepchildren, stepparents, and persons sharing a household with the related person.</td>
</tr>
</tbody>
</table>

The term “related person” is defined according to a person’s relationship with the company not at the time disclosure is made, but at or near the time of the transaction in question.

The following persons are deemed to be related persons with respect to a transaction if the specified relationship spanned any portion of the time period for which disclosure is required under Item 404(a):

• any director or executive officer of the registrant;
• any nominee for director (if the disclosure document is a proxy or information statement pertaining to an election of directors); or
• any immediate family member of such person. “Immediate family member,” in turn, means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of such person, or any person (other than a tenant or employee) sharing the household of such person.

The following persons are deemed to be related persons with respect to a transaction if the specified relationship existed at the time of the transaction:

• any person or group known to the registrant to be the beneficial owner of more than five percent of any class of voting securities; or
• any immediate family member of such person.

Calculating Amounts Involved

The amount involved in a transaction is computed based on the dollar value of the transaction (including transactions denominated in other currencies). Specific instructions are provided with respect to periodic payments or installments and indebtedness:

• In the case of any transaction providing for periodic payments or installments, such as a lease, the amount involved includes the aggregate amount of all periodic payments or installments due on or after the beginning of the last fiscal year, including any required or optional payments due at or prior to the conclusion of the transaction term.
• In the case of indebtedness, the amount involved consists of the largest aggregate amount of all indebtedness outstanding at any time since the beginning of the last fiscal year and all amounts of interest payable on it during the last fiscal year.

Disclosure Requirements

Related person transactions are subject to substantially the same disclosure requirements as under the old rules. The company must disclose, among other things, the related person’s interest in the transaction, the amount involved, and any other information that is material to investors.

In the case of indebtedness, the company must disclose the largest aggregate amount of principal outstanding during the period for which disclosure is provided, the amount thereof outstanding as of the latest practicable date, the amount of principal and the amount of interest paid during the periods for which disclosure is provided, and the rate or amount of interest payable on the indebtedness.

Two disclosure requirements are eliminated under the revised rules:

• special disclosure regarding the cost of assets that are purchased or sold otherwise than in the ordinary course of business; and
• indebtedness relating to amounts possibly owed under Section 16(b) of the Exchange Act as a result of short-swing profits earned by the related person.

Special Rules Regarding Indebtedness

The instructions to Item 404(a) include specific provisions pertaining to indebtedness:

• Indebtedness arising from transactions in the ordinary course of business, including purchases of goods or services subject to usual trade terms and ordinary business travel or expense payments, is excluded.
• Indebtedness need not be disclosed if the borrower is a related person solely as a result of stock ownership.
• If the lender is a bank, savings and loan association, or broker-dealer extending credit under Federal Reserve Regulation T, under normal circumstances the indebtedness will be covered by an instruction that permits a general statement about the terms and circumstances surrounding the loan in place of the detailed disclosure otherwise required by Item 404(a).

Exception Relating to Compensation

The revised rules contain an exception, similar to one contained in the previous rules, designed to reconcile the disclosure rules governing related person transactions and those governing executive compensation. Disclosure of an employment relationship or transaction involving an executive officer and any compensation arising solely from that relationship or transaction is not required under Item 404 if:

• the compensation is reported under Item 402; or
• The executive officer is not an immediate family member and such compensation (1) would have been reported under Item 402 if the executive officer was an NEO and (2) has been approved or recommended for approval by the compensation committee or a group of independent directors performing a similar function.

Similarly, disclosure of compensation to a director is not required under Item 404 if it is reported as director compensation pursuant to Item 402(k).

**Interests Deemed Not to Be Material**

The revised rules retain the existing provisions under which the interest of a related person in a transaction is deemed not to be material where the person's interest arises solely from such person's position as a director and/or minor equity owner of the entity or as a limited partner with a minor interest in the entity. However, a provision in the old rules excluding transactions that are not material to the other entity has been eliminated due to a concern that transactions that would otherwise be material to investors could escape disclosure.

**Procedures for Approval of Related Person Transactions**

The revised rules include a new requirement, set forth in Item 404(b), for disclosure of the policies and procedures established by a company and its board of directors regarding related person transactions. The company must describe its policies and procedures for review, approval, or ratification of any transaction required to be reported under Item 404(a). Although the material features of such policies and procedures will vary depending on circumstances, the adopting release lists some examples of features that may be included:

- the types of transactions that are covered;
- the standards to be applied;
- the members of the board or other persons who are responsible for applying such policies and procedures; and
- a statement of whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced.

The company is required in most cases to identify any transaction covered by Item 404(a) as to which such policies and procedures did not require review, approval, or ratification or such policies and procedures were not followed. However, the company is not required to identify any such transaction that occurred before a director, executive officer, or nominee became a related person unless the transaction continued afterward, because the company ordinarily would not be in a position to anticipate that such transaction would later be deemed a related person transaction.

**Promoters and Certain Control Persons**

The rules previously set forth in Item 404(d) requiring certain disclosures regarding promoters in registration statements on Form S-1 or SB-2 or Form 10 or 10-SB are retained in Item 404(c) of the new rules, but the requirements now apply to any registrant that has had a promoter at any time during the past five fiscal years, whereas the previous requirements applied only to any registrant organized within the past five years. The revised rule also extends these disclosure requirements to any person, or a member of any group, who has acquired control of a registrant that is a shell company.
Practical Tips

- To prepare for the new disclosure requirements, review all transactions with related persons with a view to whether they are material and need to be disclosed. Pay particular attention to transactions with non-employee directors who may previously have been covered by the safe harbors set forth in the old Item 404(b).

- Review any related person transactions that occurred during 2006, as well as your procedures for approving such transactions. Consider whether additional written policies should be adopted in light of the new disclosure requirements.

- Review the membership of the compensation committee to verify that there will not be related person disclosure with respect to any of the members as a result of the rule changes. If the rule changes result in new related person transaction disclosure regarding a non-employee director, that director will no longer qualify as a non-employee director for purposes of Rule 16b-3 or an outside director for purposes of Section 162(m).

- To avoid related person disclosure regarding compensation of executive officers other than NEOs, make sure that the compensation committee approves all such compensation or recommends such compensation for approval by the board.

Corporate Governance Disclosure

The SEC has adopted a new Item 407 of Regulation S-K, which consolidates its disclosure requirements regarding director independence and related corporate governance matters and updates the disclosure requirements regarding director independence to reflect current SEC requirements and exchange listing standards.

Director Independence

Key Changes

- Specific disclosure regarding independence of committee members now covers compensation committees as well as audit and nominating committees.

- An issuer that has adopted policies further defining independence for directors or committee members must disclose whether such policies are posted on its web site.

- A company must describe transactions, relationships, or arrangements that were considered by the board in determining whether a director was independent.

A company must identify its independent directors, as well as independent nominees in the case of proxy disclosures, as determined under the applicable rule for determining board independence. The company must also disclose any members of its compensation, nominating, or audit committee whom it has not identified as independent under the applicable rule for determining independence for that committee. If the company is listed on a national securities exchange or similar system, or has applied for listing in connection with its IPO, the applicable independence rules will be those set forth in the exchange’s listing standards. If the company is not a listed issuer, it must specify an exchange or similar system whose listing standards it will look to in determining independence.
If a listed company has relied on an exemption to an independence requirement set forth in the applicable listing standards, such as Nasdaq’s controlled company exemption, the company must disclose the exemption relied upon and explain the basis for its conclusion that such exemption is applicable. Similar disclosure is required for companies that are not listed issuers but would qualify for an exemption under the specified listing standards.

An issuer that has adopted policies further defining independence for directors or committee members must disclose whether such policies are posted on its web site. If the policies are not included on its web site, the company must periodically include the policies as an appendix to its proxy statement.

For each director or nominee identified as independent, the company must describe, by specific category or type, any transactions, relationships, or arrangements not disclosed under Item 404(a) that were considered by the board in determining that the applicable independence standards were met. The company need not disclose the specific details of each transaction, but the description of the category or type must be sufficiently detailed so that the nature of the transactions, relationships, or arrangements is readily apparent.

This independence disclosure is required with respect to any person who served as a director during any part of the year for which disclosure is required, including persons who no longer serve as directors or are not standing for reelection. However, a registration statement filed by a company that is not subject to the Exchange Act reporting requirements may omit such disclosure with respect to any person who is no longer a director at the time of effectiveness of the registration statement.

Practical Tip

Take care to document the relationships considered by the board when determining which directors are independent.

Disclosures Regarding Committees

Key Changes

- The compensation committee charter must be made available to shareholders. All committee charters may be posted on the company’s web site in lieu of being delivered to shareholders as part of the proxy materials.
- The company must describe its processes and procedures for determining compensation.

The SEC has amended the disclosure requirements regarding audit, nominating, and compensation committees to provide greater consistency in the disclosures that are required regarding each committee. In addition, various disclosure requirements relating to committees have been consolidated into Item 407.

Under the revised rules, a company must state whether its compensation committee has a charter and, if it does, make the charter available through its web site or proxy materials as is required with the nominating committee charter. The company must describe its processes and procedures for determining executive and director compensation, including:
• the scope of authority of the compensation committee;
• the extent to which the committee may delegate authority to others, specifying what
  authority may be so delegated and to whom;
• any role of executive officers in determining or recommending the amount or form of
  executive or director compensation; and
• any role of compensation consultants in determining or recommending the amount or form
  of executive or director compensation (identifying such consultants, stating whether they are
  engaged directly by the committee or any other person, and describing the nature and
  scope of their assignment and the material elements of the instructions or directions given to
  the consultants with respect to the performance of their duties).

**Practical Tip**

Document the processes and procedures used by the compensation committee for
determining executive and director compensation, including any past processes and
procedures followed earlier in 2006 that will need to be discussed in the 2007 proxy statement.

**Consolidation of Board- and Committee-Related Disclosure Requirements**

The following matters, previously covered in other disclosure rules, are now covered in Item 407:

• director independence (previously set forth in Schedule 14A and exchange listing
  standards);
• attendance at board and committee meetings and director attendance at annual meetings
  (previously, Schedule 14A);
• audit committee report (previously, S-K Item 306);
• audit committee financial expert (previously, S-K Item 401);
• compensation committee interlocks and insider participation (previously, S-K Item 402);
• other information pertaining to audit committees, nominating committees, and compensation
  committees (previously, Schedule 14A); and
• shareholder communications with directors (previously, Schedule 14A).

**Departure of Directors**

For most registrants, the revised rules eliminate the proxy disclosure requirement regarding
directors who have resigned or declined to stand for reelection, which has been superseded by
Item 5.02 of Form 8-K.

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Amendments to Form 8-K

In both the original proposal and the final rules, the SEC noted that its experience in reviewing Form 8-K reports with respect to executive compensation matters had led it to conclude that companies were disclosing executive compensation matters that did not always appear to be material. As a result, the SEC has revised Items 1.01 and 5.02 of Form 8-K to require disclosure of employee compensation events that more clearly satisfy the standard of being unquestionably or presumptively material. The SEC noted that the problems arose because the standard for disclosure under Item 1.01 was tied to the standard for filing of material contracts under Item 601(b)(10) of Regulation S-K, a portion of which treats certain agreements with NEOs as presumptively material. This resulted in reporting of routine compensation events that were historically disclosed, if at all, in a company’s annual proxy statement or as an exhibit to the next Form 10-Q or 10-K.

In an effort to restore a more balanced approach to this aspect of Form 8-K disclosure (recognizing that such “real-time” disclosure should be limited to items which are unquestionably or presumptively material), the amendments to the Form 8-K uncouple Item 601(b)(10)(iii) of Regulation S-K from the disclosure requirements of Form 8-K. As a result, employment compensation arrangements are no longer covered by Item 1.01 of Form 8-K but instead are governed by the expanded Item 5.02. The deletion of management compensation and compensatory plans from Item 1.01 also applies to disclosure of termination or amendments of material definitive agreements under Item 1.02.

Item 5.02 currently requires disclosure of personnel changes involving a company’s principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions. As originally adopted, Item 5.02 required a brief description of the material terms of any employment arrangement between the company and the officer. The SEC has modified Item 5.02 to incorporate information regarding employment compensation arrangements involving the NEOs (based on the NEOs listed in the most recent Summary Compensation Table included in an SEC filing). The revised rules:

- expand the information regarding retirement, resignation, or termination to include all NEOs;
- expand Items 5.02(c) and (d) to require a brief description of any material plan, contract, or arrangement (or material amendment thereto) and any grant or award (or modification thereof) in connection with the appointment of any principal executive officer, principal financial officer, president, principal accounting officer, principal operating officer, or persons performing similar functions, or the appointment of any director other than by a vote of stockholders;
- expand Item 5.02 to require a brief description of any material new compensatory plan, contract, or arrangement (or material amendment to an existing arrangement) with, or any material grant or award to, any principal executive officer, principal financial officer, or NEO, provided that disclosure of grants, awards, or modifications thereof will not be required if they are consistent with the terms of previously disclosed plans or arrangements and they are disclosed the next time the company is required to provide new compensation disclosure under Item 402 of Regulation S-K; and
- add a requirement for disclosure of salary or bonus for the most recent fiscal year (as well as updated total compensation) if that information was not available at the latest practicable date in connection with previous disclosure under Item 402 of Regulation S-K.
The SEC has emphasized that it is looking for disclosure that informs investors of specified material events or developments, not information required to update the full disclosure required under Item 402 of Regulation S-K.

Finally, the rules expand the existing limited safe harbor for failure to file reports required by certain sections of Form 8-K to include the reports required by Item 5.02(e) of Form 8-K. As a result, a company would neither lose its eligibility to use Form S-3 or be subject to liability under Section 10(b) of the Exchange Act and Rule 10b-5 if it failed to timely file a report required by Item 5.02, provided certain conditions were met.

Practical Tips

• Update your disclosure controls and procedures in light of the revised Form 8-K disclosure requirements.
• Verify that your controls and procedures are sufficient to track any salary or bonus amounts that were previously omitted from the Summary Compensation Table because they could not yet be calculated.

Beneficial Ownership Table

The beneficial ownership disclosure requirement under Item 403 of Regulation S-K has been amended to require footnote disclosure of the number of shares pledged as security by NEOs, directors, and director nominees. This includes not only shares put up as collateral for a loan but also shares held in a margin account. Persons listed on the beneficial ownership table solely by virtue of their being significant shareholders are not covered by this requirement, except to the extent such a pledge could result in a change of control. The beneficial ownership table has also been revised to require disclosure of directors’ qualifying shares.

Practical Tip

Be sure that your form of director and officer questionnaire asks about arrangements that could be deemed to involve a pledge of shares, such as margin accounts.

Small Business Issuers and Foreign Private Issuers

Small Business Issuers

Under Item 402 of Regulation S-B, a small business issuer is required to provide the following compensation disclosure items, along with related narrative disclosure:

• Summary Compensation Table (excluding pension plan disclosure) covering the last two fiscal years;
• Outstanding Equity Awards at Fiscal Year-End table; and
• Director Compensation table.
The NEO disclosure need only cover the CEO and the two other most highly compensated executives.

The changes to related person transaction disclosure set forth in Item 404 of Regulation S-B are similar to the changes to Item 404 of Regulation S-K, except that:

- small business issuers are not required to discuss policies and procedures for reviewing related person transactions; and
- the dollar threshold is the lesser of $120,000 or one percent of the average of the small business issuer’s total assets at year-end for the last three completed fiscal years.

Foreign Private Issuers

A foreign private issuer may satisfy its obligation to disclose executive and director compensation by providing the information required by Items 6.B. and 6.E.2. of Form 20-F. Additional information must be provided if it has otherwise been made publicly available or was required to be disclosed by the issuer’s home jurisdiction or trading market.

Similarly, a foreign private issuer is deemed to satisfy its obligation to disclose related person transactions by providing the information required by Item 7.B. of Form 20-F and such additional information as has been made publicly available or was required to be disclosed by the issuer’s home jurisdiction or trading market.

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