

COMPLIANCE WEEK

New SEC Guidance On Pay Disclosure Rule

By Melissa Klein Aguilar — January 30, 2007

Companies struggling with their proxy statements under the Securities and Exchange Commission's new rules for disclosing executive and director compensation, take note: The SEC staff has issued 18 pages of guidance in the form of frequently asked questions you will want to review.

The FAQs are divided into "Questions and Answers of General Applicability" and "Interpretive Responses Regarding Particular Circumstances;" they address questions related to equity awards, performance-based arrangements, perquisites, and pension calculations, among other items.






Dicker

"The staff guidance is welcome news as companies agonize over satisfying the requirements of the new rules," says Howard Dicker, a partner at law firm Weil Gotshal & Manges. Dicker also says the guidance is good news for investors: "Published guidance helps the staff get a uniform message out, which promotes more comparable disclosures between companies that are dealing with similar interpretive uncertainties."

Among other points, the compensation FAQs:

- Confirm that the same disclosures applicable for option grants—including the disclosure of grant date, if the exercise price was less than the closing price on the grant date, and the date the compensation committee took action if different than the grant date—are applicable for other forms of equity grants, such as restricted stock.
- Confirm that the Compensation Discussion and Analysis must, depending on a company's circumstances, include disclosures about prior option grants, plans, or practices that occurred outside of the fiscal year for which compensation is being presented.
- Clarify when a company may omit disclosure of performance target levels. Generally, the company must determine that the information must constitute confidential commercial or financial information, the disclosure of which would cause competitive harm. Information that has been previously disclosed may not be omitted from the proxy, based on the theory it is confidential. If information is withheld, the company must discuss how difficult it will be to achieve the undisclosed target. The SEC continues to warn that it will likely question issuers about any information withheld for confidential reasons if it reviews the issuer.


RELATED RESOURCES

-  SEC's Item 402 FAQs (Jan. 24, 2007)
-  SEC Release On Executive-Compensation Amendments (Dec. 22, 2006)
-  SEC's Interim Final Rule On Executive Compensation Disclosure (Dec. 22, 2006)

Related Coverage

-  Pay Pops Up As Proxy Season Hot Potato (Jan. 30, 2007)
-  SEC Comp Rule Change Reboots Proxy Work (Jan. 9, 2007)
-  Compliance In 2007: Implementing 2006 (Jan. 3, 2007)
-  In Wake Of Comp Rule, Perks In Crosshairs (Nov. 7, 2006)
-  Some Companies Embracing SEC Pay Proposals Now (March 7, 2006)
-  SEC Plan Expected To Ease Comp-Related 8-K Filings (Feb. 14, 2006)

- Address the issue of how an equity grant made after the fiscal year-end is reported, if it related to the completed fiscal year. The SEC clarified that an equity award made after the end of the year isn't going to be reported in the grants of plan-based awards table and likely won't show up in the summary compensation table, but probably will need to be disclosed in the CD&A, particularly since it was awarded as a result of performance in the last completed fiscal year, says Dicker. "A lot of companies make awards after the end of the year in respect of performance last year. There had been a practice at some companies of including that post-end-of-year award in the last fiscal year disclosure."
- Clarify that if a perquisite has no aggregate incremental cost to the company, it must still be disclosed by type.
- Clarify that any item for which an executive officer has fully reimbursed the company for its total cost should not be considered a perquisite, and therefore doesn't need to be identified separately by type.

 Executive Pay: And Now, The Comments Begin... (Jan 24, 2006)

Dicker says the guidance on perks may be surprising to some companies. "There was debate among practitioners as to whether something with no aggregate incremental cost needed to be identified," he says. While the guidance is helpful, he says companies might need more clarification on specific issues.



Smith giving.

Edward Smith, a partner at the law firm Chadbourne & Parke, says that guidance on pension calculations in the FAQs seems to be inconsistent with Item 402, but confirms oral advice that the SEC staff has been

An instruction to Item 402(h)(2) specifies that in calculating the actuarial present value of a named executive officer's accumulated pension benefit, the assumed retirement age is to be the normal retirement age as defined in the plan or, if not defined, the earliest time at which the named executive officer may retire and receive a benefit that is not reduced for payment commencing before normal retirement age. But in the FAQ, Smith says, the SEC states that if a retirement plan does pay an unreduced benefit starting at an earlier age, the younger age should be used for determining pension benefits even if the plan does have a definition of normal retirement age.

Smith also notes that the FAQs assemble in one place guidance the staff has been providing during various Web casts about the reporting of annual

FAQs

An excerpt follows from the SEC's frequently asked questions concerning executive compensation.

Question: If a person that was not a named executive officer in fiscal years 1 and 2 became a named executive officer in fiscal year 3, must compensation information be disclosed in the Summary Compensation Table for that person for all three fiscal years?

Answer: No, the compensation information only for fiscal year 3 need be provided in the Summary Compensation Table.

* * *

Question: Should a discretionary cash bonus that was not based on any performance criteria be reported in the Bonus column (column (d)) of the Summary Compensation Table pursuant to Item 402(c)(2)(iv) or in the Non-equity Incentive Plan Compensation column (column (g)) pursuant to Item 402(c)(2)(vii)?

Answer: The bonus should be reported in the Bonus column (column (d)). In order to be reported in the Non-equity Incentive Plan Compensation column (column (g)) pursuant to Item 402(c)(2)(vii), the bonus would have to be pursuant to a plan providing for compensation intended to serve as incentive for performance to occur over a specified period that does not fall within the scope of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ("FAS 123R"). The outcome with respect to the relevant performance target must be substantially uncertain at the time the performance target is established and the target is communicated to the executives. The length of the performance period is not relevant to this analysis, so that a plan serving as an

incentive award compensation.



Quinlivan One interpretative response addresses a question Stephen Quinlivan, a lawyer at the Leonard, Street and Deinard law firm, says “will come up quite frequently.” The SEC indicates that when a corporation is acquired by merger, the acquirer doesn’t have to address compensation paid to directors and officers of the acquired company. However, the analysis states that compensation need not be reported with respect to the company that “disappears” in the merger.

“Under structures most often used, the target becomes a subsidiary of the acquirer, and does not disappear,” Quinlivan says. “The response is perhaps not as helpful as it could be. It also leaves ambiguity as to other structures, such as stock purchases, where the target doesn’t disappear.”

He says Item 4.02 “highlights a change that will affect many companies in the future but is not well understood at this time.” Currently, most pension plan measurement dates for calendar year issuers is Sept. 30. But under recent changes to pension accounting standards, the pension measurement date will be changed to be the same as the end of a company’s fiscal year. Once that happens, Quinlivan says, “It will result in one more year-end scramble, because the pension numbers cannot be nailed down until the after the end of the year.”

While he says the SEC did “a commendable job” of addressing issues of broad interest to many issuers, Quinlivan says that many issuers will find some of their circumstances are unique, and not addressed by the FAQs. As such, he recommends issuers “continue to draft and refine all necessary disclosures to identify all interpretive issues as soon as possible.”

Quinlivan also suggests issuers review the proxy statements of companies that have already filed under the new rules—including Wrigley Jr. Co., Whole Foods Market, and Kronos Inc.—for examples of handling various disclosure issues.

incentive for a period less than a year would be considered an incentive plan under Item 402(a)(6)(iii). Further, amounts earned under a plan that meets the definition of a non-equity incentive plan, but that permits the exercise of negative discretion in determining the amounts of bonuses, generally would still be reportable in the Non-equity Incentive Plan Compensation column (column (g)). The basis for the use of various targets and negative discretion may be material information to be disclosed in the Compensation Discussion and Analysis. If, in the exercise of discretion, an amount is paid over and above the amounts earned by meeting the performance measure in the non-equity incentive plan, that amount should be reported in the Bonus column (column (d)).

* * *

Question: If an equity incentive plan award is denominated in dollars, but payable in stock, how is it disclosed in the Grants of Plan-Based Awards Table since the headings for equity-based awards (columns (f), (g) and (h)) only refer to numbers and not dollars?

Answer: The award should be disclosed in the Grants of Plan-Based Awards Table by including the dollar value and a footnote to explain that it will be paid out in stock in the form of whatever number of shares that amount translates into at the time of the payout. In this limited circumstance, and if all the awards in this column are structured in this manner, it is acceptable to change the captions for columns (f) through (g) to show “(\$)” instead of “(#).”

* * *

Question: How do you measure the actuarial present value of the accumulated benefit of a pension plan in the situation where a particular benefit is earned at a specified age? For instance, if a named executive officer at age 40 is granted an award if he stays with his company until age 60, how should the company measure this benefit when the executive is age 50 and the normal retirement age under the plan is age 65?

Answer: The computation should be based on the accumulated benefit as of the pension measurement date, assuming that the named executive continues to live and will work at the company until retirement and thus will reach age 60 and receive the award.

* * *

Question: Is director compensation disclosure required under Item 402(k) of Regulation S-K for a person who served as a director for part of the last completed fiscal year, even if the person was no longer a director at the end of the last completed fiscal year?