

# SEC ADOPTS NEW EXECUTIVE COMPENSATION DISCLOSURE RULES

On July 26, 2006, the SEC adopted changes to the executive compensation disclosure rules and other related disclosure matters. The changes will affect disclosure in proxy statements, annual reports and registration statements, as well as the current reporting of compensation arrangements. These changes will affect disclosure of executive compensation, director compensation, related party transactions, director independence, corporate governance matters, and security ownership of officers and directors. These changes will also require that most of this disclosure be provided in plain English.

## *When do these changes become effective?*

- Forms 10-K and 10-KSB -- fiscal years ending on or after Dec. 15, 2006;
- Proxy and Information Statements -- filed on or after Dec. 15, 2006, that are required to include executive compensation and related party transaction disclosure for fiscal years ending on or after Dec. 15, 2006.
- For Securities Act registration statements -- filed on or after Dec. 15, 2006, that are required to include executive compensation and related party transaction disclosure for fiscal years ending on or after Dec. 15, 2006
- Form 8-K -- compliance will be required for triggering events that occur 60 days or more after publication in the Federal Register -- likely sometime in October.

The court, calling the SEC's hedge fund rule "arbitrary," held that the rule was a result of an unreasonable interpretation of the word "client" in the Advisors Act and, therefore, the rule was invalid.

## *What are the changes?*

### **Executive and Board Compensation Disclosure**

The new rules modify the currently-required tabular disclosure and also add a narrative disclosure concerning

the principal executive and financial officers and three other highly paid officers.

### **Compensation Discussion and Analysis**

A new narrative section -- Compensation Discussion and Analysis -- is intended to address executive compensation programs. This new narrative section must explain option grants to executives, including an analysis and discussion of such matters as the reasons a company selects particular grant dates for awards or the methods a company uses to select the terms of awards. The Compensation Discussion and Analysis will be filed and be subject to the CEO and CFO certifications.

The compensation committee report will require a statement whether the committee has reviewed and discussed the Compensation Discussion and Analysis with management and, based on this review and discussion, recommended that it be included in the company's proxy statement.

### **Tabular and Narrative Disclosure**

Following the Compensation Discussion and Analysis section, executive compensation disclosure will be organized into three broad categories:

*Executive compensation for the past three years.* This section will be generally made up of a "Summary Compensation" table showing compensation for each named executive officer over the last three years, a narrative disclosure, and a "Grants of Plan-Based Awards" table that will help explain the compensation information presented in the table.

*Holdings of equity-based compensation.* Disclosure regarding outstanding equity interests will include an "Outstanding Equity Awards at Fiscal-Year End" table, which will show outstanding awards representing potential amounts that may be received in the future, and an "Option Exercises and Stock Vested" table, which will show amounts realized on equity compensation during the last fiscal year.

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*Deferred compensation.* This disclosure will include a “Pension Benefits” table, which will require disclosure of the actuarial present value of each named executive officer’s accumulated benefit under each pension plan, and a “Nonqualified Deferred Compensation” table, which will require disclosure with respect to nonqualified deferred compensation plans of executive contributions, company contributions, withdrawals, all earnings for the year and the year-end balance. In addition, the company must include a narrative description of any severance or change in control arrangements, including a quantification of potential payments and benefits.

### **Stock Options**

Further, in light of the media attention to stock option backdating, the SEC will be providing guidance regarding disclosure of company stock option and stock grant programs, with particular attention to the timing of option grants.

### **Director Compensation Disclosure**

Director compensation for the last fiscal year will be required in a “Director Compensation” table, along with related narrative, which will be similar in format to the “Summary Compensation” table described above.

### **Related Person Transactions**

The changes to this disclosure requirement will include increasing the dollar threshold for transactions required to be disclosed from \$60,000 to \$120,000, and requiring disclosure of a company’s policies and procedures for the review, approval or ratification of related person transactions.

### **Director Independence and Other Corporate Governance Matters**

A new disclosure item will consolidate existing disclosure requirements regarding director independence and related corporate governance matters. Disclosure must include disclosure of directors’ independence and any audit, nominating or compensation committee members who are not independent, and a description of any undisclosed

related party transactions that were considered by the board of directors when determining director independence.

### **Security Ownership of Officers and Directors**

Although fought during the approval process, the SEC will require disclosure of the number of shares pledged by management.

### **Form 8-K**

The rules will modify the disclosure requirements in Form 8-K to include employment arrangements and material amendments only for named executive officers. The rules will also consolidate all Form 8-K disclosure regarding employment arrangements under a single item.

A final release specifying these changes is expected from the SEC shortly. Some matters are subject to re-proposal by the SEC, so modification to these changes may be forthcoming in the final release or later amendments. Should you have any questions, please feel free to contact us: