

SEC Issues Disclosure Guidance on Executive Compensation Rules

Overview

On January 24, 2007, the SEC's Division of Corporation Finance issued interpretative guidance relating to the new executive compensation rules. The guidance addresses a number of questions that have arisen for companies and counsel seeking to apply the new rules in preparing upcoming proxy statements and Forms 10-K. The guidance also updates the staff's previously issued telephone interpretations.

Here are some highlights of the interpretative guidance:

- The requirement in the Compensation Discussion and Analysis, or CD&A, to disclose whether a company has a program, plan or practice of timing the award of options in coordination with the disclosure of material information, applies to all forms of equity compensation, not just options.
- Amounts earned under a non-equity (i.e., cash) incentive plan that permits the exercise of negative discretion in determining the amounts of bonuses, which is the case with virtually all plans designed to comply with Section 162(m), generally would be reportable in the Non-equity Incentive Plan Compensation column of the Summary Compensation Table, not in the Bonus column.
- Equity awards made after year end, but that are designed to be compensation for services performed in the prior year, are not reflected in the Summary Compensation Table for the prior year, except to the extent of any FAS 123R charge. This position creates a disparity in treatment between cash and equity awards, since cash bonuses paid after year end are included in the Summary Compensation Table. Equity awards paid after year end would also not be included in such prior year's Grants of Plan-Based Awards Table because only grants made during the year are included in the table. This interpretation will prove to be challenging at companies for which equity awards paid after year end are an integral part of total compensation for the prior year.
- Perks that have no aggregate incremental cost to the company must still be identified by type. However, if an executive officer fully reimburses the company for its "total cost," the item is not considered a perk and need not be identified. Although we think that the staff's use of the phrase "total cost" creates some unfortunate ambiguity, we believe that if the aggregate incremental cost is reimbursed, this requirement will be satisfied. While this guidance is welcome, the different treatment of items that have no incremental cost to those that have some incremental, reimbursable cost may result in non-intuitive differences in defining what is and isn't a perk.
- In the Option Exercises and Stock Vested Table, for stock-settled stock appreciation rights, companies should report the total number of shares underlying the SAR, not the net number of shares received upon exercise. The net number received should be reflected in a footnote.
- In calculating the present value of an executive's pension benefits at retirement, if a plan has a "normal" retirement age and also a younger age at which retirement benefits may be received without reduction of benefits, the younger age should be used for determining pension benefits.

- The Director Compensation Table should include all persons who served as a director during any part of the year, even if they were not directors at year end or did not stand for re-election. Also, for directors who provide consulting services to the company that are unrelated to such person's directorship, compensation amounts must include the compensation paid for such unrelated consulting services.
- A company's reimbursement to an officer of legal expenses for a lawsuit where the officer is named as a defendant is not disclosable under Item 402. The staff eliminated the language in the prior telephone interpretation on this topic, which had stated that such payments were disclosable under Item 404. This allows companies to reach the conclusion that advancement and indemnification payments are reimbursed business expenses.
- IPO filers with calendar year ends must apply the new compensation rules in filings made on or after January 2.
- The staff carried over the former telephone interpretation that earnings on nonqualified deferred compensation would not be considered as "above-market" or "preferential earnings" if they tracked investments available under the company's qualified plans. Unfortunately, the interpretation did nothing to clarify situations in which the investment choices are not exactly the same as under the qualified plan. We believe that earnings that are based on investments that are readily available in the market are not "above-market" or "preferential."
- A company that has an executive officer who is a director, but not a named executive officer, may omit the director from the Director Compensation Table as long as the officer does not receive any additional compensation for services provided as director.

These are only a few of the many topics covered by the release. We recommend that all persons preparing compensation disclosure thoroughly review the recent guidance. The SEC has posted the guidance at <http://www.sec.gov/divisions/corpfin/cfguidance.shtml> in a new section of the Corporation Finance website called "Staff Compliance and Disclosure Guidance." In that new section they also announce, almost like "Coming Attractions," that guidance on the related person disclosure, corporate governance and Form 8-K changes will be provided soon. So stay tuned.

Contact Information

If you would like to learn more about the interpretative guidance, please contact your usual legal advisor at Ropes & Gray.

