

SEC Finalizes New Proxy Statement Rules for Executive Compensation

Introduction

On August 11, 2006, the SEC released final rules for executive compensation disclosure in proxy statements, annual reports, and registration statements. Although the final rules largely adopt the proposed rules released on January 27, 2006, the final rules contain several important changes, including:

- Additional disclosure related to the timing and pricing of option grants
- Consolidation of performance-based awards and equity awards into a single supplemental table
- Required disclosure of the actuarial present value of named executive officers' accumulated benefits under defined benefit pension plans in the Pension Benefits Table
- Companies must exclude changes in actuarial present value of benefits under defined benefit pension plans and above-market or preferential earnings on non-qualified deferred compensation when determining which executive officers are subject to the disclosure requirements
- Required reporting of potential compensation from post-termination arrangements valued as though the triggering event occurred on the last day of the registrant's last completed fiscal year
- Clarification that the Compensation Discussion and Analysis is deemed "filed" with the SEC and therefore subject to certification requirements and potential liabilities for misrepresentation

The executive compensation tables, copies of which are attached at the end of this update, and narrative descriptions required by the final rules must be included in proxy statements filed for fiscal years ending after December 14, 2006.

Summary Compensation Table

Executive compensation disclosure is required of the registrant's Principal Executive Officer, Principal Financial Officer, and three other most highly compensated executive officers, based on *total compensation* for the last completed fiscal year. As with the existing rules, no disclosure is required of officers whose total compensation does not exceed \$100,000.

The final rules modify the proposed rules regarding the Summary Compensation Table and the footnotes thereunder as follows:

- The total compensation column has been relocated and is now the last column in the table.
- Equity-based awards are reportable at their FAS 123R value in the appropriate columns when awarded (e.g., stock awards (column (e)); option awards (column (f))), even if such awards are made in lieu of salary or bonus.
- Non-equity incentives are reportable only when earned (including any earnings thereon), even though such amounts may not be payable. This rule applies even if such awards are made in lieu of salary or bonus, in which case a footnote to the salary or bonus column may be required.
- A new column has been added to capture the change in pension value and

nonqualified deferred compensation earnings, instead of including this information in the “All Other Compensation” column. The registrant must report the aggregate change in the actuarial present value of the named executive’s accumulated benefit under all defined benefit pension plans (including supplemental plans) and any above-market or preferential earnings thereon. These amounts are not included for purposes of determining which executive officers are named in the disclosure.

- Regarding perquisites and personal benefits, the final rules require disclosure of the *type* of benefit, regardless of amount, if the \$10,000 threshold is exceeded for all perquisites. Each perquisite or benefit exceeding the greater of \$25,000 or 10% of the total amount of perquisites must be quantified in the footnotes.
- The All Other Compensation column must include anything not properly reported in the preceding columns (in addition to perquisites and personal benefits), *regardless of amount*.
- The final rules modify the requirement that the value of any dividends or earnings on stock or option awards be disclosed in the All Other Compensation column. Consistent with the FAS 123R valuation required of stock options and stock awards, such dividend or earnings are factored into the grant date fair value. Accordingly, any dividends or earnings paid on such awards must only be included in “All Other Compensation” if the dividends or earnings were *not* factored into the grant date fair value.

In addition, the final rules require that, if salary and bonus for a named executive cannot be calculated and therefore are not disclosed, a current report on Form 8-K will be triggered by a payment, decision, or other occurrence as a result of which such amounts may be calculated. In such case, the Form 8-K must also include a total compensation figure in order to update the amounts reported in the Summary Compensation Table.

The final rules do not require, as originally proposed, disclosure of up to three additional highly paid employees whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers. The SEC is seeking comment regarding whether such disclosure is appropri-

ate, whether employees without significant responsibilities for policy decisions should be excluded, and whether the proposed rule should apply only to large accelerated filers.

Grants of Plan-Based Awards Table

The final rules merge two of the proposed supplemental tables (“Grants of Performance-Based Awards” and “All Other Equity Awards”) into a new Grants of Plan-Based Awards Table. The new table omits information previously proposed, such as vesting date, expiration date, and consideration paid, and instead focuses on the grant date of the applicable award. As a result, if the grant date of an award is different than the date on which the committee took action to grant such award, the registrant must add an additional column disclosing the date of the committee’s action.

The final rules require an additional column to be added for equity-based awards if the per share exercise price is lower than the last sale price for the underlying security on the principal market for the security on the date of grant. In addition, the registrant must describe in a footnote the methodology for determining the lower exercise price.

Finally, if a non-equity based award is denominated in units or other rights, a column must be added to the table to disclose the rights awarded.

Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table

The final rules maintain the requirement from the proposed rules that a narrative description provide additional context to the tabular disclosure required in the Summary Compensation Table and Grants of Plan-Based Awards Table. This section must explain the material factors necessary to understand information disclosed in the tables, including, for example, the performance-based or other material conditions to an award.

In addition, this narrative section may need to address certain changes to equity-based awards, including repricing, extending exercise periods, changing vesting or forfeiture conditions, changing or eliminating applicable performance criteria, changing the bases upon which returns are determined, or any other material modification of outstanding awards.

Outstanding Equity Awards at Fiscal Year-End Table

Although containing substantially the same information as proposed, the final rule regarding the Outstanding Equity Awards at Fiscal Year-End Table has been reformatted to provide separate columns for option awards and all other stock awards. The final rules permit aggregation of awards if the exercise price and expiration date are identical, yet require separate reporting of each aspect of an award which is a distinct right (e.g., an award combining an option and a SAR would produce two entries in the table).

The final rules add the requirement that the table specify the option expiration date and option exercise price. In addition, for a non-option stock award, the table requires disclosure of the market value of unvested awards.

Option Exercises and Stock Vested Table

The Option Exercises and Stock Vested Table, like the Outstanding Equity Awards at Fiscal Year-End Table, provides separate columns for option awards and all other stock awards. The final rule eliminates the grant date fair value column because this amount would have been reported in the Summary Compensation Table. In addition, if the executive has deferred receipt of an option or other equity award, a footnote quantifying the amount deferred and the terms of the deferral is required.

Pension Benefits Table

The final rules abandon the proposed rules' approach to the Pension Benefits Table. Instead of estimating the amounts that may be payable upon retirement, the final rules require reporting of the actuarial present value of executives' accumulated benefits. In addition to describing the material terms of the pension arrangements, the final rules require the narrative to disclose whether any named executive is eligible for early retirement.

Nonqualified Deferred Compensation Table

The Nonqualified Deferred Compensation Table and narrative disclosure required by this section is substantially identical to the proposed rules.

Potential Payments upon Termination or Change-In-Control Narrative

The SEC has provided instruction on valuing potential termination and change-in-control payments. The final rules require that the amount reported be the actuarial present value of the expected payments calculated as though the event triggering payment occurred on the last business day of the fiscal year reported, unless a named executive terminated upon such event during the fiscal year, in which case the actual amount paid would be reported. In addition, the final rules clarify that the amounts reported include health benefits, and provide guidance on quantifying health benefits.

Director Compensation Table

The Director Compensation Table is similar to the Summary Compensation Table, but provides information for only the last completed fiscal year. The SEC's instructions to the Summary Compensation Table apply to analogous disclosure in the Director Compensation Table, including, for example, disclosing equity awards at their FAS 123R value on the grant date and adding a column to report a director's change in pension value and nonqualified deferred compensation earnings.

Compensation Discussion and Analysis

The final rules clarify that the Compensation Discussion and Analysis section is deemed "filed" with the SEC and is therefore subject to the certification requirements of Sarbanes-Oxley and liability for misrepresentation under the Securities Exchange Act.

The final rules provide additional guidance as to the disclosures to be made in the Compensation Discussion and Analysis, most significantly requiring the registrant to report:

- How forms of performance-based compensation are structured *and* implemented to reflect the registrant's or the executive's performance
- Whether the registrant has exercised any discretion with respect to the attainment of performance goals of the registrant, or the size of a payment based thereon, for any named executive officer

- The basis for selecting particular events as triggering payment under any plan, contract, agreement, or arrangement providing for a payment upon termination or a change in control
- Certain actions regarding executive compensation taken *after* the fiscal year being described
- How target performance levels will be measured, if not consistent with GAAP
- The registrant's policies regarding the recovery of awards or payments if the registrant's performance measures are adjusted (after payment) to reduce the amount that should have been paid

The final rules do not, however, adopt the proposed rules requirement that the Compensation Discussion and Analysis disclose what the registrant's compensation program is designed *not* to reward.

Option Timing Guidance for Compensation Discussion and Analysis Section

In addition to the items previously discussed, the SEC has, in response to the recent controversy over stock option grant backdating practices, provided some guidance for disclosure of option timing practices in the Compensation Discussion and Analysis. The preamble to the final rules provides several questions regarding option timing for consideration by a registrant in drafting the Compensation Discussion and Analysis section:

- Is there a program, plan, or practice to time option grants to its executives in coordination with the release of material non-public information?
- How does any program, plan, or practice to time option grants to executives fit in the context of the company's program, plan, or practice, if any, with regard to option grants to employees more generally?
- What was the role of the compensation committee in approving and administering such a program, plan, or practice? How did the board or compensation committee take such information into account when determining whether and in what amount to make those

grants? Did the compensation committee delegate any aspect of the actual administration of a program, plan, or practice to any other persons?

- What was the role of executive officers in the company's program, 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 non-public information?
- Does a company plan to time, or has it timed, its release of material non-public information for the purpose of affecting the value of executive compensation?

Compensation Committee Report

The proposed rules would have eliminated the Compensation Committee Report previously required in the executive compensation disclosure section. This report is restored in the final rules and would be required to name each member of the committee and state whether:

- The compensation committee has reviewed and discussed the Compensation Discussion and Analysis with management
- Based on the review and discussions, the compensation committee recommended to the board of directors that the Compensation Discussion and Analysis be included in the company's annual report and proxy statement

The Compensation Committee Report must also describe the scope and authority of the committee, the extent to which it may delegate its authority, and the role of executive officers and compensation consultants in determining executive or director compensation. Unlike the proposed rules, the final rules do not require the registrant to identify any executive officer of the company with whom compensation consultants had contact.

The Compensation Committee Report is an annual requirement, and is deemed "furnished" by the registrant.

Other Changes in Final Rules

Confidential Trade Secrets or Confidential Commercial or Financial Information

The final rules provide additional guidance on determining when disclosure of target performance levels may be omitted if such disclosure would cause competitive harm for the registrant.

Performance Graph

The proposed rules would have eliminated the Performance Graph previously required in the executive

compensation disclosure statement. The final rules, however, restore this requirement, but relocate it to the disclosure item entitled "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters." This disclosure will be required to be furnished in the registrant's annual report that accompanies or precedes the proxy statement.



For more information on the proposed rules, see our [February 2006 Dechert OnPoint](#) update.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/employeebenefits.

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Summary Compensation Table

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

Grants of Plan-Based Awards

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

Outstanding Equity Awards at Fiscal Year-End

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

Option Exercises and Stock Vested

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

Pension Benefits

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

Nonqualified Deferred Compensation

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

Director Compensation

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