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Corporate Alert: SEC Proposes New Rules Concerning Executive Compensation and Related Disclosure

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On January 17, 2006, the Securities and Exchange Commission voted to propose new rules that would amend disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters, and security ownership of officers and directors. The proposals will represent the SEC's undertaking of the most significant revisions of its rules governing executive compensation in 14 years.

The text of the proposed rules is not yet publicly available. When the SEC makes available the proposed rules, we expect to distribute a detailed memorandum explaining the proposed rules, and their impact on current practices. The SEC currently anticipates that new rules will be in effect for the 2007 proxy season.

In the meantime, we have prepared this alert based upon the open meeting of the SEC Commissioners and certain other public statements, not with a view to explaining each of the proposed rules, but for the purpose of alerting readers to matters that they may wish to take into consideration now, in anticipation of the enhanced disclosure regime that will likely govern the future disclosure of compensation awarded to, earned by or paid to directors, executives and certain other employees during the current fiscal year.

In addition, members of the Staff of the SEC have indicated that certain of the proposed rules (clearly only those that can be adopted within the currently mandated executive compensation disclosure tables) should be considered for adoption by companies in their proxy statements this year.

Some key aspects of the proposed rules that should be considered by companies now are the following:

- Revised executive compensation rules are being proposed for two principal reasons – first, the SEC's view that current disclosure may not clearly describe the compensation paid to executives and, second, the related concern of the SEC that some companies may not be disclosing all compensation as is currently required.
    - The proposed new rules would mandate extensive tabular compensation disclosure for comparability among companies and require clearer narrative disclosure. Disclosure will be "principles-based"; that is, all compensation will be required to be disclosed and listings of specific types of compensation would be as examples only. Companies should anticipate that all compensation awarded to, earned by or paid to the top executive officers will be clearly disclosed.

- A new Compensation Discussion and Analysis section would replace the current Compensation Committee report and the performance graph. This section would require discussion of the objectives of the company's compensation programs, each key element of compensation, how the amount of each element is determined and how such elements fit into the company's objectives. Companies may wish to consider this intended overview of executive compensation as Compensation Committee reports are being drafted this year.

    - The new Compensation Discussion and Analysis section would, unlike the Compensation Committee report and performance graph it replaces, be considered filed with, rather than furnished to, the SEC. This section would therefore be included in the material included or incorporated in Form 10-K that is certified by companies' CEOs and CFOs. Accordingly, companies may wish to begin drafting this section at an early enough stage as to accommodate the diligence procedures undertaken by their CEO and CFO in connection with their certifications.

- The Summary Compensation Table would include, as a new first column, total compensation for each reported person. This total compensation would include essentially all items of annual compensation, including many not currently reported with dollar values such as

        - the grant-date value of all stock-based awards, including stock options, computed in the same manner (other than being fully reported in the fiscal year of grant) as that used for financial statement purposes,

        - the aggregate increase in the actuarial value of pension plans accrued during the year and

        - all earnings on deferred compensation that is not tax-qualified.

  Companies should therefore anticipate that compensation currently reported in other tables or not currently reported with dollar values will be prominently disclosed.

    - The proposed rules would provide, for the first time in many years, guidance on how to determine which expenditures constitute perquisites, lower the dollar threshold for the disclosure of perquisites and other personal benefits to an aggregate of $10,000 per person and require the identification of all perquisites, regardless of amount, all with a view to full disclosure. In anticipation of this additional disclosure, companies may wish to review their programs and arrangements for personal benefits early in this fiscal year.

- The proposal would also mandate tabular disclosure, by named executive officer, of

- potential pension annual payments and changes during the fiscal year in deferred compensation plan balances, and

- the amounts of payments and benefits, including perquisites, payable on termination or upon a change in control.

Companies should consider the potential impact of such disclosure on currently existing and planned arrangements, and should anticipate gathering the required information.

- The proposals would require most executive compensation and related disclosure to be in plain English. This is another attribute of the proposed rules that companies may wish to consider while drafting this year's proxy statements, and certainly may wish to begin undertaking well in advance of a likely mandated plain English requirement next year.

- The SEC also appears to be concerned that the compensation of one key executive, the CFO, as well as some of the highest paid employees, may not be currently disclosed.

    - The proposed rules would expressly include in the named executive officers for whom compensation disclosure is made companies' principal financial officer.

    - The proposed rules would also include for the first time full compensation disclosure for up to three employees who are not executive officers (identifying them by job description although not by name), but who earn higher total compensation than any of the executive officers included in the disclosure tables. Companies should recognize that the compensation earned by certain commissioned salesmen, financial institution traders and broadcasting talent, as examples, may become subject to disclosure.

    - The determination of which employees are included in the compensation disclosure tables would, under the proposed rules, be determined by total compensation, rather than just salary and bonus as currently. Companies should therefore be prepared to track the compensation being earned by a number of executive officers, as well as other employees, since the ranking of total earnings may not be readily apparent during the course of the fiscal year.

As noted above, the SEC currently plans to adopt, after public comment on their proposed rules, significant changes in the executive compensation disclosure rules by next proxy season; and companies should anticipate that the SEC will provide guidance in the proposed rules, when published for comment, as to aspects of the proposed rules that companies should endeavor to adopt prior to the effectiveness of the new rules. We will be distributing a detailed memorandum explaining the proposed rules, and their impact on current practices, once the text of the proposed rules becomes publicly available.