

THE SEC'S NEW GOLDEN RULES FOR EXECUTIVE COMPENSATION©

In the world of business, the “Golden Rule” is best expressed by the aphorism that “He who has the gold, rules.” Under the new rules recently proposed by the Securities and Exchange Commission, a corollary of the Golden Rule is “Show us the money.” The new rules lower the threshold amount of the value of perquisites required to be disclosed from \$50,000 to \$10,000 and require itemization of the perquisites and disclosure of the dollar value of any perquisite if it exceeds \$25,000. The new rules apply to compensation earned by a company’s principal executive officer, principal financial officer and highest paid executive officers and members of the board of directors.

The rule proposals would require enhanced disclosure of certain payouts and perks given to executives like Donald Tyson of Tyson Foods, Jack Welch of General Electric and Philip Purcell of Morgan Stanley, but they would not limit them.

In announcing the proposed new rules, SEC Chairman Christopher Cox, characterized the purpose of the new rules as “improving the total mix of information available to the marketplace” by improving “disclosure by including all elements of compensation. It’s about wage clarity, not wage controls.”

In order to assist companies in determining what perquisites require disclosure, the SEC provided interpretive advice applicable both to existing and proposed disclosure in its release announcing the proposals (see <http://sec.gov/rules/proposed/33-8655.pdf>). This interpretive advice employs a principles-based test which clarifies the SEC’s view that most benefits provided to executives should be disclosed as perquisites and that items of a personal nature that do not require disclosure as a perquisite are very limited. Public companies should review this guidance in connection with the preparation of disclosure about executive compensation in the current proxy season.

In addition to the executive compensation disclosure proposals, the SEC’s proposals also address and bring together in one unified disclosure requirement the disclosure of (i) related party transactions, (ii) director independence, including a description of any relationships considered in making the determination of independence, and (iii) corporate governance, including information concerning board and committee membership and independence, and specific disclosure about audit and nominating committees.

The changes are intended to provide increased and clearer information about executive compensation and key financial relationships among companies and their executive officers, directors, significant shareholders and their respective family members. The new rules will apply to disclosures made in proxy and information statements, periodic reports, current reports and other filings under the Securities Exchange Act of 1934 and in registration statements under the Exchange Act and the Securities Act of 1933.

Executive Compensation Disclosure Proposals

The SEC's executive compensation proposals are intended to improve the quality of disclosure by requiring a narrative which provides a general overview in a Compensation Discussion and Analysis that explains (i) the goals and objectives behind a company's executive pay policy, (ii) the elements of the executive compensation paid, (iii) the factors and the relative weight assigned to various factors in determining specific compensation types and amounts, and (iv) how each element of the compensation package will further achievement of the company's goals and objectives. This overview would address in one place factors relating to the separate elements of executive compensation as well as executive compensation as a whole.

The disclosure contained in the CD&A must be company specific and not boilerplate. The SEC has characterized its approach as requiring "principles-based" disclosure which identifies the disclosure concept and provides several illustrative examples.

The overview provided by the CD&A would replace the compensation committee report and performance graph required under current rules. Unlike the compensation committee report, the CD&A would be deemed a company disclosure filed with the SEC, and therefore subject to the securities laws liability rules, and covered by the certifications required by a company's CEO and CFO. To encourage the use of forward-looking statements in the CD&A, the rule proposals provide that such statements are protected under the safe harbor provided for forward-looking statements included in other filed disclosure.

Under the proposed rules, the CD&A will be followed by a detailed disclosure of executive compensation using a combination of narrative disclosure and a modified version of current compensation tables which group disclosure into three primary categories:

- (1) compensation during the last three years;
- (2) holdings of outstanding equity-related interests received as compensation that may be the source of "future gains;" and
- (3) retirement plans and other post-employment payments and benefits, including payments made in connection with a change of control of the company.

Historical Compensation. Under the rule proposals, the current Summary Compensation Table would be reconfigured by adding a new column which reports total compensation (a sum total of the other five columns) and would include additional information about compensation paid currently or deferred (including options, restricted stock and similar grants) and compensation consisting of current earning or awards that are part of a plan. The dollar value of stock-based awards would be measured at grant at fair value computed pursuant to FAS 123R.

Equity Holdings. The rule proposals require disclosure in a table of outstanding equity awards at fiscal year-end including the potential future value of such awards, as well as option exercises and vested stock awards, indicating amounts outstanding, the strike price and vesting dates, and any gains realized from equity compensation during the last fiscal year.

Retirement and Post-Employment Payments and Benefits. The proposed rules would require a company to disclose the dollar value of (i) annual payments payable to each named executive officer, (ii) year-end balances and executive contributions, company contributions and earnings and withdrawals for the year and (iii) payments and other benefits (including perquisites) payable upon termination or a change in control.

Director Compensation

The proposed rules would require a tabular presentation and narrative discussion of all elements of director compensation for the most recent year.

Plain English

The proposed rules require that disclosure of executive compensation be made in “plain English,” and approach used successfully in prospectuses filed under the Securities Act.

This Article is not comprehensive and is not intended as legal advice.

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