



# LEGAL TOPICS

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## EXECUTIVE COMPENSATION - SEC CHANGES DISCLOSURE REQUIREMENTS

by Iain MacSween

Last week the SEC voted to adopt changes to executive and director compensation disclosure rules and certain other corporate governance matters<sup>1</sup>.

While some of the changes are expected to become effective early October<sup>2</sup>, the majority of the changes will first become effective for proxy statements and Forms 10-K and 10-KSB filings related to fiscal years ending on or after December 15, 2006.

### *Who do these rule changes affect?*

These changes affect bank holding companies and banks that are required to file periodic reports with either the SEC or the FDIC pursuant to the Securities Exchange Act of 1934 or the Federal Deposit Insurance Act. They also affect banks and bank holding companies that intend to distribute prospectus or offering circulars in stock offerings. Although the FDIC is not itself changing its rules, under the Federal Deposit Insurance Act, these changes once implemented by the SEC, automatically apply to FDIC reporting companies.

### *What is the purpose of the new disclosure?*

These rule changes are part of the SEC's continuing efforts to provide investors with easy-to-understand and readily comparable annual compensation figures for named executive officers and directors.

### *What forms are affected by these changes?*

- Form 8-K
- Registration Statements - holding companies
- Forms 10-K & 10-KSB
- Offering Circulars - banks
- Proxy Statements

### *Summary of the changes*

#### **Executive & Director Compensation Disclosure in Proxy Statements and Annual Reports on Forms 10-K and 10-KSB**

A major addition to executive compensation disclosure is entitled *Compensation Discussion & Analysis*. This new disclosure requires companies and banks to describe their overall compensation policies and objectives. The *Compensation Committee Report* and the *Performance Graph* (for 10-K companies) are still required, as discussed below. The additional disclosure will be divided into three general areas:

- Compensation over the past three years;
- Compensation received in the form of equity-related interests that are the source of future gains; and
- Retirement plans, deferred compensation and other post-employment payments and benefits.

<sup>1</sup> Full details of the rule changes have not yet been published by the SEC. This advisory is based on information provided in a Press Release issued by the SEC.

<sup>2</sup> The first changes will become effective 60 days after the rule changes are published in the Federal Register. As of the date of this advisory, the Federal Register has not published the rule changes, but it is anticipated that the rule changes will be published within the next few weeks.

Compensation over the past three years

- The new *Compensation Table*, shown below, will be used to disclose the previous three years compensation for each named executive officer. A similar table will also be required for disclosure of director compensation.

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)

- The table will be supplemented by a narrative disclosure and a *Grants of Plan-based Awards Table*.
- Column (h) will disclose the annual change in the actuarial present value of accumulated pension benefits and above-market or preferential earnings on nonqualified deferred compensation. (Note that this amount will be deducted from total compensation for purposes of identifying the company's or bank's named executive officers).
- Column (i) will disclose the aggregate amount of all other compensation not otherwise reported in the table, including perquisites. Perquisites will be included in the table unless the aggregate amount is less than \$10,000.
- Note the provision of an aggregate figure for the total compensation earned in each year in Column (j).

Compensation in the form of equity interests

- An *Outstanding Equity Awards at Fiscal-Year End Table* will be more detailed than in previous years. It will show outstanding awards, representing potential amounts that may be received in the future. Information will include the amount of securities underlying exercisable and unexercisable options, the exercise prices and the expiration dates

for each outstanding option (rather than on an aggregate basis).

- An *Option Exercises and Stock Vested Table* will show amounts realized on equity compensation during the last fiscal year.

Retirements plans and post-employment payments

- A *Pension Benefits Table* will require disclosure of the actuarial present value of each named executive officer's accumulated benefit under each pension plan, computed using the same assumptions (except for the normal retirement age) and measurement period as used for financial reporting purposes under GAAP.
- A *Nonqualified Deferred Compensation Table* will require disclosure with respect to nonqualified deferred compensation plans of executive contributions, company/bank contributions, withdrawals, all earnings for the year (not just the above-market or preferential portion) and the year-end balance.
- A *narrative description* of any arrangement that provides for payments or benefits at, following, or in connection with any termination of a named executive officer, a change in responsibilities, or a

change in control of the company or bank. The description will quantify these potential payments and benefits assuming that the triggering event took place on the last business day of the company's or bank's last fiscal year and the price per share was the closing market price on that date.

## Disclosure of Option Grants

The SEC Release will provide additional guidance regarding disclosure of programs, plans and practices relating to the granting of options. Specifically, it will include guidance on the timing of option grants in coordination with the release of material nonpublic information and the selection of exercise prices that differ from the underlying stock's price on the grant date.

- The following disclosures will be required:
  - The grant date fair value;
  - The grant date (as determined in accordance with FAS123(R));
  - The closing market price on the grant date if greater than the exercise price;
  - The date the Compensation Committee (or full Board of Directors) took action to grant the award, if that date is different than the grant date;
  - If the exercise price of an option grant is not the grant date closing market price per share, a description of the methodology employed to determine the exercise price; and
  - Analysis and discussion of the company's or bank's option-granting process, such as the reasons for selecting particular grant dates and the methods used to determine the terms of the award.

## Reporting of Related Person Transactions

Changes to the related person transaction disclosure requirement, include:

- Increasing the threshold for transactions requiring disclosure from \$60,000 to \$120,000;
- Requiring disclosure of the company's or bank's policies and procedures for the review, approval or ratification of related person transactions; and
- Eliminating the distinction between indebtedness and other types of related person transactions, and eliminating requirements for disclosure of specific types of director relationships.

## Security Ownership of Officers and Directors

The amendments will require disclosure of the number of shares pledged by management, and the inclusion of directors' qualifying shares in the total amount of securities owned.

## Changes to Form 8-K

New rules will modify Form 8-K disclosure requirements relating to named executive officers' employment arrangements and material amendments to any such arrangements.

## Other

A brief *Compensation Committee Report* will still be required. To encourage issuers to follow best practice, the Report will include a statement as to whether the Committee has reviewed and discussed the *Compensation Discussion & Analysis* with management and recommended its inclusion in the Proxy Statement and Annual Report on Forms 10-K or 10-KSB.

The *Performance Graph* will be retained but will be moved from the executive compensation disclosure requirements found in Regulation S-K, Item 402 to the equity market disclosure requirements in Item 201 of Regulation S-K.

The proposal that companies and banks also disclose compensation of up to three non-executive employees continues to be considered by the SEC, with no new rules adopted at this time. Under a revised proposal this provision (referred to in the press as the *Couric Clause*, after CBS newscaster, Katie Couric) would only apply to large accelerated filers.

## *When will these changes become effective?*

- **Forms 8-K** – for *triggering events* occurring 60 days or more after the Rules are published in the Federal Register (i.e. effective early October).
- **Forms 10-K & 10-KSB** – for fiscal years ending on or after 12/15/2006.
- **Proxy Statements** - for proxy statements filed on or after 12/15/2006 by companies and banks with fiscal years ending on or after 12/15/2006.
- **Registration Statements and Offering Circulars** - for registration statements filed on or after 12/15/2006 by companies with fiscal years ending on or after 12/15/2006; and for offering circulars distributed on or after 12/15/2006 by banks with fiscal years ending on or after 12/15/06.

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If you have any questions about this client advisory or if you have any questions about how the changes will affect you, please contact Iain MacSween at (336) 271 3192, or one of the other Brooks Pierce banking attorneys in the following list.

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