

## SEC Adopts Final Disclosure Rules

On July 26, 2006, the Securities and Exchange Commission (SEC) unanimously voted to adopt new disclosure requirements for executive and director compensation, which were proposed in January 2006. However, the proposed rule requiring disclosure of compensation of up to three non-executives whose pay exceeds that of any of the executives included in the tables received so many comments that the SEC decided to repropose it and ask for new comments. The final rules require that all disclosures be provided in plain English.

We anticipate that it will take up to 10 days for the SEC to post the final and reproposed rules.

### Highlights of Final Rules

**CD&A Section.** There will be a new compensation discussion and analysis (CD&A) section that will give companies the opportunity to explain their compensation policies and decisions. The section will be similar in concept and design to narrative disclosure in the management discussion and analysis section in today's reports. The CD&A will be filed and will be part of the disclosure subject to certification by the CEO and CFO.

Regarding stock options, the final rules have been designed to require companies to address their practices as to the timing of stock option grants and the establishment of the exercise price.

**New Compensation Committee Report.** A Compensation Committee Report similar to the Audit Committee Report must now be furnished. The Compensation Committee Report must include a statement that the committee had reviewed and discussed the CD&A with management and, based on this review and discussion, whether it recommended that it be included in the company's annual report and proxy statement. The SEC indicated that CEOs and CFOs could rely on the Compensation Committee Report concerning matters of which they had no knowledge (e.g., the setting of their own pay) for purposes of their certifications.

**Company Performance Graph.** In response to numerous comments, the performance graph will not be eliminated. However, the graph will likely be moved from the executive compensation disclosure to Item 201 of Regulation S-K.

### Summary Compensation Table.

- All elements of executive compensation will be disclosed individually (improved disclosure of perquisites, more precise disclosure of retirement benefits, clear explanation of compensation paid post-employment, and improved disclosure of stock options with protections against date manipulation), and in total.
- The table will be revised to include a column for changes in pension value and nonqualified deferred compensation earnings, and the “Total” column will be moved to the far right side of the table. The calculation of who is considered a named executive officer for disclosure purposes will be based on total compensation *excluding* changes in pension value and nonqualified deferred compensation earnings.
- A sample of the revised table is available on the [SEC Website](#).

**Retirement Benefits.** The final rules will require the disclosure of the actuarial present value of the accumulated pension benefit based on current compensation and normal retirement as stated in the plan. (The proposed rules would have required disclosure of the annual retirement benefits to be paid during retirement.) Companies will be instructed to use the same assumptions and periods as used for financial reporting purposes.

**Post-Employment Payments and Benefits.** In quantifying post-employment payments and benefits, the final rules will state that companies should assume the triggering date occurs on the last day of the fiscal year and that the stock price is the closing stock price on that same date.

### Effective Dates.

- The Form 8-K provisions (which appear to be unchanged from the proposed rules) will apply to triggering events that occur 60 days or more after the final rules are published in the Federal Register.
- The Annual Report provisions will apply for fiscal years ending on or after December 15, 2006.
- The Proxy and Information Statement provisions will apply to any such statements filed on or after December 15, 2006 that are required to include Items 402 (executive compensation) and 404 (related party transactions) disclosures for fiscal years ending on or after December 15, 2006.

**Transition Rules.** It appears that the proposed transition rules were kept in the final rules. As a result, companies will only need to provide disclosures for years that were not previously subject to the current disclosure rules, e.g., starting for 2006 for calendar year companies.

## Reproposed Rule Regarding Disclosure of Compensation of Up to Three Employees

The proposed rules would have required companies to disclose the compensation and position of up to three employees whose compensation exceeded that of any named executive officer. The reproposed rule would

require disclosure for these individuals only if they have a significant policy-making function with the company, a significant subsidiary or a principal business unit, division or function. The repropose rule would only apply to large accelerated filers (companies with a market cap greater than \$700 million).

## Conclusion

At this point, our understanding of what the final rules require is based on statements made by SEC Commissioners and staff during the open meeting and in the [SEC press release](#) concerning the meeting. The final rules may have additional or slightly different requirements, the nuances of which were not discussed at the July 26 meeting. We will publish a more detailed *For Your Information* on the final and proposed rules and their implications once the rules are published.

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