



K&L GATES

Practical Guidebook  
to the  
Executive Compensation  
Disclosure Rules

*PRACTICAL GUIDEBOOK TO THE EXECUTIVE  
COMPENSATION DISCLOSURE RULES*

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## **A. INTRODUCTION**

In July 2006, the Securities and Exchange Commission adopted rules that significantly expanded executive officer and director compensation disclosure requirements.

The rules require disclosure of all elements of compensation through an expanded set of tables and significant qualitative disclosures regarding the manner in which compensation is awarded and earned. The rules also:

- changed the disclosure rules regarding related party transactions, corporate governance and beneficial ownership of shares by executive officers and directors;
- changed Form 8-K reporting requirements for executive compensation matters; and
- require that most disclosures related to executive compensation be written in plain English.

This Practical Guidebook to the Executive Compensation Disclosure Rules was designed as a practical reference guide to the new rules.

The guidebook is divided into different sections broken down by topic, each of which:

- contains the full text of the rules applicable to the topic;
- sets forth important excerpts from the adopting release that supplement the guidance contained in the instructions to the rules;
- provides “practice pointers” to keep in mind relating to the topic; and
- includes references to important source materials, many of which are attached as appendices to the guidebook.

This guidebook was last updated in January 2013. It is intended to provide general information only and is not intended as legal advice.

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## **B. THE RULES**

On July 26, 2006, the Securities and Exchange Commission adopted rules that significantly expanded disclosure requirements relating to executive officer and director compensation. The rules require disclosure of all elements of compensation through an expanded set of tables and significant qualitative disclosures regarding the manner and context in which compensation is awarded and earned.

The new rules also:

- changed the disclosure rules regarding related party transactions, corporate governance and beneficial ownership of shares by executive officers and directors; and
- changed Form 8-K reporting requirements for executive compensation matters.

On December 22, 2006, the SEC adopted amendments to the rules designed to more closely align the reporting of equity awards with the accounting treatment required under FASB ASC Topic 718.

On December 19, 2007, the SEC adopted amendments to its disclosure and reporting requirements to streamline and simplify disclosure requirements, including executive compensation disclosure requirements, for companies that qualify as smaller reporting companies.

On June 26, 2008, the SEC first published Compliance & Disclosure Interpretations regarding Form 8-K, which are periodically updated.

On July 3, 2008, the SEC first published Compliance & Disclosure Interpretations regarding Regulation S-K, including Items 402 and 404, which are periodically updated.

On December 16, 2009, the SEC adopted amendments to its executive compensation and corporate governance disclosure requirements which among other things:

- change the way equity awards are reported in the summary compensation and director compensation tables;
- require expanded disclosures regarding compensation consultants; and
- potentially require a new narrative disclosure that describes how a company's overall compensation policies and practices create incentives that affect the company's risk and management of risk.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted. While the law's primary purpose is to broadly reform regulation of the financial services industry, it also added certain executive compensation and corporate governance disclosure requirements that impact most public companies including:

- say-on-pay and related say-on-frequency requirements;

- a “golden parachute” say-on-pay rule;
- expanded compensation committee and compensation adviser requirements; and
- various other new requirements (including enhanced disclosures covering “pay versus performance” and the ratio of CEO compensation compared to median employee compensation, expanded compensation clawback requirements and disclosures regarding hedging policies) that require rulemaking to become effective.

On January 25, 2011, the SEC adopted rules implementing the Dodd-Frank Act’s say-on-pay, say-on-frequency and “golden parachute” say-on-pay requirements.

On June 27, 2012, the SEC adopted rules implementing the Dodd-Frank Act’s compensation committee and compensation adviser requirements.

## Rules

The basic requirements of the rules are described in Item 402(a)(2) of Regulation S-K which reads as follows:

### **Regulation S-K, Item 402 (Executive Compensation).**

#### *(a) General.*

- (2) *All compensation covered.* This Item requires clear, concise and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers designated under paragraph (a)(3) of this Item, and directors covered by paragraph (k) of this Item, by any person for all services rendered in all capacities to the registrant and its subsidiaries, unless otherwise specifically excluded from disclosure in this Item. All such compensation shall be reported pursuant to this Item, even if also called for by another requirement, including transactions between the registrant and a third party where a purpose of the transaction is to furnish compensation to any such named executive officer or director. No amount reported as compensation for one fiscal year need be reported in the same manner as compensation for a subsequent fiscal year; amounts reported as compensation for one fiscal year may be required to be reported in a different manner pursuant to this Item.

## Adopting Releases and Interpretive Guidance

- A copy of the adopting release is located at [Appendix B-I](#).
  - Note this copy of the adopting release omits Parts IX (Cost-Benefit Analysis), X (Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation) and XI (Final Regulatory Flexibility Act Analysis) as well as the portions of Part XII (Statutory Authority and Text of the Amendments) relating to Regulation S-B.

- An electronic copy of the full release can be found at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.
- A copy of the release adopting the December 2006 changes is located at Appendix B-II.
  - An electronic copy of the December 2006 release can be found at <http://www.sec.gov/rules/final/2006/33-8765fr.pdf>.
- A registrant that qualifies as a “smaller reporting company” may provide the scaled disclosure called for by paragraphs (m) through (r) of Item 402 instead of paragraphs (a) through (k) and (s) of such Item.
  - *See Part T. Smaller Reporting Companies.*
- A copy of the SEC’s Compliance & Disclosure Interpretations dated July 8, 2011 regarding Form 8-K is located at Appendix S-I.
  - An electronic copy of the compliance & disclosure interpretations which is intended to be updated from time to time can be found at <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>.
- A copy of the SEC’s Compliance & Disclosure Interpretations dated July 8, 2011 regarding Regulation S-K, including Items 402 and 404, is located at Appendix B-III.
  - An electronic copy of the compliance & disclosure interpretations which is intended to be updated from time to time may be found at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>.
- A summary of the results of the SEC’s review of the initial executive compensation disclosures of 350 public companies under the rules is located at Appendix B-IV.
- A copy of the release adopting the December 2009 changes is located at Appendix B-V.
  - An electronic copy of the December 2009 release can be found at <http://www.sec.gov/rules/final/2009/33-9089.pdf>
- A copy of the release adopting the January 2011 “say on pay” rules is located at Appendix V-I.
  - An electronic copy of the January 2011 release can be found at <http://www.sec.gov/rules/final/2011/33-9178.pdf>.
- A copy of the release adopting the June 2012 compensation committee and compensation adviser rules is located at Appendix B-VII.
  - An electronic copy of the June 2012 release can be found at <http://www.sec.gov/rules/final/2012/33-9330.pdf>.

### Approach of Rules

- The rules continue to require tabular disclosure to permit comparability from year to year and from company to company and also:
  - confirm that all elements of compensation must be disclosed;
  - provide a new format for the Summary Compensation Table that requires disclosure of a single figure for total compensation; and
  - require enhanced narrative disclosure comprising both a general discussion and analysis of compensation and specific material information regarding tabular items where necessary to an understanding of the tabular disclosure.

### Principles-Based Disclosure

- The rules are intended to be “principles based.” For example, the CD&A requirement identifies the basic disclosure principles (*e.g.*, explain all material elements of a company’s compensation of its named executive officers, including all material information that is necessary to an understanding of its compensation policies and decisions regarding the named executive officers) and then provides illustrative examples for guidance in applying the principles.
- As situations inevitably arise that are not contemplated by the rules, companies should interpret the rules in light of their underlying principles and should not attempt to avoid disclosure of relevant information through narrowly construed interpretations of the rules.
- In an important speech entitled *Principles Matter* given on September 6, 2006, a copy of which is located at [Appendix B-VI](#), John W. White, the Director of the SEC’s Division of Corporation Finance, noted that:
  - The principles-based theme runs throughout the rules and as a concept runs deeper than just the places expressly labeled as such in the adopting release.
  - The rules do not provide a specific rule for every possible situation, and companies are therefore required to keep in mind the principles behind the required disclosures.
  - One of the basic principles of the rules is that all material elements of a company’s executive compensation program must be disclosed (*i.e.*, whether or not the rules specifically address a particular situation, if a disclosure is required to put into context a company’s executive compensation program, the rules require that disclosure be made).

## **Risk Disclosure**

- On December 16, 2009, the SEC adopted amendments to its executive compensation and corporate governance disclosure requirements which among other things potentially require a new narrative disclosure that describes how a company’s overall compensation policies and practices create incentives that affect the company’s risk and management of risk.
  - Disclosure is required if a company determines its overall compensation policies (including non-executive compensation policies) create risks that are “reasonably likely” to have a “material adverse effect” on the company.
  - *See Part U. Risk Disclosure.*

## **SEC Review**

- The SEC expects companies to understand the rules and apply them thoroughly so any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules.
  - *See Shelley Parratt, Speech by SEC Staff: Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010* (Nov. 9, 2009), a copy of which is located at Appendix E-VII.

## **Say-on-Pay**

- On January 25, 2012, the SEC adopted rules implementing the Dodd-Frank Act’s say-on-pay, say-on-frequency and “golden parachute” say-on-pay requirements.
  - *See Part V. Say-on-Pay.*

**APPENDIX B-I**

**SEC Adopting Release**



# Federal Register

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Friday,  
September 8, 2006

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## Part II

### **Securities and Exchange Commission**

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17 CFR Parts 228, 229 et al.  
**Executive Compensation and Related  
Person Disclosure; Final Rule and  
Proposed Rule**

## SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 228, 229, 232, 239, 240, 245, 249 and 274

[Release Nos. 33-8732A; 34-54302A; IC-27444A; File No. S7-03-06]

RIN 3235-A180

### Executive Compensation and Related Person Disclosure

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission is adopting amendments to the disclosure requirements for executive and director compensation, related person transactions, director independence and other corporate governance matters and security ownership of officers and directors. These amendments apply to disclosure in proxy and information statements, periodic reports, current reports and other filings under the Securities Exchange Act of 1934 and to registration statements under the Exchange Act and the Securities Act of 1933. We are also adopting a requirement that disclosure under the amended items generally be provided in plain English. The amendments are intended to make proxy and information statements, reports and registration statements easier to understand. They are also intended to provide investors with a clearer and more complete picture of the compensation earned by a company's principal executive officer, principal financial officer and highest paid executive officers and members of its board of directors. In addition, they are intended to provide better information about key financial relationships among companies and their executive officers, directors, significant shareholders and their respective immediate family members. In Release No. 33-8735, published elsewhere in the proposed rules section of this issue of the **Federal Register**, we also request additional comments regarding the proposal to require compensation disclosure for three additional highly compensated employees.

**DATES:** *Effective Date:* November 7, 2006.

*Comment Date:* Comments regarding the request for comment in Section II.C.3.b. of this document should be received on or before October 23, 2006.

*Compliance Dates:* Companies must comply with these disclosure requirements in Forms 8-K for triggering events that occur on or after

November 7, 2006 and in Forms 10-K and 10-KSB for fiscal years ending on or after December 15, 2006. Companies other than registered investment companies must comply with these disclosure requirements in Securities Act registration statements and Exchange Act registration statements (including pre-effective and post-effective amendments), and in any proxy or information statements filed on or after December 15, 2006 that are required to include Item 402 and 404 disclosure for fiscal years ending on or after December 15, 2006. Registered investment companies must comply with these disclosure requirements in initial registration statements and post-effective amendments that are annual updates to effective registration statements on Forms N-1A, N-2 (except those filed by business development companies) and N-3, and in any new proxy or information statements, filed with the Commission on or after December 15, 2006.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/final.shtml>): or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-03-06 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington DC 20549-1090.

All submissions should refer to File Number S7-03-06. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/final.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC, 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

#### FOR FURTHER INFORMATION CONTACT:

Anne Krauskopf, Carolyn Sherman, or Daniel Greenspan, at (202) 551-3500, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3010 or, with respect to questions regarding investment companies, Kieran Brown in the Division of Investment Management, at (202) 551-6784.

**SUPPLEMENTARY INFORMATION:** We are amending: Items 201,<sup>1</sup> 306,<sup>2</sup> 401,<sup>3</sup> 402,<sup>4</sup> 403<sup>5</sup> and 404<sup>6</sup> of Regulations S-K<sup>7</sup> and S-B,<sup>8</sup> Item 601<sup>9</sup> of Regulation S-K, Item 1107<sup>10</sup> of Regulation AB,<sup>11</sup> Item 304<sup>12</sup> of Regulation S-T,<sup>13</sup> and Rule 100<sup>14</sup> of Regulation BTR.<sup>15</sup> We are also adding new Item 407 to Regulations S-K and S-B. In addition, we are amending Rules 13a-11,<sup>16</sup> 14a-3,<sup>17</sup> 14a-6,<sup>18</sup> 14c-5,<sup>19</sup> 15d-11<sup>20</sup> and 16b-3<sup>21</sup> under the Securities Exchange Act of 1934.<sup>22</sup> We are adding Rules 13a-20 and 15d-20 under the Exchange Act. We are further amending Schedule 14A<sup>23</sup> under the Exchange Act, as well as Exchange Act Forms 8-K,<sup>24</sup> 10,<sup>25</sup> 10SB,<sup>26</sup> 10-Q,<sup>27</sup> 10-QSB,<sup>28</sup> 10-K,<sup>29</sup> 10-KSB<sup>30</sup> and 20-F.<sup>31</sup> Finally, we are amending Forms SB-2,<sup>32</sup> S-1,<sup>33</sup> S-3,<sup>34</sup> S-4<sup>35</sup> and S-11<sup>36</sup> under the Securities Act of 1933,<sup>37</sup> Forms N-

<sup>1</sup> 17 CFR 229.201 and 17 CFR 228.201.

<sup>2</sup> 17 CFR 229.306 and 17 CFR 228.306.

<sup>3</sup> 17 CFR 229.401 and 17 CFR 228.401.

<sup>4</sup> 17 CFR 229.402 and 17 CFR 228.402.

<sup>5</sup> 17 CFR 229.403 and 17 CFR 228.403.

<sup>6</sup> 17 CFR 229.404 and 17 CFR 228.404.

<sup>7</sup> 17 CFR 229.10 *et seq.*

<sup>8</sup> 17 CFR 228.10 *et seq.*

<sup>9</sup> 17 CFR 229.601.

<sup>10</sup> 17 CFR 229.1107.

<sup>11</sup> 17 CFR 229.1100 *et seq.*

<sup>12</sup> 17 CFR 232.304.

<sup>13</sup> 17 CFR 232.10 *et seq.*

<sup>14</sup> 17 CFR 245.100.

<sup>15</sup> 17 CFR 245.100 *et seq.*

<sup>16</sup> 17 CFR 240.13a-11.

<sup>17</sup> 17 CFR 240.14a-3.

<sup>18</sup> 17 CFR 240.14a-6.

<sup>19</sup> 17 CFR 240.14c-5.

<sup>20</sup> 17 CFR 240.15d-11.

<sup>21</sup> 17 CFR 240.16b-3.

<sup>22</sup> 15 U.S.C. 78a *et seq.*

<sup>23</sup> 17 CFR 240.14a-101.

<sup>24</sup> 17 CFR 249.308.

<sup>25</sup> 17 CFR 249.210.

<sup>26</sup> 17 CFR 249.210b.

<sup>27</sup> 17 CFR 249.308a.

<sup>28</sup> 17 CFR 249.308b.

<sup>29</sup> 17 CFR 249.310.

<sup>30</sup> 17 CFR 249.310b.

<sup>31</sup> 17 CFR 249.220f.

<sup>32</sup> 17 CFR 239.10.

<sup>33</sup> 17 CFR 239.11.

<sup>34</sup> 17 CFR 239.13.

<sup>35</sup> 17 CFR 239.25.

<sup>36</sup> 17 CFR 239.18.

<sup>37</sup> 15 U.S.C. 77a *et seq.*

1A,<sup>38</sup> N-2,<sup>39</sup> and N-3<sup>40</sup> under the Securities Act and the Investment Company Act of 1940,<sup>41</sup> and Form N-CSR<sup>42</sup> under the Investment Company Act and the Exchange Act.

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#### I. Background and Overview

On January 27, 2006, we proposed revisions to our rules governing disclosure of executive compensation, director compensation, related party transactions, director independence and other corporate governance matters, current reporting regarding compensation arrangements and beneficial ownership.<sup>43</sup> We received over 20,000 comment letters in response to our proposals. In general, commenters supported the proposals and their objectives. We are adopting the rules and amendments substantially as proposed, with certain modifications to address a number of points that commenters raised.

The amendments to the compensation disclosure rules are intended to provide investors with a clearer and more complete picture of compensation to principal executive officers, principal financial officers, the other highest paid executive officers and directors. Closely related to executive officer and director compensation is the participation by executive officers, directors, significant shareholders and other related persons in financial transactions and relationships with the company. We are also adopting revisions to our disclosure rules regarding related party transactions and director independence and board committee functions.

Finally, some compensation arrangements must be disclosed under our rules relating to current reports on Form 8-K. Accordingly, we are reorganizing and more appropriately focusing our requirements on the type of compensation information that should be disclosed on a real-time basis.

Since the enactment of the Securities Act and the Exchange Act,<sup>44</sup> the

<sup>43</sup> *Executive Compensation and Related Party Disclosure*, Release No. 33-8655 (Jan. 27, 2006) [71 FR 6542] (the "Proposing Release").

<sup>44</sup> Initially, disclosure requirements regarding executive and director compensation were set forth in Schedule A to the Securities Act and Section 12(b) of the Exchange Act, which list the type of information to be included in Securities Act and Exchange Act registration statements. Item 14 of Schedule A called for disclosure of the "remuneration, paid or estimated to be paid, by the issuer or its predecessor, directly or indirectly."

Continued

<sup>38</sup> 17 CFR 239.15A and 274.11A.

<sup>39</sup> 17 CFR 239.14 and 274.11a-1.

<sup>40</sup> 17 CFR 239.17a and 274.11b.

<sup>41</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>42</sup> 17 CFR 249.331 and 274.128.

Commission has on a number of occasions explored the best methods for communicating clear, concise and meaningful information about executive and director compensation and relationships with the company.<sup>45</sup> The Commission also has had to reconsider executive and director compensation disclosure requirements in light of changing trends in executive compensation. Most recently, in 1992, the Commission adopted amendments to the disclosure rules that eschewed a mostly narrative disclosure approach adopted in 1983 in favor of formatted tables that captured all compensation, while categorizing the various elements of compensation and promoting comparability from year to year and from company to company.<sup>46</sup>

We believe this tabular approach remains a sound basis for disclosure. However, especially in light of the complexity of and variations in compensation programs, the very formatted nature of those rules has resulted in too many cases in disclosure that does not inform investors adequately as to all elements of compensation. In those cases investors may lack material information that we believe they should receive.

during the past year and ensuing year to (a) the directors or persons performing similar functions, and (b) its officers and other persons, naming them wherever such remuneration exceeded \$25,000 during any such year." Section 12(b) of the Exchange Act as enacted required disclosure of "(D) the directors, officers, and underwriters, and each security holder of record holding more than 10 per centum of any class of any equity security of the issuer (other than an exempted security), their remuneration and their interests in the securities of, and their material contracts with, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer;" and "(E) remuneration to others than directors and officers exceeding \$20,000 per annum."

<sup>45</sup> In 1938, the Commission promulgated its first executive and director compensation disclosure rules for proxy statements. Release No. 34-1823 (Aug. 11, 1938) [3 FR 1991]. At different times thereafter, the Commission has adopted rules mandating narrative, tabular, or combinations of narrative and tabular disclosure as the best method for presenting compensation disclosure in a manner that is clear and useful to investors. See, e.g., Release No. 34-3347 (Dec. 18, 1942) [7 FR 10653] (introducing first tabular disclosure); Release No. 34-4775 (Dec. 11, 1952) [17 FR 11431] (introducing separate table for pensions and deferred remuneration); *Uniform and Integrated Reporting Requirements: Management Remuneration*, Release No. 33-6003 (Dec. 4, 1978) [43 FR 58151] (the "1978 Release") (expanding tabular disclosure to cover all forms of compensation); and *Disclosure of Executive Compensation*, Release No. 33-6486 (Sept. 23, 1983) [48 FR 44467] (the "1983 Release") (limiting tabular disclosure to cash remuneration).

<sup>46</sup> *Executive Compensation Disclosure*, Release No. 33-6962 (Oct. 16, 1992) [57 FR 48126] (the "1992 Release"). See also *Executive Compensation Disclosure: Securityholder Lists and Mailing Requests*, Release No. 33-7032 (Nov. 22, 1993) [58 FR 63010] (the "1993 Release"), at Section II.

We are thus today adopting an approach that builds on the strengths of the requirements adopted in 1992 rather than discarding them. However, today's amendments do represent a thorough rethinking of the rules in place prior to these amendments, combining a broader-based tabular presentation with improved narrative disclosure supplementing the tables. This approach will promote clarity and completeness of numerical information through an improved tabular presentation, continue to provide the ability to make comparisons using tables, and call for material qualitative information regarding the manner and context in which compensation is awarded and earned.

The amendments that we publish today require that all elements of compensation must be disclosed. We also have sought to structure the revised requirements sufficiently broadly so that they will continue to operate effectively as new forms of compensation are developed in the future.

Under the amendments, compensation disclosure will now begin with a narrative providing a general overview. Much like the overview that we have encouraged companies to provide with their Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A),<sup>47</sup> the new Compensation Discussion and Analysis calls for a discussion and analysis of the material factors underlying compensation policies and decisions reflected in the data presented in the tables. This overview addresses in one place these factors with respect to both the separate elements of executive compensation and executive compensation as a whole. We are adopting the overview substantially as proposed, but, in response to comments, we are requiring a separate report of the compensation committee similar to the report required of the audit committee,<sup>48</sup> which will be considered furnished and not filed.<sup>49</sup>

<sup>47</sup> Item 303 of Regulation S-K [17 CFR 229.303]. See also *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release No. 33-8350 (Dec. 19, 2003) [68 FR 75055], at Section III.A.

<sup>48</sup> The Audit Committee Report, required by Item 306 of Regulations S-B [17 CFR 228.306] and S-K [17 CFR 229.306] prior to these amendments, will now be required by Item 407(d) of Regulations S-B and S-K.

<sup>49</sup> The Compensation Committee Report that we adopt today is not deemed to be "soliciting material" or to be "filed" with the Commission or subject to Regulation 14A or 14C [17 CFR 240.14a-1 et seq. or 240.14c-1 et seq.], other than as specified, or to the liabilities of Section 18 of the Exchange Act [15 U.S.C. 78r], except to the extent a company specifically requests that the report be

Following the Compensation Discussion and Analysis, we have organized detailed disclosure of executive compensation into three broad categories:

- Compensation with respect to the last fiscal year (and the two preceding fiscal years), as reflected in an amended Summary Compensation Table that presents compensation paid currently or deferred (including options, restricted stock and similar grants) and compensation consisting of current earnings or awards that are part of a plan, and as supplemented by a table providing back-up information for certain data in the Summary Compensation Table;

- Holdings of equity-related interests that relate to compensation or are potential sources of future gains, with a focus on compensation-related equity interests that were awarded in prior years and are "at risk," whether or not these interests are in-the-money, as well as recent realization on these interests, such as through vesting of restricted stock or the exercise of options and similar instruments; and

- Retirement and other post-employment compensation, including retirement and deferred compensation plans, other retirement benefits and other post-employment benefits, such as those payable in the event of a change in control.

We are requiring improved tabular disclosure for each of the above three categories and appropriate narrative disclosure that provides material information necessary to an understanding of the information presented in the individual tables.<sup>50</sup> We have made some modifications from the proposal in response to comments.

In Release No. 33-8735, published elsewhere in the proposed rules section of this issue of the **Federal Register** and for which comments are due on or before October 23, 2006, we also solicit additional comments regarding the proposed disclosure requirement of the total compensation and job description of up to an additional three most highly compensated employees who are not

treated as filed or as soliciting material or specifically incorporates it by reference into a filing under the Securities Act or the Exchange Act, other than by incorporating by reference the report from a proxy or information statement into the Form 10-K. Instructions 1 and 2 to Item 407(e)(5).

<sup>50</sup> This narrative disclosure, together with the Compensation Discussion and Analysis noted above, will replace the narrative discussion that was required in the Board Compensation Report on Executive Compensation prior to these amendments. The narrative discussion, along with the rest of the amended executive officer and director compensation disclosure, other than the new Compensation Committee Report, will be company disclosure filed with the Commission.

executive officers or directors but who earn more than the named executive officers. In particular, we have specific requests for comment as to whether the proposal should be modified to apply only to large accelerated filers who would disclose the total compensation for the most recent fiscal year and a description of the job position for each of their three most highly compensated employees whose total compensation is greater than any of the named executive officers, whether or not such persons are executive officers. Under this approach, employees who have no responsibility for significant policy decisions within either the company, a significant subsidiary or a principal business unit, division, or function, would be excluded from the determination of the three most highly compensated employees and no disclosure regarding them would be required.

Finally, we are adopting a director compensation table that is similar to the amended Summary Compensation Table.<sup>51</sup>

We also highlight in the release that the principles-based disclosure rules we are adopting today, including but not limited to the Compensation Discussion and Analysis section, may require disclosure of various aspects of a company's use of options in compensating its executives and directors, including any programs, plans or practices a company may have with regard to the timing or dating of option grants.

We are also modifying, as proposed, some of the Form 8-K requirements regarding compensation. Form 8-K requires disclosure within four business days of the entry into, amendment of, and termination of, material definitive agreements that are entered into outside of the ordinary course of business. Under our definition of material contracts in Item 601 of Regulation S-K for the purposes of determining what exhibits are required to be filed, many agreements regarding executive compensation are deemed to be material agreements entered into outside the ordinary course. When, in 2004, for purposes of consistency, we looked to this definition for use in the Form 8-K requirements, we incorporated all of these executive compensation agreements into the Form 8-K disclosure requirements. Therefore, many agreements regarding executive compensation, including some not

related to named executive officers, have been required to be disclosed on Form 8-K within four business days of the applicable triggering event. Consistent with our intent that Form 8-K capture only events that are unquestionably or presumptively material to investors, we are today amending the Form 8-K requirements substantially as proposed.

We believe that executive and director compensation is closely related to financial transactions and relationships involving companies and their directors, executive officers and significant shareholders and respective immediate family members. Disclosure requirements regarding these matters historically have been interconnected, given that relationships among these parties and the company can include transactions that involve compensation or analogous features. Such disclosure also represents material information in evaluating the overall relationship with a company's executive officers and directors. Further, this disclosure provides material information regarding the independence of directors. The related party transaction disclosure requirements were adopted piecemeal over the years and were combined into one disclosure requirement beginning in 1982.<sup>52</sup> In light of many developments since then, including the increasing focus on corporate governance and director independence, we believe it is necessary to revise our requirements. Today's amendments update, clarify and somewhat expand the related party transaction disclosure requirements. The amendments fold into the disclosure requirements for related party transactions what had been a separate disclosure requirement regarding indebtedness of management and directors.<sup>53</sup> Further, we are adopting a requirement that calls for a narrative explanation of the independence status of directors under a company's director independence policies. We intend this requirement to be consistent with recent significant changes to the listing standards of the nation's principal securities trading markets.<sup>54</sup> We also are consolidating

<sup>52</sup> *Disclosure of Certain Relationships and Transactions Involving Management*, Release No. 33-6441 (Dec. 2, 1982) [47 FR 55661] (the "1982 Release").

<sup>53</sup> Prior to these amendments, related party transactions were disclosed under Item 404(a) of Regulations S-K and S-B, while indebtedness was separately required to be disclosed under Item 404(c) of Regulation S-K.

<sup>54</sup> See, e.g., *NASD and NYSE Rulemaking: Relating to Corporate Governance*, Release No. 34-48745 (Nov. 4, 2003) [68 FR 64154] (the "NASD and NYSE Listing Standards Release"). This new requirement will replace the disclosure requirement

this and other corporate governance disclosure requirements regarding director independence and board committees, including new disclosure requirements about the compensation committee, into a single expanded disclosure item.<sup>55</sup>

In order to ensure that these amended requirements result in disclosure that is clear, concise and understandable for investors, we are adding Rules 13a-20 and 15d-20 under the Exchange Act to require that most of the disclosure provided in response to the amended items be presented in plain English. This extends the plain English requirements currently applicable to portions of registration statements under the Securities Act to the disclosure required under the items that we have amended, which impose requirements for Exchange Act reports and proxy or information statements incorporated by reference into those reports.

Finally, we are amending our beneficial ownership disclosure requirements as proposed to require disclosure of shares pledged by named executive officers, directors and director nominees, as well as directors' qualifying shares.<sup>56</sup>

## II. Executive and Director Compensation Disclosure

Executive and director compensation disclosure has been required since 1933, and the Commission has had disclosure rules in this area applicable to proxy statements since 1938. In 1992, the Commission proposed and adopted substantially revised rules that embody our current requirements.<sup>57</sup> In doing so, the Commission moved away from narrative disclosure and back to using tables that permit comparability from year to year and from company to company. As we noted in the Proposing Release, although the reasoning behind this approach remains fundamentally sound, significant changes are appropriate. Much of the concern with the tables adopted in 1992 had also been their strength: they were highly formatted and rigid.<sup>58</sup> Thus, information not specifically called for in the tables had sometimes not been provided. For example, the highly formatted and specific approach had led some to

about director relationships that could affect independence specified in Item 404(b) of Regulation S-K prior to these amendments.

<sup>55</sup> New Item 407 of Regulations S-K and S-B.

<sup>56</sup> Item 403(b) of Regulations S-K and S-B.

<sup>57</sup> 1992 Release.

<sup>58</sup> See, e.g., Council of Institutional Investors' Discussion Paper on Executive Pay Disclosure, *Executive Compensation Disclosure: How it Works Now. How It Can Be Improved*, at 11 (available at [www.cii.org/site\\_files/pdfs/CIIPay%20primer%20edited.pdf](http://www.cii.org/site_files/pdfs/CIIPay%20primer%20edited.pdf)).

<sup>51</sup> We had proposed similar amendments, which we did not act on, regarding director compensation in 1995. *Streamlining and Consolidation of Executive and Director Compensation Disclosure*, Release No. 33-7184 (Aug. 6, 1995) [60 FR 35633] (the "1995 Release"), at Section I.B.

suggest that items that did not fit squarely within a "box" specified by the rules need not have been disclosed.<sup>59</sup> As another example, because the tables did not call for a single figure for total compensation, that information had generally not been provided prior to today's amendments, although there had been considerable commentary indicating that a single total figure is high on the list of information that some investors wish to have. To preserve the strengths of the former approach and build on them, we are taking several steps in adopting amendments to Item 402,<sup>60</sup> substantially as we proposed:

- First, we are retaining the tabular approach to provide clarity and comparability while improving the tabular disclosure requirements;
- Second, we are confirming that all elements of compensation must be included in the tables;
- Third, we are providing a format for the amended Summary Compensation Table that requires disclosure of a single figure for total compensation; and
- Finally, we are requiring narrative disclosure comprising both a general discussion and analysis of compensation and specific material information regarding tabular items where necessary to an understanding of the tabular disclosure.

#### A. Options Disclosure

##### 1. Background

Many companies use stock options to compensate their employees, including executives. In a simple stock option, a company may grant an employee the right to purchase a specified number of shares of the company's stock at a specific price, called the exercise price and usually set as the market price of the company's stock on the grant date. While some options require no future service from the employee, most include vesting provisions, such that the employee does not earn the option unless he remains employed by the company for a specified period of service. Often a company will grant a specific number of options that will then vest proportionately in staggered

increments over a set time period. For example, if the grant vests at a rate of 20% per year for five years, the option for the last 20% is earned by the employee's provision of five years of services. Most options become exercisable upon vesting and remain exercisable until their stated expiration. Generally, upon termination of the employment relationship, however, an employee loses unvested options, and has a limited term (*e.g.*, 90 days) to exercise vested options.<sup>61</sup>

Options have most often been issued "at-the-money"—*i.e.*, with an exercise price equal to the market price of the underlying stock at the date of grant—but may also be issued either "in-the-money"—*i.e.*, with an exercise price below the market price of the underlying stock at the date of grant—or "out-of-the-money"—*i.e.*, with an exercise price above the market price of the underlying stock at the date of grant. An option holder benefits only when the company's stock price is above the exercise price when the employee exercises the option. Hence, setting a lower exercise price increases the value of the option.

As some commentators have observed, using options for compensation purposes may have advantages. These commentators point out that, unlike salary and bonus compensation, stock option compensation does not require the payment of cash by the company, and therefore can be particularly attractive to companies for which cash is a scarce resource. Stock option compensation may also provide an incentive for employees to work to increase the company's stock price. Additionally, some companies may be able to use stock option compensation to help retain employees, because an employee forfeits their potential value if he leaves the company's employ.

At the same time, other commentators stress that option compensation is not without costs and disadvantages. Options granted to employees, if ultimately exercised with the resulting issuance of the underlying stock, give rise to a dilution of the interests in the company held by existing stockholders. Options that are not in-the-money may not provide a retention benefit, and some managers believe that options that fall out-of-the-money (or are "underwater") not only fail to motivate employees but, in fact, can result in

poor employee morale and resultant turnover, especially at companies where option compensation is an important component of total compensation. In addition, options with shorter vesting periods or longer term options approaching their vesting dates may provide incentives to employees to focus on increasing the company's stock price in the short term rather than working toward achieving longer term business goals and objectives that would enable the company to achieve and sustain future success.

The Commission does not seek to encourage or discourage the use of stock options or any other particular form of executive compensation. The federal securities laws, however, do require full and fair disclosure of compensation information to the extent material or required by Commission rule.

##### 2. Required Option Disclosures

The Commission acknowledged the importance to investors of proper disclosure of executives' option compensation throughout the Proposing Release. The existing body of rules regarding disclosure of executive stock option grants, however, has not previously contained a line-item requirement with respect to information regarding programs, plans or practices concerning the selection of stock option grant dates or exercise prices.<sup>62</sup> The disclosure we proposed in January, along with related disclosure we also adopt today, should provide investors with more information about option compensation.<sup>63</sup> We have summarized

<sup>62</sup> Our existing rules for companies' disclosure do prohibit material misrepresentations of option grant dates, as well as any resulting material misstatements of affected financial statements. Companies are also required under our existing rules to disclose any material information that may be necessary to make their other disclosures, in the light of the circumstances under which they are made, not misleading. See, *e.g.*, Rule 12b-20 under the Exchange Act [17 CFR 240.12b-20].

<sup>63</sup> We note that Exchange Act Rule 16a-3 [17 CFR 240.16a-3] sets forth the general reporting requirements under Exchange Act Section 16(a). Prior to August 2002, a number of transactions between an issuer and its officers or directors—such as the granting of options—were required to be disclosed following the end of the fiscal year in which the transaction took place although individuals could disclose those transactions earlier if they chose to. In implementing Section 403(a) of the Sarbanes-Oxley Act of 2002, in August 2002, the Commission required immediate disclosure of these transactions for the first time. As a result, since August 2002, grants, awards and other acquisitions of equity-based securities from the issuer, including those pursuant to employee benefit plans (which were previously reportable on an annual basis on Form 5) have been required to be reported by officers and directors on Form 4 within two business days. *Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, Release No. 34-46421 (Aug. 27, 2002) [56 FR 56461] at Section II.B.

<sup>59</sup> For examples, see, *e.g.*, The Corporate Counsel (Sept.–Oct. 2005) at 6–7; The Corporate Counsel (Sept.–Oct. 2004) at 7; but see Alan L. Beller, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, *Remarks Before Conference of the NASPP, The Corporate Counsel and the Corporate Executive* (Oct. 20, 2004), available at [www.sec.gov/news/speech/spch102004alb.htm](http://www.sec.gov/news/speech/spch102004alb.htm).

<sup>60</sup> The discussion that follows focuses on amendments to Item 402 of Regulation S–K, with Section II.D.1. explaining the different amendments to Item 402 of Regulation S–B. References throughout the following discussion are to Items of Regulation S–K, unless otherwise indicated.

<sup>61</sup> More complex stock options can include provisions that alter the terms of the instrument based on whether performance or other targets are met.

below the various provisions of the rules that we adopt today that relate to options disclosure.<sup>64</sup>

#### a. Tabular Disclosures

The following disclosures are required in the tables we adopt today. These provisions are discussed in more detail later in the section relating to each particular table.

- As proposed and adopted, grants of stock options will be disclosed in the Summary Compensation Table at their fair value on the date of grant, as determined under FAS 123R. By basing the executive compensation disclosure on the full grant date fair value computed in accordance with FAS 123R, companies will give shareholders an accurate picture of the value of options at the time they are actually granted to the highest-paid executive officers.<sup>65</sup>

- A separate table including disclosure of equity awards, the Grants of Plan-Based Awards Table, requires disclosure of the grant date as determined pursuant to FAS 123R.<sup>66</sup> The grant date is generally considered the day the decision is made to award the option as long as recipients of the award are notified promptly. Even if the option's exercise price is set based on trading prices as of an earlier date or dates, the grant date does not change.

- If the exercise price is less than the closing market price of the underlying security on the date of the grant, a separate, adjoining column would have to be added to this table showing that market price on the date of the grant.<sup>67</sup>

- If the grant date is different from the date the compensation committee or full board of directors takes action or is deemed to take action to grant an option, a separate, adjoining column would have to be added to this table showing the date the compensation committee or full board of directors took action or was deemed to take action to grant the option.<sup>68</sup>

Further, if the exercise or base price of an option grant is not the closing market price per share on the grant date, we require a description of the methodology for determining the exercise or base price.<sup>69</sup>

<sup>64</sup> We also note that under our rules regarding disclosure of director compensation, the concerns and considerations for disclosure of option timing or dating practices in the executive compensation realm would also apply when the recipients of the stock option grants are directors of the company.

<sup>65</sup> Item 402(c)(2)(vi).

<sup>66</sup> Item 402(d)(2)(ii) and Item 402(a)(6)(iv).

<sup>67</sup> Item 402(d)(2)(vii).

<sup>68</sup> Item 402(d)(2)(iii).

<sup>69</sup> Instruction 3 to Item 402(d).

#### b. Compensation Discussion and Analysis

Companies will also be required to address matters relating to executives' option compensation in the new Compensation Discussion and Analysis section, particularly as they relate to the timing and pricing of stock option grants. Without being an exhaustive list, several of the examples provided in Item 402(b)(2) illustrate how these types of issues and questions might be covered in a company's disclosure. For example, Item 402(b)(2)(iv) shows that how the determination is made as to when awards are granted could be required disclosure. This example was included in part to note that material information to be disclosed under Compensation Discussion and Analysis may include the reasons a company selects particular grant dates for awards, such as for stock options. Similarly, other examples we provide in Item 402(b)(2) illustrate how the material information to be disclosed under Compensation Discussion and Analysis might need to include the methods a company uses to select the terms of awards, such as the exercise prices of stock options.

##### i. Timing of Option Grants

We understand that some companies grant options in coordination with the release of material non-public information. If the company had since the beginning of the last fiscal year, or intends to have during the current fiscal year, a program, plan or practice to select option grant dates for executive officers in coordination with the release of material non-public information, the company should disclose that in the Compensation Discussion and Analysis section. For example, a company may grant awards of stock options while it knows of material non-public information that is likely to result in an increase in its stock price, such as immediately prior to a significant positive earnings or product development announcement. Such timing could occur in at least two ways:

- The company grants options just prior to the release of material non-public information that is likely to result in an increase in its stock price (whether the date of that release of material non-public information is a regular date or otherwise pre-announced, or not); or
- The company chooses to delay the release of material non-public information that is likely to result in an increase in its stock price until after a stock option grant date.

Although the facts would be slightly different, a company also may coordinate its grant of stock options with the release of *negative* material non-public information. Again, such timing could occur in at least two ways:

- The company delays granting options until after the release of material non-public information that is likely to result in a decrease in its stock price; or
- The company chooses to release material non-public information that is likely to result in a decrease in its stock price prior to an upcoming stock option grant.

The Commission does not express a view as to whether or not a company may or may not have valid and sufficient reasons for such timing of option grants, consistent with a company's own business purposes. Some commentators have expressed the view that following these practices may enable a company to receive more benefit from the incentive or retention effect of options because recipients may value options granted in this manner more highly or because doing so provides an immediate incentive for employee retention because an employee who leaves the company forfeits the potential value of unvested, in-the-money options. Other commentators believe that timing option grants in connection with the release of material non-public information may unfairly benefit executives and employees.

Regardless of the reasons a company or its board may have, the Commission believes that in many circumstances the existence of a program, plan or practice to time the grant of stock options to executives in coordination with material non-public information would be material to investors and thus should be fully disclosed in keeping with the rules we adopt today. Consistent with principles-based disclosure, companies should consider their own facts and circumstances and include all relevant material information in their corresponding disclosures.<sup>70</sup> If the company has such a program, plan or practice, the company should disclose that the board of directors or compensation committee may grant options at times when the board or committee is in possession of material non-public information. Companies might also need to consider disclosure about how the board or compensation committee takes such information into

<sup>70</sup> Relevant material information might include disclosure in response to the examples in Item 402(b)(2) in the Compensation Discussion and Analysis section, discussed below.

account when determining whether and in what amount to make those grants.

Although it is not an exhaustive list, there are some elements and questions about option timing to which we believe a company should pay particular attention when drafting the appropriate corresponding disclosure.

- Does a company have any 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?

Disclosure would also be required where a company has not previously disclosed a program, plan or practice of timing option grants, but has adopted such a program, plan or practice or has made one or more decisions since the beginning of the past fiscal year to time option grants.

## ii. Determination of Exercise Price

Separate from these timing issues, some companies may have a program, plan or practice of awarding options and setting the exercise price based on the stock's price on a date other than the actual grant date. Such a program, plan or practice would also require disclosure, including, as appropriate, in the tables described in II.A.2.a above and in the Compensation Discussion and Analysis section. Again, as with the timing matters discussed above, companies should consider their own facts and circumstances and include all

relevant material information in their corresponding disclosures.

Similar to such a practice of setting the exercise price based on a date other than the actual grant date, some companies have provisions in their option plans or have followed practices for determining the exercise price by using formulas based on average prices (or lowest prices) of the company's stock in a period preceding, surrounding or following the grant date. In some cases these provisions may increase the likelihood that recipients will be granted in-the-money options. As these provisions or practices relate to a material term of a stock option grant, they should be discussed in the Compensation Discussion and Analysis section.

### B. Compensation Discussion and Analysis

We are adopting a new Compensation Discussion and Analysis section.<sup>71</sup> As we proposed, this section will be an overview providing narrative disclosure that puts into context the compensation disclosure provided elsewhere.<sup>72</sup> Commenters generally supported the new Compensation Discussion and Analysis section.<sup>73</sup> This overview will

<sup>71</sup> Item 402(b). In addition to the narrative Compensation Discussion and Analysis, we are amending the rules so that, to the extent material, additional narrative disclosure will be provided following certain tables to supplement the disclosure in the table. See, e.g., Section II.C.3.a., discussing the narrative disclosure to the Summary Compensation Table and the Grants of Plan-Based Awards Table. We are also requiring disclosure of compensation committee procedures and processes as well as information regarding compensation committee interlocks and insider participation in compensation decisions as part of new Item 407 of Regulation S-K. See Section V.D., below.

<sup>72</sup> See Jeffrey N. Gordon, *Executive Compensation: What's the Problem, What's the Remedy? The Case for Compensation Discussion and Analysis*, 30 J. Corp. L. 695 (2005) (arguing that the Commission should require proxy disclosure that includes a "Compensation Discussion and Analysis" section that collects and summarizes all the compensation elements for senior executives, providing a "bottom line assessment" of the different compensation elements and an explanation as to why the board thinks such compensation is warranted).

<sup>73</sup> See, e.g., letters from British Columbia Investment Management Corporation ("BCIMC"); Leo J. Burns ("L. Burns"); CFA Centre for Financial Market Integrity, dated April 13, 2006 ("CFA Centre 1"); Chamber of Commerce of the United States of America ("Chamber of Commerce"); Board of Fire and Police Pension Commissioners of the City of Los Angeles ("F&P Pension Board"); F&C Asset Management; Foley & Lardner LLP ("Foley"); Hermes Investment Management Limited; Governance for Owners USA, Inc. ("Governance for Owners"); International Association of Machinists and Aerospace Workers ("IAM"); Board of Trustees of the International Brotherhood of Electrical Workers Pension Benefit Fund ("IBEW PBF"); International Brotherhood of Teamsters ("Teamsters"); Remuneration Committee of the International Corporate Governance Network;

explain material elements of the particular company's compensation for named executive officers by answering the following questions:

- What are the objectives of the company's compensation programs?
- What is the compensation program designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and, where applicable, the formula) for each element?
- How do each element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements?

As proposed, the second question also asked what the compensation program is designed *not* to reward. Commenters stated that compensation committees often may not consider this objective in developing compensation programs, expressing concern that the question could generate potentially limitless disclosure that would not add meaning to disclosure of what the compensation program is designed to award.<sup>74</sup> In response to this concern, we have not included this question in the rule as adopted.

### 1. Intent and Operation of the Compensation Discussion and Analysis

The purpose of the Compensation Discussion and Analysis disclosure is to provide material information about the compensation objectives and policies for named executive officers without resorting to boilerplate disclosure. The Compensation Discussion and Analysis is intended to put into perspective for investors the numbers and narrative that follow it.

Investment Company Institute ("ICI"); Institutional Shareholder Services ("ISS"); jointly, California Public Employees' Retirement System, California State Teachers' Retirement System, Co-operative Insurance Society—UK, F&C Asset Management—UK, Illinois State Board of Investment, London Pensions Fund Authority—UK, New York State Common Retirement Fund, New York City Pension Funds, Ontario Teachers' Pension Plan, PGGM Investments—Netherlands, Public Sector and Commonwealth Super (PSS/CSS)—Australia, RAILPEN Investments—UK, State Board of Administration (SBA) of Florida, Stichting Pensioenfondsen ABP—Netherlands, UniSuper Limited—Australia, and Universities Superannuation Scheme—UK ("Institutional Investors Group"); The Pension Boards—United Church of Christ ("PB-UCC"); State of Wisconsin Investment Board; and T. Rowe Price Associates, Inc.

<sup>74</sup> See, e.g., letters from American Bar Association, Committee on Federal Regulation of Securities ("ABA"); Committee on Securities Regulation of the New York City Bar ("NYCBA"); and WorldatWork ("WorldatWork").

As described in the Proposing Release and as adopted, the Compensation Discussion and Analysis requirement is principles-based, in that it identifies the disclosure concept and provides several illustrative examples. Some commenters suggested that a principles-based approach would be better served without examples, on the theory that "laundry lists" would lead to boilerplate.<sup>75</sup> Other commenters expressed the opposite view—that more specific description of required disclosure topics would more effectively elicit meaningful disclosure.<sup>76</sup>

As we explained in the Proposing Release, overall we designed the proposals to state the requirements sufficiently broadly to continue operating effectively as future forms of compensation develop, without suggesting that items that do not fit squarely within a "box" specified by the rules need not be disclosed. We believe that the adopted principles-based Compensation Discussion and Analysis, utilizing a disclosure concept along with illustrative examples, strikes an appropriate balance that will effectively elicit meaningful disclosure, even as new compensation vehicles develop over time.

We wish to emphasize, however, that the application of a particular example must be tailored to the company and that the examples are non-exclusive. We believe using illustrative examples helps to identify the types of disclosure that may be applicable. A company must assess the materiality to investors of the information that is identified by the example in light of the particular situation of the company. We also note that in some cases an example may not be material to a particular company, and therefore no disclosure would be required. Because the scope of the Compensation Discussion and Analysis is intended to be comprehensive, a company must address the compensation policies that it applies, even if not included among the examples. The Compensation Discussion and Analysis should reflect the individual circumstances of a company and should avoid boilerplate disclosure.

We have adopted, substantially as proposed, the following examples of the issues that would potentially be appropriate for the company to address in given cases in the Compensation Discussion and Analysis:

- Policies for allocating between long-term and currently paid out compensation;
- Policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation;
  - For long-term compensation, the basis for allocating compensation to each different form of award;
  - How the determination is made as to when awards are granted, including awards of equity-based compensation such as options;
  - What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions;
    - How specific elements of compensation are structured and implemented to reflect these items of the company's performance and the executive's individual performance;
    - The factors considered in decisions to increase or decrease compensation materially;
    - How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g., how gains from prior option or stock awards are considered in setting retirement benefits);
    - The impact of accounting and tax treatments of a particular form of compensation;
    - The company's equity or other security ownership requirements or guidelines and any company policies regarding hedging the economic risk of such ownership;
    - Whether the company engaged in any benchmarking of total compensation or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies); and
    - The role of executive officers in the compensation process.

At the suggestion of a commenter,<sup>77</sup> we have expanded the example addressing how specific forms of compensation are structured to reflect company performance to also address implementation. We have made a similar change with regard to the example regarding the executive's individual performance.<sup>78</sup> As adopted, this example includes not only whether discretion can be exercised (either to award compensation absent attainment of the relevant performance goal(s) or to

reduce or increase the size of any award or payout), as proposed, but also whether such discretion has been exercised. By doing this, we move to the Compensation Discussion and Analysis overview an example of a material factor that had been proposed for the narrative disclosure that follows the Summary Compensation Table,<sup>79</sup> and expand its scope so that it is no longer limited to non-equity incentive plans. Because of the policy significance of decisions to waive or modify performance goals, we believe that they are more appropriately discussed in the Compensation Discussion and Analysis.

As discussed in Section II.A. above, a company's policies, programs and practices regarding the award of stock options and other equity-based instruments to compensate executives may require disclosure and discussion in the Compensation Discussion and Analysis. As with all disclosure in the Compensation Discussion and Analysis, a company must evaluate the specific facts and circumstances of its grants of options and equity-based instruments and provide such disclosure if it supplies material information about the company's compensation objectives and policies for named executive officers.

Further in response to comment,<sup>80</sup> we have revised the example addressing how the determination is made as to when awards are granted so that it is not limited to equity-based compensation, as was proposed, but we clarify in the rule as adopted that it would include equity-based compensation, such as stock options.<sup>81</sup> Regarding the example noting the impact of accounting and tax treatments of a particular form of compensation, some commenters urged that companies be required to continue to disclose their Internal Revenue Code Section 162(m) policy.<sup>82</sup> The adoption of this example should not be construed to eliminate this discussion. Rather, this example indicates more broadly that any tax or accounting treatment, including but not limited to Section 162(m), that is material to the company's compensation policy or decisions with respect to a named

<sup>79</sup> This example had been proposed as Item 402(f)(1)(iv).

<sup>80</sup> See letter from ABA.

<sup>81</sup> This example is discussed in more detail above in Section II.A., the discussion of stock option disclosure.

<sup>82</sup> See, e.g., letters from Buck Consultants; Frederic W. Cook & Co., Inc., dated March 9, 2006 ("Frederic W. Cook & Co."); Thomas Rogers; and WorldatWork. The Commission has construed the Board Compensation Committee Report on Executive Compensation (which had been required to be furnished by Item 402(k) prior to these amendments) to require discussion of this policy. 1993 Release at Section III.

<sup>77</sup> See letter from ABA.

<sup>78</sup> We have also reordered this example, so it is clearer that the items of company performance referenced are the ones noted in the immediately preceding example.

<sup>75</sup> See, e.g., letter from Curt Kollar ("C. Kollar").

<sup>76</sup> See, e.g., letters from CFA Centre 1 and Hewitt Associates LLC ("Hewitt").

executive officer is covered by Compensation Discussion and Analysis. Tax consequences to the named executive officers, as well as tax consequences to the company, may fall within this example.

In addition, we have followed commenters' recommendations to add the following specific examples addressing additional factors:

- Company policies and decisions regarding the adjustment or recovery of awards or payments if the relevant company performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;<sup>83</sup> and
- The basis for selecting particular events as triggering payment with respect to post-termination agreements (e.g., the rationale for providing a single trigger for payment in the event of a change-in-control).<sup>84</sup>

Commenters also requested clarification as to whether Compensation Discussion and Analysis is limited to compensation for the last fiscal year, like the former Board Compensation Committee Report on Executive Compensation that was required prior to these amendments.<sup>85</sup> While the Compensation Discussion and Analysis must cover this subject, the Compensation Discussion and Analysis may also require discussion of post-termination compensation arrangements, on-going compensation arrangements, and policies that the company will apply on a going-forward basis.<sup>86</sup> Compensation Discussion and

Analysis should also cover actions regarding executive compensation that were taken after the last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.

The Compensation Discussion and Analysis should be sufficiently precise to identify material differences in compensation policies and decisions for individual named executive officers where appropriate. Where policies or decisions are materially similar, officers can be grouped together. Where, however, the policy or decisions for a named executive officer are materially different, for example in the case of a principal executive officer, his or her compensation should be discussed separately.

## 2. Instructions to Compensation Discussion and Analysis

We are adopting instructions to make clear that the Compensation Discussion and Analysis should focus on the material principles underlying the company's executive compensation policies and decisions, and the most important factors relevant to analysis of those policies and decisions, without using boilerplate language or repeating the more detailed information set forth in the tables and related narrative disclosures that follow. The instructions also provide that the Compensation Discussion and Analysis should concern the information contained in the tables and otherwise disclosed.<sup>87</sup> Because this section is intended to provide meaningful analysis, it may specifically refer to the tabular or other disclosures where helpful to make the discussion more robust. A commenter raised a concern that the instruction not to repeat information set forth in the other disclosures might somehow limit the disclosure made in Compensation Discussion and Analysis.<sup>88</sup> We have revisited this instruction, which is intended to encourage analysis and to forestall mere repetition of the information in the tables, to provide that repetition and boilerplate language should be avoided. The instruction does

not prohibit or discourage discussion of that specific information.

We are adopting an instruction to make clear that, as was the case with the Board Compensation Committee Report on Executive Compensation required prior to the adoption of these amendments, companies are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm to the company.<sup>89</sup> Some commenters objected that this instruction would impair the quality of information disclosed by making it difficult to assess the link between pay and company performance, and suggested that competitive harm would be mitigated if disclosure were required on an after-the-fact basis, after the performance related to the award is measured.<sup>90</sup> Different commenters stated that performance targets often are based on confidential, competitively sensitive business plans, and that requiring disclosure could encourage the use of more generic targets that could hinder a company's goal of pay-for-performance.<sup>91</sup> Other commenters observed that companies rarely use a performance metric for a single year or plan cycle, but select measures because of their relevance to the company's business strategy over several years, so that even disclosure on an after-the-fact basis could reveal proprietary business information that would be useful to competitors.<sup>92</sup> Having considered these comments, we remain persuaded that this disclosure, even on an after-the-fact basis could pose significant risk of competitive harm and we are therefore not requiring it in those cases in which the factors or criteria considered involve confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm to the company.

As noted in the Proposing Release, in applying this instruction, we intend the standard for companies to use in making a determination that this information

<sup>83</sup> See, e.g., letters from Amalgamated Bank Long-View Funds ("Amalgamated"); CFA Centre 1; and Council of Institutional Investors, dated March 29, 2006 ("CII"). Section 304 of the Sarbanes-Oxley Act of 2002 [codified at 15 U.S.C. 7243] provides that if a company is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the principal executive officer and principal financial officer of the company shall reimburse the company for any bonus or other incentive-based or equity-based compensation received by that person from the company during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement, and any profits realized from the sale of securities of the company during that 12-month period. This example would not necessarily be limited to policies covering only situations contemplated by Section 304.

<sup>84</sup> See letter from Anonymous, dated April 10, 2006.

<sup>85</sup> See, e.g., letters from Buck Consultants; Frederic W. Cook & Co.; and Mercer Human Resource Consulting, Inc., dated April 10, 2006 ("Mercer").

<sup>86</sup> Forward looking information in the Compensation Discussion and Analysis will fall within the safe harbors for disclosure of such information. See, e.g., Securities Act Section 27A

[15 U.S.C. 77z-2] and Exchange Act Section 21E [15 U.S.C. 78u-5].

<sup>87</sup> Instruction 2 to Item 402(b).

<sup>88</sup> See letter from ABA.

<sup>89</sup> Instruction 4 to Item 402(b). Prior to these amendments, Instruction 2 to Item 402(k) had provided a similar exclusion for this type of information.

<sup>90</sup> See, e.g., letters from American Federation of Labor and Congress of Industrial Organizations, dated April 5, 2006 ("AFL-CIO"); CII; Governance for Owners; IAM; and The Honorable Barney Frank, United States Representative (MA).

<sup>91</sup> See, e.g., letter from Sullivan & Cromwell LLP ("Sullivan").

<sup>92</sup> See, e.g., letter from Mercer.

does not have to be disclosed to be the same one that would apply when companies request confidential treatment of confidential trade secrets or confidential commercial or financial information that otherwise is required to be disclosed in registration statements, periodic reports and other documents filed with us.<sup>93</sup> Under this approach, to the extent a performance target has otherwise been disclosed publicly, non-disclosure pursuant to this instruction would not be permitted. To make these standards clearer and respond to commenters' concerns that companies may exploit the instruction to exclude information in inappropriate circumstances, we are revising this instruction as adopted to clearly apply the same standard as for confidential treatment requests. Companies will not be required, however, to submit confidential treatment requests in order to rely on the instruction.<sup>94</sup> To mitigate commenters' concerns that omission of specific performance targets would impair the quality of disclosure, the instruction requires additional disclosure regarding the significance of the undisclosed target. Specifically, if the company uses target levels for specific quantitative or qualitative performance-related factors, or other factors or criteria that it does not disclose in reliance on the instruction, the company must discuss how difficult it will be for the executive or how likely it will be for the company to achieve the undisclosed target levels or other factors. In addition, as discussed below, the Compensation Discussion and Analysis will be considered soliciting material and will be filed with the Commission. This disclosure will be subject to review by the Commission and its staff. Therefore, if a company uses target levels that otherwise would need to be disclosed but does not disclose them in reliance on the instruction, the company may be required to demonstrate to the Commission or its staff that the

particular factors or criteria involve confidential trade secrets or confidential commercial or financial information and why disclosure would result in competitive harm. If the Commission or its staff ultimately determines that a company has not met these standards, then the company will be required to disclose publicly the factors or criteria used. In response to a commenter's concern,<sup>95</sup> we have also added an instruction to clarify that disclosure of a target level that applies a non-GAAP financial measure will not be subject to the general rules regarding disclosure of non-GAAP financial measures but the company must disclose how the number is calculated from the audited financial statements.<sup>96</sup>

One commenter stated that the Compensation Discussion and Analysis of a new public company should be permitted to be a prospective-only discussion.<sup>97</sup> While we agree the most significant disclosure in that situation may be future plans, we do not believe a prospective-only discussion is appropriate. Instead, companies may emphasize the new plans or policies.

### 3. "Filed" Status of Compensation Discussion and Analysis and the "Furnished" Compensation Committee Report

We proposed that the Compensation Discussion and Analysis would be considered a part of the proxy statement and any other filing in which it was included. Unlike the Board Compensation Committee Report on Executive Compensation that was required prior to these amendments, we proposed that the Compensation Discussion and Analysis would be considered soliciting material and would be filed with the Commission. Therefore, it would be subject to Regulation 14A or 14C and to the liabilities of Section 18 of the Exchange Act.<sup>98</sup> In addition, to the extent that the Compensation Discussion and Analysis and any of the other disclosure regarding executive officer and director compensation or other matters are included or incorporated by reference into a periodic report, the disclosure would be covered by the certifications that principal executive officers and principal financial officers are required to make under the Sarbanes-Oxley Act

of 2002.<sup>99</sup> Likewise, a company's disclosure controls and procedures<sup>100</sup> apply to the preparation of the company's proxy statement and Form 10-K, including the Compensation Discussion and Analysis.

We noted in the Proposing Release that in adopting the rules that have applied since 1992, the Commission took into account comments that the Board Compensation Committee Report on Executive Compensation should be furnished rather than filed to allow for more open and robust discussion in the reports.<sup>101</sup> The Board Compensation Committee Reports on Executive Compensation that were provided prior to today's amendments in general did not suggest that this treatment resulted in such discussion, nor the more transparent disclosure that the comments suggested would result.<sup>102</sup> Further, we noted that we believe that it is appropriate for companies to take responsibility for disclosure involving board matters as with other disclosure.

Some commenters supported the proposal to have the Compensation Discussion and Analysis filed, noting among other things that filing should lead to increased accuracy and better disclosure.<sup>103</sup> Other commenters objected to this treatment, claiming that certification by principal executive officers and principal financial officers with regard to the disclosure included in the annual report on Form 10-K, including particularly the Compensation Discussion and Analysis, would inappropriately insert these officers into the compensation

<sup>93</sup> See Securities Act Rule 406 [17 CFR 230.406], Exchange Act Rule 24b-2 [17 CFR 240.24b-2], Exemption 4 of the Freedom of Information Act [5 U.S.C. 552(b)(4)], and Rule 80(b)(4) promulgated under the Freedom of Information Act [17 CFR 200.80(b)(4)].

<sup>94</sup> While the instruction adopted today, like the instruction that it replaces, does not require a company to seek confidential treatment under the procedures in Securities Act Rule 406 and Exchange Act Rule 24b-2 with regard to the exclusion of the information from the disclosure provided in response to this item, the standards specified in Securities Act Rule 406, Exchange Act Rule 24b-2, Exemption 4 of the Freedom of Information Act and Rule 80(b)(4) promulgated under the Freedom of Information Act still apply and are subject to review and comment by the staff of the Commission.

<sup>95</sup> See letter from ABA.

<sup>96</sup> Instruction 5 to Item 402(b). The non-GAAP financial measure provisions are specified in Regulation G [17 CFR 244.100-102], Item 10(e) of Regulation S-K [17 CFR 229.10] and Item 10(h) of Regulation S-B [17 CFR 228.10].

<sup>97</sup> See letter from ABA.

<sup>98</sup> 15 U.S.C. 78r.

<sup>99</sup> Exchange Act Rules 13a-14 [17 CFR 240.13a-14] and 15d-14 [17 CFR 240.15d-14]. See also *Certification of Disclosure in Companies' Quarterly and Annual Reports*, Release No. 34-46427 (Aug. 29, 2002) [67 FR 57275], at n. 35 (the "Certification Release") (stating that "the certification in the annual report on Form 10-K or 10-KSB would be considered to cover the Part III information in a registrant's proxy or information statement as and when filed").

<sup>100</sup> Exchange Act Rules 13a-15 [17 CFR 240.13a-15] and 15d-15 [17 CFR 240.15d-15].

<sup>101</sup> 1992 Release, at Section II.H.

<sup>102</sup> See also Martin D. Mobley, *Compensation Committee Reports Post-Sarbanes-Oxley: Unimproved Disclosure for Executive Compensation Policies and Practices*, 2005 Colum. Bus. L. Rev. 111 (2005).

<sup>103</sup> See, e.g., letters from AFL-CIO; American Federation of State, County and Municipal Employees; California Public Employees' Retirement System ("CalPERS"); Paul Hodgson, Senior Research Associate, Executive and Board Compensation, the Corporate Library ("Corporate Library"); Connecticut Retirement Plans and Trust Funds, dated April 10, 2006 ("CRPTF"); Southwestern Pennsylvania and Western Maryland Area Teamsters and Employers Pension Fund ("Teamsters PA/MD"); Teamsters Local 671 Health Services and Insurance Plan ("Teamsters Local 671"); Walden Asset Management ("Walden"); and Western PA Teamsters & Employers Welfare Fund ("Western PA Teamsters Fund").

committee's deliberative process, potentially calling into question the committee's independence.<sup>104</sup> Further, many commenters expressed the view that the Compensation Discussion and Analysis should, in effect, be the report of the compensation committee, submitted under the names of its members, for which they should be accountable.<sup>105</sup>

Some of these objections may reflect a misconception of the purpose of the Compensation Discussion and Analysis. Although the Compensation Discussion and Analysis discusses company compensation policies and decisions, the Compensation Discussion and Analysis does not address the deliberations of the compensation committee, and is not a report of that committee. Consequently, in certifying the Compensation Discussion and Analysis, principal executive officers and principal financial officers will not need to certify as to the compensation committee deliberations.

However, in response to concerns of commenters that compensation committees should continue to be focused on the executive compensation disclosure process, we are adopting a Compensation Committee Report similar to the Audit Committee Report.<sup>106</sup> Drawing on commenters' suggestions for a new Compensation Committee Report,<sup>107</sup> the rules we adopt today require the compensation committee to state whether:

- The compensation committee has reviewed and discussed the Compensation Discussion and Analysis with management; and
- 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 on Form 10-K and, as applicable, the company's proxy or information statement.

Unlike the Audit Committee Report, the Compensation Committee Report

will be required to be included or incorporated by reference into the company's annual report on Form 10-K, so that it is presented along with the Compensation Discussion and Analysis when that disclosure is provided in the Form 10-K or incorporated by reference from a proxy or information statement.<sup>108</sup> Like the Audit Committee Report, the Compensation Committee Report will only be required one time during any fiscal year.<sup>109</sup> The name of each member of the company's compensation committee (or, in the absence of a compensation committee, the persons performing equivalent functions or the entire board of directors) must appear below the disclosure.<sup>110</sup> This report will be "furnished" rather than "filed." The principal executive officer and principal financial officer will be able to look to the Compensation Committee Report in providing their certifications required under Exchange Act Rules 13a-14 and 15d-14.<sup>111</sup>

#### 4. Retention of the Performance Graph

In light of the Compensation Discussion and Analysis requirement, we proposed to eliminate both the Board Compensation Committee Report on Executive Compensation and the Performance Graph.<sup>112</sup> The report and the graph were intended to be related and to show the relationship, if any, between compensation and corporate performance, as reflected by stock price. The rules we adopt today eliminate the Board Compensation Committee Report on Executive Compensation, as we proposed, in favor of the more comprehensive Compensation

Discussion and Analysis and the new Compensation Committee Report, as described immediately above.<sup>113</sup>

Given the widespread availability of stock performance information about companies, industries and indexes through business-related Web sites or similar sources, we proposed to eliminate the requirement for the Performance Graph in the belief that it was outdated, particularly since the disclosure in the Compensation Discussion and Analysis regarding the elements of corporate performance that a given company's policies might reach is intended to allow broader discussion than just that of the relationship of compensation to the performance of the company as reflected by stock price. Many commenters objected to eliminating the Performance Graph, however, stating that it provides an easily accessible visual comparison of a company's performance relative to its peers and the market, and provides a standardized source for this type of information.<sup>114</sup> In light of the significance of this disclosure to a broad spectrum of commenters, we have decided to retain the Performance Graph in the amendments we adopt today.

However, we remain of the view that the Performance Graph should not be presented as part of executive compensation disclosure. In particular, as noted above, the disclosure in the Compensation Discussion and Analysis regarding the elements of corporate performance that a given company's policies consider is intended to encourage broader discussion than just that of the relationship of executive compensation to the performance of the company as reflected by stock price. Presenting the Performance Graph as compensation disclosure may weaken this objective. Accordingly, we have decided to retain the requirements for the Performance Graph, but have moved them to the disclosure item entitled "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters."<sup>115</sup> As

<sup>108</sup> The audit committee report is only required in a company proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). See Instruction 3 to Item 407(d).

<sup>109</sup> Instruction 3 to Item 407(e)(5). The audit committee instruction is specified in Instruction 2 to Item 407(d).

<sup>110</sup> Item 407(e)(5)(iii).

<sup>111</sup> We note that one commenter suggested that the Compensation Discussion and Analysis should not be required of companies that have only registered the offer and sale of debt securities. See letter from Financial Security Assurance Holdings Ltd. The Compensation Discussion and Analysis is intended to put into perspective for investors the numbers and narrative that follow it. This section will provide a broader discussion than just that of the relationship of compensation to the performance of the company as reflected by stock price. Therefore, we believe it is appropriate for all companies that are not small business issuers or foreign private issuers filing on forms specified for their use to include the information.

<sup>112</sup> Prior to these amendments, the Board Compensation Committee Report on Executive Compensation had been required by Item 402(k) and the Performance Graph had been required by Item 402(l).

<sup>113</sup> Section II.B.3.

<sup>114</sup> See, e.g., letters from CalSTRS; CFA Centre 1; CII; IUE-CWA Pension Fund and 401(k) Plan ("IUE-CWA"); John W. Hamm; NYCBA; Standard Life Investments Limited ("Standard Life"); and Vivient Consulting LLC.

<sup>115</sup> New Item 201(e) of Regulation S-K [17 CFR 229.201(e)] will require the Performance Graph. Consistent with our belief that the Performance Graph should not be linked to the compensation disclosure, we have not retained the portion of the language that was included in Instruction 4 to Item 402(l) prior to these amendments, which conditioned that other performance measures in addition to total return may be included in the graph only so long as the compensation committee (or persons performing equivalent functions or the entire board if there is no such committee) provided

<sup>104</sup> See, e.g., letters from The Corporate & Securities Law Committee and the Employment & Labor Law Committee of the Association of Corporate Counsel ("ACC"); Compass Bancshares, Inc. ("Compass Bancshares"); National Association of Manufacturers ("NAM"); Peabody Energy Corporation ("Peabody Energy"); and WorldatWork.

<sup>105</sup> See, e.g., letters from Jesse Brill, Chair of CompensationStandards.com and Chair of the National Association of Stock Plan Professionals, dated March 1, 2006 ("J. Brill 1"); CFA Centre 1; CRPTF; Frederic W. Cook & Co.; and Hewitt.

<sup>106</sup> We are moving the audit committee report previously required by Item 306 of Regulations S-K and S-B to Item 407(d) under the amendments adopted today. See Section V.D., below.

<sup>107</sup> See, e.g., letters from J. Brill 1; California State Teachers' Retirement System ("CalSTRS"); CFA Centre 1; and Professor William J. Heisler.

retained, the Performance Graph will continue to be "furnished" rather than "filed." The Performance Graph will be required only in the company's annual report to security holders that accompanies or precedes a proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting), and will not be deemed to be soliciting material under the proxy rules or incorporated by reference into any filing except to the extent that the company specifically incorporates it.<sup>116</sup>

### C. Compensation Tables

To enhance the benefits of the tabular approach to eliciting compensation disclosure,<sup>117</sup> we proposed to reorganize and streamline the tables to provide a clearer and more logical picture of total compensation and its elements for named executive officers. We are adopting reorganized compensation tables and related narrative disclosure that cover three broad categories:

1. Compensation with respect to the last fiscal year (and the two preceding fiscal years), as reflected in a revised Summary Compensation Table that presents compensation paid currently or deferred (including options, restricted stock and similar grants) and compensation consisting of current earnings or awards that are part of a plan, and as supplemented by one table providing back-up information for certain data in the Summary Compensation Table;<sup>118</sup>

2. Holdings of equity-based interests that relate to compensation or are potential sources of future compensation, focusing on compensation-related equity-based

interests that were awarded in prior years<sup>119</sup> and are "at risk," as well as recent realization on these interests, such as through vesting of restricted stock or the exercise of options and similar instruments;<sup>120</sup> and

3. Retirement and other post-employment compensation, including retirement and deferred compensation plans, other retirement benefits and other post-employment benefits, such as those payable in the event of a change in control.<sup>121</sup>

Reorganizing the tables along these themes should help investors understand how compensation components relate to each other. At the same time, we are retaining the ability for investors to use the tables to compare compensation from year to year and from company to company.

As we noted in the Proposing Release, by more clearly organizing the compensation tables to explain how the elements relate to each other, we may in some situations be requiring disclosure of both amounts earned (or potentially earned) and amounts subsequently paid out. This approach raises the possible perception of "double counting" some elements of compensation in multiple tables. However, a particular item of compensation only appears once in the Summary Compensation Table. In order to explain the item of compensation, it may also appear in one or more of the other tables. We believe the possible perception of double disclosure is outweighed by the clearer and more complete picture the disclosure in the additional tables will provide to investors. We strongly encourage companies to use the narrative following the tables (and where appropriate the Compensation

Discussion and Analysis) to explain how disclosures relate to each other in their particular circumstances.

Commenters stated their general support for the format and presentation of the proposed tables.<sup>122</sup> We are adopting the tables substantially as proposed with some revisions, as noted below, in response to comments.

#### 1. Compensation to Named Executive Officers in the Last Three Completed Fiscal Years—The Summary Compensation Table and Related Disclosure

Under today's amendments, the Summary Compensation Table continues to serve as the principal disclosure vehicle regarding executive compensation. This table, as amended, shows the named executive officers' compensation for each of the last three years, whether or not actually paid out. Consistent with the requirements prior to today's amendments, the amended Summary Compensation Table continues to require disclosure of compensation for each of the company's last three completed fiscal years.<sup>123</sup>

As we proposed, the amendments add disclosure of a figure representing total compensation, as reflected in other columns of the Summary Compensation Table, and simplify the presentation from that of the table prior to these amendments. As described in greater detail below, the amendments also provide for a supplemental table disclosing additional information about grants of plan-based awards. Narrative disclosure will follow the two tables, providing disclosure of material information necessary to an understanding of the information disclosed in the tables.

a description of the link between the measure and the level of compensation in the Board Compensation Committee Report on Executive Compensation. As a result, companies may include other performance measures, such as return on average common shareholders' equity, so long as the meaning of any such measures is clear from the Performance Graph and any related legend or other disclosure.

<sup>116</sup> Instructions 7 and 8 to Item 201(e). A "small business issuer" as defined in Regulation S-B, is not required to provide the Performance Graph. Instruction 6 to Item 201(e). Because Nasdaq has registered as a national securities exchange under Section 6 of the Exchange Act [15 U.S.C. 78f], the former separate reference to "Nasdaq market" is not retained. See Release No. 34-53128 (Jan. 13, 2006) ordering that the application of The NASDAQ Stock Market LLC for registration as a national securities exchange be granted. We also adopt a conforming revision to Rules 304(d) and (e) of Regulation S-T [17 CFR 232.304(d) and (e)], and we make technical revisions to those rules to correctly reference Item 22(b)(7)(ii) of Form N-1A and to eliminate the references to "prospectuses."

<sup>117</sup> The tabular disclosure and related narrative disclosure under amended Item 402 applies, as it did prior to today's amendments, to named executive officers, with amended Item 402(k) applying to directors, as described in Section II.C.9. below. As discussed below in Section II.C.6.a., we are adopting certain changes to the definition of named executive officer.

<sup>118</sup> The table supplementing the Summary Compensation Table is the Grants of Plan-Based Awards Table, discussed below in Section II.C.2., which combines into a single table the disclosure of the proposed Grants of Performance-Based Awards Table and the proposed Grants of All Other Equity Awards Table. The accompanying narrative disclosure requirement is discussed below in Section II.C.3.a.

<sup>119</sup> Under the disclosure rules as adopted, these interests will be disclosed as current compensation for those prior years.

<sup>120</sup> Information regarding holdings of such equity-based interests that relate to compensation will be disclosed in the Outstanding Equity Awards at Fiscal Year-End Table, discussed below in Section II.C.4.a. Information regarding realization on holdings of equity-based interests will be required

in the Option Exercises and Stock Vested Table discussed below in Section II.C.4.b.

<sup>121</sup> Disclosure regarding retirement and post-employment compensation is required in the Pension Benefits Table, discussed below in Section II.C.5.a., the Nonqualified Deferred Compensation Table, discussed below in Section II.C.5.b., and the narrative disclosure requirement for other potential post-employment payments discussed below in Section II.C.5.c.

<sup>122</sup> See, e.g., letters from CFA Centre 1; jointly, Jennifer Clowes, Lindsey Erskine, Kendra Freeck and Kapri Malesich; F&P Pension Board; IAM; IBEW PBF; Plumbers & Pipefitters National Pension Fund; and Standard Life.

<sup>123</sup> Prior to today's amendments, an instruction to Item 402(b) permitted the exclusion of information for fiscal years prior to the last completed fiscal year if the company was not a reporting company pursuant to Exchange Act Section 13(a) or 15(d) at any time during that year, unless the company previously was required to provide information for any such year in response to a Commission filing requirement. This instruction has been retained and redesignated as Instruction 1 to Item 402(c) in the amended rule.

SUMMARY COMPENSATION TABLE

Name and principal position	Year	Salary (\$)	Bonus (\$)	Stock awards (\$)	Option awards (\$)	Non-equity incentive plan compensation (\$)	Change in pension value and non-qualified deferred compensation earnings (\$)	All other compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO <sup>124</sup>									
PFO <sup>125</sup>									
A									
B									
C									

#### a. Total Compensation Column

We are modifying the Summary Compensation Table to provide a clearer picture of total compensation. As we proposed, we are requiring that all compensation be disclosed in dollars and that a total of all compensation be provided.<sup>126</sup> The new "Total" column aggregates the total dollar value of each form of compensation quantified in the other columns (revised columns (c) through (i)). This column responds to concerns that investors, analysts and other users of Item 402 disclosure have not been able to compute aggregate amounts of compensation using the disclosure in the table as specified prior to these amendments in a manner that was accurate or comparable across years or companies. Many commenters

<sup>124</sup> "PEO" refers to principal executive officer. See Section II.C.6.a. below for a description of the proposed named executive officers for whom compensation disclosure is required.

<sup>125</sup> "PFO" refers to principal financial officer.

<sup>126</sup> Instruction 2 to Item 402(c) (requiring all compensation values in the Summary Compensation Table to be reported in dollars and rounded to the nearest dollar). Prior to today's amendments, some stock-based compensation was disclosed in per share increments rather than in dollar amounts. Instruction 2 to Item 402(c) further requires, where compensation was paid or received in a different currency, footnote disclosure identifying that currency and describing the rate and methodology used for conversion to dollars.

expressed their support for the proposal to include a Total column.<sup>127</sup>

Other commenters expressed concerns that, as proposed, the total number was an amalgam of dissimilar types of compensation.<sup>128</sup> These concerns centered on the mix of compensation elements reported in the Summary Compensation Table being measured at different times and having different valuation methods, so that a Total column in effect would combine "apples" with "oranges."<sup>129</sup> To address this issue, some commenters suggested dividing the Total column into two separate columns reporting Total Earned Compensation and Total Contingent Compensation.<sup>130</sup> Others recommended two separate Summary Compensation Tables—one for compensation that had been earned or realized and another for compensation that remained contingent or an opportunity.<sup>131</sup>

<sup>127</sup> See, e.g., letters from CFA Centre 1; CII; Frederic W. Cook & Co.; ISS; Standard Life; and Walden. In addition, over 20,000 form letters from individuals specifically supported this proposal. See Letter Type A, available at [www.sec.gov/rules/proposed/s70306.shtml](http://www.sec.gov/rules/proposed/s70306.shtml).

<sup>128</sup> See, e.g., letters from Fenwick & West LLP ("Fenwick"); Chamber of Commerce; and Hodak Value Advisors, LLC ("Hodak Value Advisors").

<sup>129</sup> See, e.g., letters from Caterpillar Inc. and Corporate Library.

<sup>130</sup> See, e.g., letters from Business Roundtable ("BRT") and Mercer.

<sup>131</sup> See, e.g., letters from Eli Lilly and Company ("Eli Lilly"); Hewitt; Society of Corporate

As we noted in the Proposing Release, the Summary Compensation Table is designed to disclose all compensation. Each element of compensation is only disclosed once in the Summary Compensation Table, although it may also be disclosed in some of the other tables. We realize that the timing of when particular items of compensation are disclosed in the Summary Compensation Table varies depending on the form of the compensation.<sup>132</sup> Given the various forms and complexities of compensation and the different periods they may be designed to relate to,<sup>133</sup> it is unavoidable that the timing of disclosure may vary from element to element in this table.<sup>134</sup>

Secretaries & Governance Professionals ("SCSGP"); Towers Perrin, dated April 10, 2006 ("Towers Perrin"); and Watson Wyatt Worldwide ("Watson Wyatt").

<sup>132</sup> Compensation is generally calculated in a manner that reflects the cost of the compensation to the company and its shareholders.

<sup>133</sup> See, e.g., letter from ABA (noting that option grants made early in the year may be viewed by the compensation committee primarily as an award for the prior year's performance or as an incentive for future performance).

<sup>134</sup> The approach as to the timing of disclosure that we proposed and that we adopt today is the same approach that has been used in the Summary Compensation Table since it was first proposed in 1992. See *Executive Compensation Disclosure*, Release No. 33-6940 (June 23, 1992) [57 FR 29582] (noting that the Summary Compensation Table will "provide shareholders a concise, comprehensive overview of compensation awarded, earned or paid in the reporting period").

We note that some commenters were particularly concerned that non-equity incentive plan awards are reported when earned, while equity incentive plan awards are reported based on grant date value when awarded.<sup>135</sup> No single accepted standard for measuring non-equity incentive plan awards at grant date currently exists. Some commenters nonetheless suggested that we require grant date fair value estimates of non-equity incentive plan awards in the Summary Compensation Table.<sup>136</sup> We do not believe it is appropriate at this time for us to develop such a standard expressly for compensation disclosure purposes. Nevertheless, we believe that the Summary Compensation Table that we adopt today, including a total of all of the various elements presented, provides meaningful disclosure to investors and allows for comparability between companies and within a company.

However, in response to comments, we have created a separate column for the annual change in actuarial value of defined benefit plans and earnings on nonqualified deferred compensation.<sup>137</sup> As proposed, these compensation elements would have been included in the aggregate amount reported in the All Other Compensation column. We believe that presenting these items in a separate column will permit investors and other users of the Summary Compensation Table to readily identify elements included in the Total column that may relate principally to longevity of service. These items will not be used to determine the officers included in the table.<sup>138</sup>

We proposed that the new column disclosing total compensation would appear as the first column providing compensation information.<sup>139</sup> Some commenters suggested moving this column to the right of the table, so that it would follow—rather than precede—the relevant component numbers.<sup>140</sup> In

response to these comments, we have moved the Total column to the final column in the table.

#### b. Salary and Bonus Columns

The first columns providing compensation information that we are requiring are the salary and bonus columns (columns (c) and (d), respectively), which are retained substantially in their previous form. However, we are adopting some changes, as proposed, that will give an investor a clearer picture of the total amount earned.

As we proposed, compensation that is earned, but for which payment will be deferred, must be included in the salary, bonus or other column, as appropriate. A new instruction, applicable to the entire Summary Compensation Table, provides that if receipt of any amount of compensation is currently payable but has been deferred for any reason, the amount so deferred must be included in the appropriate column.<sup>141</sup> This treatment is no longer limited to salary and bonus, as it was prior to these amendments, and under the amended rules this treatment applies regardless of the reason for the deferral.<sup>142</sup>

We also proposed that the amount so deferred must be disclosed in a footnote to the applicable column. As described below, the amount deferred will also generally be reflected as a contribution in the deferred compensation presentation.<sup>143</sup> The proposed footnote disclosure was intended to clarify the extent to which amounts disclosed in the Nonqualified Deferred Compensation Table described below represent compensation already reported, rather than additional compensation. Because commenters thought it could lead to potential double counting, we have not adopted this proposed footnote requirement.<sup>144</sup>

As proposed, we have eliminated the delay that existed under the former

rules where salary or bonus for the most recent fiscal year is determined following compliance with Item 402 disclosure. Under our new rules, where salary or bonus cannot be calculated as of the most recent practicable date, a current report under Item 5.02 of Form 8-K will be triggered by a payment, decision or other occurrence as a result of which either of such amounts become calculable in whole or part.<sup>145</sup> The Form 8-K will include disclosure of the salary or bonus amount and a new total compensation figure including that salary or bonus amount.

#### c. Plan-Based Awards

As we proposed, the next three columns—Stock Awards, Option Awards and Non-Equity Incentive Plan Compensation—cover plan-based awards.

##### i. Stock Awards and Option Awards Columns

As proposed and adopted, the Stock Awards column (column (e)) discloses stock-related awards that derive their value from the company's equity securities or permit settlement by issuance of the company's equity securities and, as we have clarified, are thus within the scope of FAS 123R for financial reporting, such as restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or other similar instruments that do not have option-like features.<sup>146</sup> Valuation is based on the

<sup>145</sup> New Item 5.02(f) of Form 8-K and Instruction 1 to Item 402(c)(2)(iii) and (iv). Prior to these amendments, in the event that such amounts were not determinable at the most recent practicable date, they were generally reported in the annual report on Form 10-K or proxy statement for the following fiscal year. We believe providing the information more quickly is appropriate and are therefore adopting the use of a current report on Form 8-K. Instruction 1 to Item 402(c)(2)(iii) and (iv) requires that the company disclose in a footnote that the salary or bonus is not calculable through the latest practicable date and the date that the salary or bonus is expected to be determined. We proposed to include this requirement in an instruction to proposed paragraph (e) of Item 5.02 of Form 8-K. We are adopting it as a separate paragraph of Item 5.02 in order to make it clearer that it is a separate triggering event.

<sup>146</sup> Generally speaking, a restricted stock award is an award of stock subject to vesting conditions, such as performance-based conditions or conditions based on continued employment for a specified period of time. This type of award is referred to as "nonvested equity shares" in FAS 123R. Phantom stock, phantom stock units, common stock equivalent units and other similar awards are typically awards where an executive obtains a right to receive payment in the future of an amount based on the value of a hypothetical, or notional, amount of shares of common equity (or in some cases stock based on that value). To the extent that the terms of phantom stock, phantom stock units, common stock equivalents or other similar awards include option-like features, the awards will be required to

Continued

<sup>135</sup> See, e.g., letters from ACC; Amalgamated; BDO Seidman, LLP ("BDO Seidman"); CII; IUE-CWA; and Mercer.

<sup>136</sup> See, e.g., letters from CII; IUE-CWA; and CRPTF. Information about the amounts that could be earned under non-equity incentive plans is required to be disclosed in the Grants of Plan-Based Awards Table when such awards are granted.

<sup>137</sup> See Section II.C.1.d.i. below, which describes a modification of the proposed Summary Compensation Table disclosure of nonqualified deferred compensation earnings to present only the above-market or preferential portion in this table.

<sup>138</sup> See Section II.C.6.b. below describing how in response to commenters this column is excluded from total compensation for the purpose of identifying named executive officers.

<sup>139</sup> Columns (a) and (b) specify the executive officer and the year in question.

<sup>140</sup> See, e.g., letters from Buck Consultants; Frederic W. Cook & Co.; and SCSGP.

<sup>141</sup> Instruction 4 to Item 402(c).

<sup>142</sup> Prior to the amendments, this requirement was triggered only if the officer elected the deferral. We are amending this requirement as we proposed to cover all deferrals, no matter who has initiated the deferrals.

<sup>143</sup> See Section II.C.5.b., describing the Nonqualified Deferred Compensation Table. Disclosure of these amounts as contributions will now be required for nonqualified deferred compensation plans. This disclosure will not be required for qualified plans. Nonqualified deferred compensation plans and arrangements provide for the deferral of compensation that does not satisfy the minimum coverage, nondiscrimination and other rules that "qualify" broad-based plans for favorable tax treatment under the Internal Revenue Code.

<sup>144</sup> See, e.g., letter from WorldatWork. As described in Section II.C.5.b. below, however, we have adopted the corresponding footnote proposed for the Nonqualified Deferred Compensation Table.

grant date fair value of the award determined pursuant to FAS 123R for financial reporting purposes. Stock awards granted pursuant to an equity incentive plan are also included in this column to ensure consistent reporting of stock awards and to ensure their inclusion in the revised Summary Compensation Table.<sup>147</sup>

Awards of options, stock appreciation rights, and similar equity-based compensation instruments that have option-like features that, as we have clarified, are within the scope of FAS 123R, must be disclosed in the Option Awards column (column (f)) in a manner similar to the treatment of stock and other equity-based awards under the amendments.<sup>148</sup> Instead of the disclosure of the number of securities underlying the awards as was the case prior to today's amendments, this column requires disclosure of the grant date fair value of the award as determined pursuant to FAS 123R. In order to calculate a total dollar amount of compensation, the value rather than the number of securities underlying an award must be used. The FAS 123R valuation must be used whether the award itself is in the form of stock, options or similar instruments or the award is settled in cash but the amount of payment is tied to performance of the company's stock.<sup>149</sup>

Under FAS 123R, the compensation cost is initially measured based on the grant date fair value of an award,<sup>150</sup> and

be included in the Option Awards column. Prior to these amendments, restricted stock awards were valued in the Summary Compensation Table by multiplying the closing market price of the company's unrestricted stock on the date of grant by the number of shares awarded.

<sup>147</sup> Prior to these amendments, these performance-based stock awards could be reported at the company's election as incentive plan awards under what was then specified in Instruction 1 to Item 402(b)(2)(iv). Our amendments today eliminate this alternative.

<sup>148</sup> A stock appreciation right usually gives the executive the right to receive the value of the increase in the price of a specified number of shares over a specified period of time. These awards may be settled in cash or in shares.

<sup>149</sup> As proposed, we are eliminating the requirement that had been specified in Options/SAR Grants in Last Fiscal Year Table under Item 402(c)(2)(vi) to report the potential realizable value of each option grant under 5% or 10% increases in value or the present value of each grant (computed under any option pricing model). These alternative disclosures are no longer necessary insofar as the grant date fair value of equity-based awards is included in the Summary Compensation Table.

<sup>150</sup> Under FAS 123R, the classification of an award as an equity or liability award is an important aspect of the accounting because the classification will affect the measurement of compensation cost. Awards with cash-based settlement, repurchase features, or other features that do not result in an employee bearing the risks and rewards normally associated with share ownership for a specified period of time would be

generally recognized for financial reporting purposes over the period in which the employee is required to provide service in exchange for the award (generally the vesting period). Some commenters suggested that rather than requiring disclosure of the grant date fair value of equity awards, we should require a company to disclose just the portion of the award expensed in the company's financial statements.<sup>151</sup> These commenters expressed concerns that disclosing the full grant date fair value would be inconsistent with the company's financial statements, would overstate compensation earned related to service rendered for the year, and would be inconsistent with the presentation of non-equity incentive plan compensation. Other commenters expressed support for requiring companies to report the full grant date fair value in the year of the award because it would provide a more complete representation of compensation.<sup>152</sup>

We are adopting these columns substantially as proposed.<sup>153</sup> Under our amendments, the compensation cost calculated as the grant date fair value will be shown as compensation in the year in which the grant is made.<sup>154</sup> As

classified as liability awards under FAS 123R. For an award classified as an equity award under FAS 123R, the compensation cost recognized is fixed for a particular award, and absent modification, is not revised with subsequent changes in market prices or other assumptions used for purposes of the valuation. In contrast, liability awards are initially measured at fair value on the grant date, but for purposes of recognition in financial statement reporting are then re-measured at each reporting date through the settlement date under FAS 123R. These re-measurements would not be the basis for executive compensation disclosure under our amended rules, unless the award has been modified, as described later in this release.

<sup>151</sup> See, e.g., letters from the SEC Regulations Committee of the American Institute of Certified Public Accountants ("AICPA"); Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C.; Chamber of Commerce; Computer Sciences Corporation ("Computer Sciences"); Deloitte & Touche LLP; Ernst & Young LLP ("E&Y"); Fenwick; Foley; HR Policy Association ("HRPA"); American Bar Association, Joint Committee on Employee Benefits ("ABA-JCEB"); and KPMG LLP ("KPMG").

<sup>152</sup> See, e.g., letters from CalPERS; CFA Centre 1; CRPTF; L. Burns; Governance for Owners; Laborers International Union of North America; Nancy Lucke Ludgus ("N. Ludgus"); Institutional Investors Group; State Board of Administration (SBA) of Florida ("SBAF"); Teamsters Local 671; Teamsters PA/MD; United Church Foundation, Inc. ("UCF"); Washington State Investment Board ("WSIB"); and Western PA Teamsters Fund.

<sup>153</sup> Item 402(c)(2)(v) and (vi).

<sup>154</sup> FAS 123R requires a company to aggregate individuals receiving awards into relatively homogenous groups with respect to exercise and post-vesting employment termination behaviors for the purpose of determining expected term, for example executives and non-executives. The rules we adopt today are not intended to change the method used to value employee stock options for

we stated in the Proposing Release, we believe that this approach is more consistent with the purpose of executive compensation disclosure. We are adopting an approach that subscribes to the measurement method of FAS 123R based on grant date fair value, but also provides for immediate disclosure of compensation. This timing of disclosure of option awards remains the same as it has been since 1992. The only change is that the awards are now disclosed in dollars rather than numbers of units or shares. Disclosing these awards as they are expensed for financial statement reporting purposes would not mirror the timing of disclosure of non-equity incentive plan compensation. While we have imported a financial statement reporting principle to enable disclosure of compensation costs, executive compensation disclosure must continue to inform investors of current actions regarding plan awards—a function that would not be fulfilled applying financial reporting recognition timing. If a company does not believe that the full grant date fair value reflects compensation earned, awarded or paid during a fiscal year, it can provide appropriate explanatory disclosure in the accompanying narrative section. Furthermore, disclosing grant date fair value will give investors a clearer picture of the value of any in-the-money awards. As we proposed, the number of shares underlying an award and other details regarding the award must be disclosed in a separate table covering grants of plan-based awards supplementing the Summary Compensation Table.<sup>155</sup> This supplemental table, which combines the disclosure that would have been required by the proposed Grants of Performance-Based Awards Table and Grants of All Other Equity Awards Table, discloses equity awards granted pursuant to incentive plans separately from other equity awards.

We are adopting as proposed an instruction that requires a footnote referencing the discussion of the relevant assumptions in the notes to the company's financial statements or the discussion of relevant assumptions in the MD&A.<sup>156</sup> The same instruction also

purposes of FAS 123R or to affect the judgments as to reasonable groupings for purposes of determining the expected term assumption required by FAS 123R. Under the rules we adopt today, where a company uses more than one group, the measurement of grant date fair value for purposes of Item 402 would be derived using the expected term assumption for the group that includes the named executive officers (or the group that includes directors for purposes of Item 402(k)).

<sup>155</sup> See Section II.C.2., discussing the Grants of Plan-Based Awards Table required by Item 402(d).

<sup>156</sup> Instruction 1 to Item 402(c)(2)(v) and (vi).

provides that the referenced sections will be deemed to be part of the disclosure provided pursuant to Item 402. The referenced sections containing this disclosure are required in the company's annual report to shareholders that must precede or accompany the company's proxy statement.<sup>157</sup> In the case of Internet disclosure of proxy materials, companies could provide hyperlinks from the proxy statement to the referenced sections contained in the annual report.<sup>158</sup> While some commenters recommended requiring these valuation assumptions to be presented in the proxy statement,<sup>159</sup> we believe that investors will be able to easily access this information without requiring it to be repeated from other documents.

We proposed that previously awarded options or freestanding stock appreciation awards that the company repriced or otherwise materially modified during the last fiscal year be disclosed in the Summary Compensation Table based on the total fair value of the award as so modified. Under FAS 123R, only the incremental fair value, computed as of the repricing or modification date, is recognized for such an award. Several commenters recommended conforming Summary Compensation Table reporting to the incremental fair value recognition approach of FAS 123R, objecting that the proposed total fair value approach would inappropriately double count the fair value of many modified awards.<sup>160</sup> As adopted, the new rules reflect this recommendation.<sup>161</sup> Grants of reload or restorative options, however, are reportable based on total grant date fair value because they are new awards that do not replace previously cancelled awards.<sup>162</sup>

We proposed that all earnings, such as dividends, be included in the Stock

Awards and Option Awards columns when paid. Several commenters noted that the value of the right to receive dividends is factored into the grant date fair value computed under FAS 123R.<sup>163</sup> If the stock award or option award entitles the holder to receive dividends, then such "dividend protection" is included in the grant date fair value computed under FAS 123R. We are persuaded by the commenters that subsequent disclosure of the value of dividends in these circumstances, as they are received, would repeat in the same table compensation that was previously disclosed. Therefore, we have revised the requirement. However, we note that if the stock award or option award does not entitle the holder to receive dividends, then "dividend protection" is not included in the grant date fair value computed under FAS 123R. Accordingly, the value of any dividends received would not have been previously disclosed in the Summary Compensation Table as part of the grant date fair value of the award. In order to appropriately capture the compensation in these latter circumstances, we are adopting a requirement to disclose any earnings on stock awards or option awards that are not included in the grant date fair value computation for those awards in the All Other Compensation column of the Summary Compensation Table when the dividends or other earnings are paid.<sup>164</sup> In addition, the material terms of any equity award (including whether dividends will be paid, the applicable dividend rate and whether that rate is preferential) may be factors to be discussed in the related narrative section.<sup>165</sup>

We had proposed a definition of "non-stock incentive plan" that some commenters stated would result in confusing and potentially anomalous treatment of some awards.<sup>166</sup> To clarify the reporting treatment of different types of awards, we have:

- Adopted a separate definition of "equity incentive plan" as "an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of FAS 123R";<sup>167</sup> and

- Defined "non-equity incentive plan" as "an incentive plan or portion of an incentive plan that is not an equity incentive plan."<sup>168</sup>

#### ii. Non-Equity Incentive Plan Compensation Column

The Non-Equity Incentive Plan Compensation column (column (g)) will report, as proposed, the dollar value of all amounts earned during the fiscal year pursuant to non-equity incentive plans.<sup>169</sup> This column includes all other incentive plan awards not included in the stock awards and option awards columns.<sup>170</sup> Compensation awarded under an incentive plan that is not within the scope of FAS 123R will be disclosed in the Summary Compensation Table in the year when the relevant specified performance criteria under the plan are satisfied and the compensation earned, whether or

rendering service for a specified (either explicitly or implicitly) period of time and (b) achieving a specified performance target that is defined solely by reference to the employer's own operations (or activities). Attaining a specified growth rate in return on assets, obtaining regulatory approval to market a specified product, selling shares in an initial public offering or other financing event, and a change in control are examples of performance conditions for purposes of this Statement. A performance target also may be defined by reference to the same performance measure of another entity or group of entities. For example, attaining a growth rate in earnings per share that exceeds the average growth rate in earnings per share of other entities in the same industry is a performance condition for purposes of this Statement. A performance target might pertain either to the performance of the enterprise as a whole or to some part of the enterprise, such as a division or an individual employee." An award also would be considered to have a performance condition if it is subject to a market condition, which is "a condition affecting the exercise price, exercisability, or other pertinent factors used in determining the fair value of an award under a share-based payment arrangement that relates to the achievement of (a) a specified price of the issuer's shares or a specified amount of intrinsic value indexed solely to the issuer's shares or (b) a specified price of the issuer's shares in terms of a similar (or index of similar) equity security (securities)." An award that vests on an accelerated basis upon the occurrence of a change in control is not considered an award under an equity incentive plan if (a) the award contains no other performance or market conditions and (b) the award would otherwise vest based on the completion of a specified employee service period.

<sup>168</sup> Item 402(a)(6)(iii). See also discussion of the definition of "incentive plan" at Section II.C.1.f. below.

<sup>169</sup> Item 402(c)(2)(vii). An incentive plan generally provides for compensation intended to serve as an incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the company or an affiliate, the company's stock price, or any other performance measure. See Item 402(a)(6)(iii) for the definition of "incentive plan."

<sup>170</sup> Awards disclosed in this column, column (g), are not covered by FAS 123R for financial reporting purposes because they do not involve share-based payment arrangements. Awards that involve share-based payment arrangements should be disclosed in the Stock Awards or Option Awards columns, as appropriate.

<sup>157</sup> See Exchange Act Rule 14a-3 [17 CFR 240.14a-3].

<sup>158</sup> In addition, in December 2005, we proposed rules that would allow companies and other persons to use the Internet to satisfy proxy material delivery requirements. *Internet Availability of Proxy Materials*, Release No. 34-52926 (Dec. 8, 2005) [70 FR 74597].

<sup>159</sup> See, e.g., letters from Buck Consultants; CII; Frederic W. Cook & Co.; and IUE-CWA.

<sup>160</sup> See, e.g., letters from AICPA; Cleary Gottlieb Steen & Hamilton LLP ("Cleary"); Compass Bancshares; Cravath, Swaine & Moore LLP ("Cravath"); Hewitt; KPMG; Leggett & Platt, Incorporated ("Leggett & Platt"); SCSGP; and Sullivan.

<sup>161</sup> Instruction 2 to Item 402(c)(2)(v) and (vi).

<sup>162</sup> Generally speaking, reload or restorative options are grants of new options that are granted automatically when an executive exercises the old option. Reload or restorative options are treated as new grants under FAS 123R.

<sup>163</sup> See, e.g., letters from Cleary; Emerson Electric Co. ("Emerson"); Foley; Hewitt; SCSGP; and Towers Perrin.

<sup>164</sup> Item 402(c)(2)(ix)(G).

<sup>165</sup> Item 402(e)(1)(iii), discussed in Section II.C.3.a. below.

<sup>166</sup> See, e.g., letter from ABA.

<sup>167</sup> Item 402(a)(6)(iii). An equity incentive plan includes plans that have a performance or market condition. As defined in Appendix E of FAS 123R, a performance condition is "a condition affecting the vesting, exercisability, exercise price or other pertinent factors used in determining the fair value of an award that relates to both (a) an employee's

not payment is actually made to the named executive officer in that year.

The grant of an award under a non-equity incentive plan will be disclosed in the supplemental Grants of Plan-Based Awards Table in the year of grant, which may be some year prior to the year in which compensation under the non-equity incentive plan is reported in the Summary Compensation Table.<sup>171</sup> As noted above, several commenters recommended Summary Compensation Table reporting of non-equity incentive plan awards on a grant date fair value basis, consistent with the reporting of equity incentive plans.<sup>172</sup> However, because there is not one clearly required or accepted standard for measuring the value at grant date of these non-equity incentive plan awards that reflects the applicable performance contingencies, as there is for equity-based awards with FAS 123R, we are not including such a value in the Summary Compensation Table. Instead, we continue the disclosure approach of reflecting these items of compensation when earned.<sup>173</sup>

Once the disclosure has been provided in the Summary Compensation Table when the specified performance criteria have been satisfied and the compensation earned, and the grant of the award has been disclosed in the Grants of Plan-Based Awards Table, no further disclosure will be specifically required when payment is actually made to the named executive officer. Some commenters objected to Summary Compensation Table reporting of awards for which the relevant performance condition has been satisfied that remain subject to forfeiture conditions (such as conditions requiring continued service or conditions that provide for forfeiture based on future company performance).<sup>174</sup> We continue to believe that satisfaction of the relevant performance condition (including an interim performance condition in a long term plan) is the event that is material to investors for Summary Compensation Table reporting purposes. We encourage companies to use the related narrative section to disclose material features that are not reflected in the tabular disclosure including, for example, subsequent forfeitures of amounts

<sup>171</sup> See Section II.C.2., discussing the Grants of Plan-Based Awards Table.

<sup>172</sup> See, e.g., letters from Amalgamated; Anonymous Compensation Consultant; BDO Seidman; CII; CRPTF; Mercer; and Teamsters Local 671. See discussion at Section II.C.1.a. above.

<sup>173</sup> Prior to these amendments, Items 402(b)(2)(iv)(C) and 402(e) required disclosure of long-term incentive plan payouts when earned.

<sup>174</sup> See, e.g., letters from Mercer; Watson Wyatt; and Richard E. Wood.

reported in the table with respect to previous fiscal years.<sup>175</sup>

As proposed and adopted, earnings on outstanding non-equity incentive plan awards are also included in the Non-Equity Incentive Plan Compensation column and identified and quantified in a footnote to the table.<sup>176</sup>

#### d. Change in Pension Value and Nonqualified Deferred Compensation Earnings Column

As we proposed, we are expanding the Summary Compensation Table to include information regarding the aggregate increase in actuarial value to the named executive officer of all defined benefit and actuarial plans (including supplemental plans) accrued during the year and earnings on nonqualified deferred compensation. However, as mentioned above, we have decided to present this information in a separate column rather than include it in the All Other Compensation column as proposed.<sup>177</sup> Footnote identification and quantification of the full amount of each element is required.<sup>178</sup> Any amount attributable to the defined benefit and actuarial plans that is a negative number should be disclosed by footnote, but should not be reflected in the amount reported in the column.<sup>179</sup>

#### i. Earnings on Deferred Compensation

We proposed to require disclosure of all earnings on compensation that is deferred on a basis that is not tax-qualified, including non-tax qualified defined contribution retirement plans.<sup>180</sup> Prior to our amendments, these earnings were required to be

<sup>175</sup> Commenters' issues concerning the scope of awards reportable in this column, in particular as compared to compensation reportable in the bonus column, are discussed in Section II.C.1.f. below.

<sup>176</sup> Item 402(c)(2)(vii). These earnings were reportable prior to today's amendments in the Other Annual Compensation or All Other Compensation columns of the Summary Compensation Table under Items 402(b)(2)(iii)(C)(3) and 402(b)(2)(v)(C), respectively.

<sup>177</sup> See the discussion of the Total column in Section II.C.1.a. above and the discussion of determination of named executive officers in Section II.C.6. below.

<sup>178</sup> Instruction 3 to Item 402(c)(2)(viii). In contrast, as proposed to be disclosed in the All Other Compensation Column, separate identification and quantification of each element would have been required only if the element exceeded \$10,000, although the amounts would have been included in that column without regard to size.

<sup>179</sup> Instruction 3 to Item 402(c)(2)(viii).

<sup>180</sup> Nonqualified defined contribution and other nonqualified deferred compensation plans are plans providing for deferral of compensation that do not satisfy the minimum coverage, nondiscrimination and other rules that "qualify" broad-based plans for favorable tax treatment under the Internal Revenue Code. A typical 401(k) plan, by contrast, is a qualified deferred compensation plan.

disclosed only to the extent of any portion that was "above-market or preferential." This limitation generated criticism that the rule prior to today's amendments permitted companies to avoid disclosure of substantial compensation.

Some commenters supported this proposal.<sup>181</sup> However, many commenters asserted that the Summary Compensation Table should continue to require disclosure only of earnings at above-market or preferential rates.<sup>182</sup> Commenters stated that differences in earnings on nonqualified deferred compensation among executives may result entirely from the executives' investment acumen and decisions as to amounts to defer. Commenters further claimed that deferred amounts invested at market rates are conceptually no different from amounts invested directly by an executive. Absent providing an above-market return, contributing additional amounts or guaranteeing investment returns, commenters asserted that the company has no role in the annual growth of the account.

We are persuaded that Summary Compensation Table disclosure of nonqualified deferred compensation earnings should continue to be limited to the above-market or preferential portion.<sup>183</sup> As under the rule prior to these amendments, the above-market or preferential portion is determined for interest by reference to 120% of the applicable federal long-term rate and for dividends by reference to the dividend rate on the company's common stock.<sup>184</sup> Footnote or narrative disclosure of the company's criteria for determining any portion considered to be above-market may be provided. The above-market or preferential earnings in this column would always be positive, as it would not be possible for above-market or preferential losses to occur.

However, we do not overlook the fact that the company is obligated to pay the executive the entire amount of the nonqualified deferred compensation account, which represents a claim on company assets and is part of a plan that provides the executive with tax

<sup>181</sup> See, e.g., letters from CFA Centre 1 and jointly, Lucian A. Bebchuk, Jesse M. Fried and Robert J. Jackson, Jr. ("Professor Bebchuk, et al.").

<sup>182</sup> See, e.g., letters from American Academy of Actuaries' Pension Committee ("Academy of Actuaries"); BRT; Frederic W. Cook & Co.; Computer Sciences; Kimball International, Inc.; NAM; and Sullivan.

<sup>183</sup> Item 402(c)(2)(viii)(B).

<sup>184</sup> Instruction 2 to Item 402(c)(2)(viii), which is based on the language which had appeared in Instructions 3 and 4 to Item 402(b)(2)(iii)(C) prior to these amendments.

benefits.<sup>185</sup> To reflect this obligation, we have decided to require disclosure of all earnings on nonqualified deferred compensation in the separate Nonqualified Deferred Compensation Table, as we proposed.<sup>186</sup> The disclosure required by that table discloses the rate at which the company's obligation grows on an annual basis.

Further, the method of calculating earnings on deferred compensation plans is an example of a factor that may be material and therefore described in the narrative disclosure to the Summary Compensation Table and the Grants of Plan-Based Awards Table.<sup>187</sup>

#### ii. Increase in Pension Value

We proposed to require Summary Compensation Table disclosure of the aggregate increase in actuarial value to the executive officer of defined benefit and actuarial plans (including supplemental plans) accrued during the year.

In contrast to defined contribution plans, for which the Summary Compensation Table requires disclosure of company contributions, the rules prior to our amendments did not require disclosure of the annual change in value of defined benefit plans, such as pension plans, in which the named executive officers participated.<sup>188</sup> The annual increase in actuarial value of these plans may be a significant element of compensation that is earned on an annual basis, thus we proposed to include it in the computation of total compensation.

Such disclosure is necessary to permit the Summary Compensation Table to reflect total compensation for the year. Such disclosure also permits a full understanding of the company's compensation obligations to named executive officers, given that defined benefit plans guarantee what can be a lifetime stream of payments and allocate risk of investment performance to the company and its shareholders. In addition commentators have noted that

<sup>185</sup> Nonqualified defined contribution and other nonqualified deferred compensation plans are generally unfunded, and their taxation is governed by Section 409A of the Internal Revenue Code [26 U.S.C. 409A].

<sup>186</sup> This separate table is discussed in Section II.C.5.b. below.

<sup>187</sup> See Section II.C.3.a. below.

<sup>188</sup> A typical defined contribution plan is a retirement plan in which the company and/or the executive makes contributions of a specified amount, and the amount that is paid out to the executive depends on the return on investments from the contributed amounts. A typical defined benefit plan is a retirement plan in which the company pays the executive specified amounts at retirement which are not tied to investment performance of the contributions that fund the plan.

the absence of such a disclosure requirement creates an incentive to shift compensation to pensions, results in the understatement of non-performance-based compensation, and distorts pay comparisons between executives and between companies.

We are adopting the requirement substantially as proposed.<sup>189</sup> As proposed and adopted, an instruction specifies that this disclosure applies to each plan that provides for the payment of retirement benefits, or benefits that will be paid primarily following retirement, including but not limited to tax-qualified defined benefit plans and supplemental executive retirement plans, but excluding defined contribution plans.<sup>190</sup> The retirement section, discussed below, provides more information regarding these covered plans.<sup>191</sup>

Some commentators raised issues regarding computation of the amount to be disclosed.<sup>192</sup> In response to these comments, we have revised the language of the requirement as adopted to clarify that the disclosure applies to the change, from the pension plan measurement date used for the company's audited financial statements for the prior completed fiscal year to the pension plan measurement date used for the company's audited financial statements for the covered fiscal year, in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans). The disclosure therefore includes both:

- The increase in value due to an additional year of service, compensation increases, and plan amendments (if any); and
- The increase (or decrease) in value attributable to interest.

As discussed below, this disclosure relates to the disclosure provided in the Pension Benefits Table<sup>193</sup> and promotes company-to-company comparability. In computing the amount to be disclosed, the company must use the assumptions it uses for financial reporting purposes

<sup>189</sup> Item 402(c)(2)(viii)(A).

<sup>190</sup> Instruction 1 to Item 402(c)(2)(viii). Defined benefit plans include, for example, cash balance plans in which the retiree's benefit may be determined by the amount represented in an account rather than based on a formula referencing salary while still employed.

<sup>191</sup> See Section II.C.5.a., discussing the Pension Benefits Table.

<sup>192</sup> See, e.g., letters from Academy of Actuaries; Frederick W. Cook & Co.; ABA-JCEB; and Mercer.

<sup>193</sup> Item 402(b), discussed in Section III.C.5.a. below.

under generally accepted accounting principles.<sup>194</sup>

Other commenters objected to this item's potential to "distort" the Total column and the determination of named executive officers.<sup>195</sup> As described above, we continue to believe that inclusion of this element in the table is necessary to permit the Summary Compensation Table to reflect total compensation. However, we have addressed commenters' concerns by segregating this item and above-market or preferential earnings on nonqualified deferred compensation from the All Other Compensation column, presenting their sum in a separate column so that it will be deducted from the total for purposes of determining the named executive officers.<sup>196</sup>

#### e. All Other Compensation Column

The next column in the Summary Compensation Table discloses all other compensation not required to be included in any other column.<sup>197</sup> This approach allows the capture of all compensation in the Summary Compensation Table and also allows a total compensation calculation. We confirm that disclosure of all compensation is clearly required under the rules.<sup>198</sup>

As proposed, we are clarifying the disclosure required in the All Other Compensation column (revised column (i)) in two principal respects:

- Consistent with the requirement that the Summary Compensation Table

<sup>194</sup> Instruction 1 to Item 402(c)(2)(viii) and Instruction 2 to Item (h)(2). Regarding such key assumptions as interest rate, form of benefit, number of years of service, level of compensation used to determine the benefit and mortality tables, a company must use the same assumptions as it applies pursuant to Financial Accounting Standards Board Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions* (FAS 87) both for this Summary Compensation Table column and the separate Pension Benefits Table.

<sup>195</sup> See, e.g., letters from Eli Lilly and SCSCP.

<sup>196</sup> See Section II.C.6. below.

<sup>197</sup> Item 402(c)(2)(ix).

<sup>198</sup> The only exception, as discussed below, is for perquisites and personal benefits if they aggregate less than \$10.00 for a named executive officer. The 1992 Release, at Section II.A.4., also noted "the revised item includes an express statement that it requires disclosure of all compensation to the named executive officers and directors for services rendered in all capacities to the registrant and its subsidiaries." See also Item 402(a)(2) as stated prior to these amendments. Further, as described above, Summary Compensation Table disclosure of nonqualified deferred compensation earnings is limited to the above-market or preferential portion of earnings. As was previously the case before these amendments, companies may omit information regarding group life, health, hospitalization and medical reimbursement plans that do not discriminate in scope, terms or operation in favor of executive officers or directors of the company and that are available generally to all salaried employees. See Item 402(a)(6)(ii).

disclose all compensation, we state explicitly that compensation not properly reportable in the other columns reporting specified forms of compensation must be reported in this column; and

- To simplify the Summary Compensation Table and eliminate confusing distinctions between items currently reported as "Annual" and "Long Term" compensation, we have moved into this column all items formerly reportable as "Other Annual Compensation."<sup>199</sup>

We also are requiring that each item of compensation included in the All Other Compensation column that exceeds \$10,000 be separately identified and quantified in a footnote. We believe that the \$10,000 threshold balances our desire to avoid disclosure of clearly *de minimis* matters against the interests of investors in the nature of items comprising compensation. Each item of compensation less than that amount will be included in the column (other than aggregate perquisites and other personal benefits less than \$10,000 as discussed below), but is not required to be identified by type and amount.<sup>200</sup> Items to be disclosed in the All Other Compensation column include, but are not limited to, the items discussed below.

#### i. Perquisites and Other Personal Benefits

Perquisites and other personal benefits are included in the All Other Compensation column. As we proposed, we are adopting changes to the disclosure of perquisites and other personal benefits to improve disclosure and facilitate computing a total amount of compensation. Our amendments require the disclosure of perquisites and other personal benefits unless the aggregate amount of such compensation is less than \$10,000. Some commenters thought this threshold was too high;<sup>201</sup> while other commenters thought it was too low.<sup>202</sup> While we realize that this threshold may result in the total amount of compensation reportable in the Summary Compensation Table being slightly less than a complete total

<sup>199</sup> Prior to today's amendments, Item 402(b)(2)(iii)(c) had required the separate column entitled "Other Annual Compensation."

<sup>200</sup> See Section II.C.1.e.i. regarding separate standards for identification of perquisites and other personal benefits.

<sup>201</sup> See, e.g., letters from Association of BellTel Retirees ("ABTR"); AFL-CIO; Amalgamated Association of US West Retirees ("AUSWR"); Corporate Library; ISS; UCF; and Walden.

<sup>202</sup> See e.g., letters from Buck Consultants; Chamber of Commerce; Compass Bancshares; Computer Sciences; Eli Lilly; Emerson; Hodak Value Advisors; C. Kollar; NAM; and SCSGP.

amount of compensation, we believe \$10,000 is a reasonable balance between investors' need for disclosure of total compensation and the burden on a company to track every benefit, no matter how small. Prior to today's amendments, the rule permitted omission of perquisites and other personal benefits if the aggregate amount of such compensation was the lesser of either \$50,000 or 10% of the total of annual salary and bonus, allowing omission of too much information that investors may consider material.

The amendments we adopt today require, as proposed, footnote disclosure that identifies perquisites and other personal benefits. Prior to these amendments, the rule required identification and quantification only of perquisites and other personal benefits that were 25% of the total amount for each named executive officer.<sup>203</sup> We have modified this requirement so that, unless the aggregate value of perquisites and personal benefits is less than \$10,000, any perquisite or other personal benefit must be identified and, if it is valued at the greater of \$25,000 or ten percent of total perquisites and other personal benefits, its value must be disclosed.<sup>204</sup> Consistent with our objective to streamline the Summary Compensation Table, the revised threshold is intended to avoid requiring separate quantification of perquisites having *de minimis* value. Where perquisites are subject to identification, they must be described in a manner that identifies the particular nature of the benefit received. For example, it is not sufficient to characterize generally as "travel and entertainment" different company-financed benefits, such as clothing, jewelry, artwork, theater tickets and housekeeping services.

As was formerly the case, tax "gross-ups" or other reimbursement of taxes owed with respect to any compensation, including but not limited to perquisites and other personal benefits, must be separately quantified and identified in the tax reimbursement category described below, even if the associated perquisites or other personal benefits are eligible for exclusion or would not require identification or footnote quantification under the rule.

In the Proposing Release, we provided interpretive guidance about factors to be considered in determining whether an item is a perquisite or other personal benefit. One commenter suggested that

<sup>203</sup> The requirement had been set forth in Instruction 1 to Item 402(b)(2)(iii)(C) prior to these amendments.

<sup>204</sup> Instruction 4 to Item 402(c)(2)(ix).

the Commission engage in a separate rulemaking to adopt a definition of perquisites in Regulation S-K.<sup>205</sup> As we noted in the Proposing Release, for decades questions have arisen as to what is a perquisite or other personal benefit required to be disclosed. We continue to believe that it is not appropriate for Item 402 to define perquisites or personal benefits, given that different forms of these items continue to develop, and thus a definition would become outdated. As stated in the Proposing Release, we are concerned that sole reliance on a bright line definition in our rules might provide an incentive to characterize perquisites or personal benefits in ways that would attempt to circumvent the bright lines. Many commenters sought additional or modified interpretive guidance, including guidance with respect to an item that is integrally and directly related to the performance of the executive's duties but has a personal benefit aspect as well.<sup>206</sup> Accordingly, we are providing additional explanation regarding how to apply this guidance. The amendments we adopt today require perquisites and personal benefits to be disclosed for both named executive officers and directors.<sup>207</sup> Further, the disclosure requirements we adopt regarding potential payments upon termination or change-in-control include disclosure of perquisites.<sup>208</sup> Accordingly, this discussion also applies in the context of each of these disclosure requirements.

Among the factors to be considered in determining whether an item is a perquisite or other personal benefit are the following:

- An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties.
- Otherwise, an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.

We believe the way to approach this is by initially evaluating the first prong of the analysis. If an item is integrally and directly related to the performance of the executive's duties, that is the end of the analysis—the item is not a perquisite or personal benefit and no

<sup>205</sup> See letter from Chamber of Commerce.

<sup>206</sup> See, e.g., letter from SCSGP.

<sup>207</sup> For directors, the disclosure will be required in the Director Compensation Table discussed below in Section II.C.9.

<sup>208</sup> Item 402(j), discussed in Section II.C.5.c. below.

compensation disclosure is required. Moreover, if an item is integrally and directly related to the performance of an executive's duties under this analysis, there is no requirement to disclose any incremental cost over a less expensive alternative. For example, with respect to business travel, it is not necessary to disclose the cost differential between renting a mid-sized car over a compact car.

Because of the integral and direct connection to job performance, the elements of the second part of the analysis (e.g., whether there is also a personal benefit or whether the item is generally available to other employees) are irrelevant. An example of such an item could be a "Blackberry" or a laptop computer if the company believes it is an integral part of the executive's duties to be accessible by e-mail to the executive's colleagues and clients when out of the office. Just as these devices represent advances over earlier technology (such as voicemail), we expect that as new technology facilitates the extent to which work is conducted outside the office, additional devices may be developed that will fall into this category.

The concept of a benefit that is "integrally and directly related" to job performance is a narrow one. The analysis draws a critical distinction between an item that a company provides because the executive needs it to do the job, making it integrally and directly related to the performance of duties, and an item provided for some other reason, even where that other reason can involve both company benefit and personal benefit. Some commenters objected that "integrally and directly related" is too narrow a standard, suggesting that other business reasons for providing an item should not be disregarded in determining whether an item is a perquisite.<sup>209</sup> We do not adopt this suggested approach. As we stated in the Proposing Release, the fact that the company has determined that an expense is an "ordinary" or "necessary" business expense for tax or other purposes or that an expense is for the benefit or convenience of the company is not responsive to the inquiry as to whether the expense provides a perquisite or other personal benefit for disclosure purposes. Whether the company should pay for an expense or it is deductible for tax purposes relates principally to questions of state law regarding use of corporate assets and of tax law; our

disclosure requirements are triggered by different and broader concepts.

As we noted in the Proposing Release, business purpose or convenience does not affect the characterization of an item as a perquisite or personal benefit where it is not integrally and directly related to the performance by the executive of his or her job. Therefore, for example, a company's decision to provide an item of personal benefit for security purposes does not affect its characterization as a perquisite or personal benefit. A company policy that for security purposes an executive (or an executive and his or her family) must use company aircraft or other company means of travel for personal travel, or must use company or company-provided property for vacations, does not affect the conclusion that the item provided is a perquisite or personal benefit.

If an item is not integrally and directly related to the performance of the executive's duties, the second step of the analysis comes into play. Does the item confer a direct or indirect benefit that has a personal aspect (without regard to whether it may be provided for some business reason or for the convenience of the company)? If so, is it generally available on a non-discriminatory basis to all employees? For example, a company's provision of helicopter service for an executive to commute to work from home is not integrally and directly related to job performance (although it would benefit the company by getting the executive to work faster), clearly bestows a benefit that has a personal aspect, and is not generally available to all employees on a non-discriminatory basis. As we have noted, business purpose or convenience does not affect the characterization of an item as a perquisite or personal benefit where it is not integrally and directly related to the performance by the executive of his or her job.

A company may reasonably conclude that an item is generally available to all employees on a non-discriminatory basis if it is available to those employees to whom it lawfully may be provided. For this purpose, a company may recognize jurisdictionally based legal restrictions (such as for foreign employees) or the employees' "accredited investor"<sup>210</sup> status. In contrast, merely providing a benefit consistent with its availability to employees in the same job category or at the same pay scale does not establish

that it is generally available on a non-discriminatory basis to all employees.

Applying the concepts that we outline above, examples of items requiring disclosure as perquisites or personal benefits under Item 402 include, but are not limited to: club memberships not used exclusively for business entertainment purposes, personal financial or tax advice, personal travel using vehicles owned or leased by the company, personal travel otherwise financed by the company, personal use of other property owned or leased by the company, housing and other living expenses (including but not limited to relocation assistance and payments for the executive or director to stay at his or her personal residence), security provided at a personal residence or during personal travel, commuting expenses (whether or not for the company's convenience or benefit), and discounts on the company's products or services not generally available to employees on a non-discriminatory basis.

Beyond the examples provided, we assume that companies and their advisors, who are more familiar with the detailed facts of a particular situation and who are responsible for providing materially accurate and complete disclosure satisfying our requirements, can apply the two-step analysis to assess whether particular arrangements require disclosure as perquisites or personal benefits. In light of the importance of the subject to many investors, all participants should approach the subject of perquisites and personal benefits thoughtfully.<sup>211</sup>

The amendments we adopt today, as proposed, call for aggregate incremental cost to the company as the proper measure of value of perquisites and other personal benefits.<sup>212</sup> Some commenters instead recommended valuing perquisites based on current market values.<sup>213</sup> Consistent with our

<sup>211</sup> The Commission has taken action in circumstances where perquisites were not properly disclosed. See *SEC v. Greg A. Gadel and Daniel J. Skrypek*, Litigation Release No. 19720 (June 7, 2006) and *In the Matter of Tyson Foods, Inc. and Donald Tyson*, Litigation Release No. 19208 (Apr. 28, 2005).

<sup>212</sup> Instruction 4 to Item 402(c)(2)(is).

<sup>213</sup> See e.g., letters from ABTR; AUSWR; CH; Computer Sciences; Pearl Meyer & Partners; and Institutional Investors Group. As we stated in the Proposing Release, the amount attributed to perquisites and other personal benefits for federal income tax purposes is not the incremental cost for purposes of our disclosure rules unless, independently of the tax characterization, it constitutes such incremental cost. Therefore, for example, the cost of aircraft travel attributed to an executive for federal income tax purposes is not generally the incremental cost of such a perquisite or personal benefit for purposes of our disclosure rules. See IRS Regulation § 1.61-21(g) [26 CFR

Continued

<sup>209</sup> See, e.g., letters from NACCO Industries, Inc. ("NACCO Industries") and NAM.

<sup>210</sup> "Accredited investor" is defined in Securities Act Rule 501(a) [17 CFR 230.501(a)] for purposes of Regulation D [17 CFR 230.501-508].

approach of disclosing a company's compensation costs, we remain of the view that perquisites should be valued based on aggregate incremental cost.

Finally, commenters observed that investors cannot fully understand disclosed perquisite amounts without disclosure of the methodology used to compute them.<sup>214</sup> We agree that this disclosure will improve investors' ability to compare the cost of perquisites from company to company. The rule as adopted requires footnote disclosure of the methodology for computing the aggregate incremental cost for the perquisites.<sup>215</sup>

#### ii. Additional All Other Compensation Column Items

We are adopting as proposed a requirement that items to be disclosed in the All Other Compensation column include, but are not limited to, the following items:<sup>216</sup>

- Amounts paid or accrued pursuant to a plan or arrangement in connection with any termination (or constructive termination) of employment or a change in control;<sup>217</sup>
- Annual company contributions or other allocations to vested and unvested defined contribution plans;<sup>218</sup>
- The dollar value of any insurance premiums paid by the company with respect to life insurance for the benefit of a named executive officer;<sup>219</sup>

1.61–21(g) regarding Internal Revenue Service guidelines for imputing taxable personal income to an employee who travels for personal reasons on corporate aircraft. These complex regulations are known as the Standard Industry Fare Level or SIFL rules.

<sup>214</sup> See, e.g., letter from Mercer.

<sup>215</sup> Instruction 4 to Item 402(c)(2)(ix).

<sup>216</sup> All of these items were required to be disclosed either under All Other Compensation or under Other Annual Compensation prior to these amendments.

<sup>217</sup> Unlike the text of Item 402(b)(2)(v)(A) prior to these amendments, Item 402(c)(2)(ix)(D) as amended does not refer to amounts payable under post-employment benefits. Instruction 5 to Item 402(c)(2)(ix) provides that an accrued amount is an amount for which payment has become due, such as a severance payment currently owed by the company to an executive officer. These items, as well as amounts that are payable in the future, are also the subject of disclosure as post-termination compensation, as described in Section II.C.5.c. below. For any compensation as a result of a business combination, other than pursuant to a plan or arrangement in connection with any termination of employment or change-in-control, such as a retention bonus, acceleration of option or stock vesting period, or performance-based compensation intended to serve as an incentive for named executive officers to acquire other companies or enter into a merger agreement, disclosure will now be required in the appropriate Summary Compensation Table column and in the other tables or narrative disclosure where the particular element of compensation is required to be disclosed.

<sup>218</sup> Item 402(c)(2)(ix)(E).

<sup>219</sup> Item 402(c)(2)(ix)(F). Because the amendments call for disclosure of the dollar value of any life

• “Gross-ups” or other amounts reimbursed during the fiscal year for the payment of taxes;<sup>220</sup> and

• For any security of the company or its subsidiaries purchased from the company or its subsidiaries (through deferral of salary or bonus) at a discount from the market price of such security at the date of purchase, unless that discount is available generally either to all security holders or to all salaried employees of the company, the compensation cost, if any, computed in accordance with FAS 123R.<sup>221</sup>

An additional requirement to include the dollar value of any dividends or other earnings paid on stock or option awards when the dividends or earnings were not factored into the grant date fair value has been adopted for this column as discussed above.<sup>222</sup>

In response to commenters' concerns about double counting pension benefits,<sup>223</sup> we have not retained the aspect of proposed Instruction 2 to this column that would have required disclosure of pension benefits paid to the named executive officer during the period covered by the table.<sup>224</sup> As adopted, an instruction provides that benefits paid pursuant to defined benefit and actuarial plans are not reportable as All Other Compensation unless accelerated pursuant to a change in control.<sup>225</sup> Similarly, distributions of nonqualified deferred compensation are not reportable as All Other Compensation.

#### f. Captions and Table Layout

Before today's amendments, a portion of the table was labeled as “annual compensation” and another portion as “long term compensation.” These

insurance premiums, rather than only premiums with respect to term life insurance (as was required prior to these amendments), the requirement that had been previously specified in Item 402(b)(2)(v)(E)(1) and (2) to disclose the value of any remaining premiums with respect to circumstances where the named executive officer has an interest in the policy's cash surrender value is not retained in the amended rule.

<sup>220</sup> Item 402(c)(2)(ix)(B).

<sup>221</sup> Item 402(c)(2)(ix)(C). This requirement as adopted has been revised from the proposal to clarify that no amount of compensation is required to be disclosed if there is no compensation cost computed for the discounted securities purchase in accordance with FAS 123R. For example, under FAS 123R, if the discount is five percent or less, all qualified employees can participate in the offer and there are no option features, then there is no compensation cost to recognize for financial reporting purposes and thus no compensation is reported for this item in the All Other Compensation column.

<sup>222</sup> Item 402(c)(2)(ix)(G).

<sup>223</sup> See, e.g., letter from Cravath.

<sup>224</sup> We have moved this disclosure requirement to the Pension Benefits Table, described in Section II.C.5.a. below.

<sup>225</sup> Instruction 2 to Item 402(c)(2)(ix).

captions created distinctions that may have been confusing to both users and preparers of the Summary Compensation Table. As proposed, the amendments we adopt today do not separately identify some columns as “annual” and other columns as “long term” compensation. Consistent with this change, as described above, we are merging the current Other Annual Compensation column into the new All Other Compensation column, and include current earnings information regarding non-equity incentive plan compensation in the column for that form of award.

In eliminating this distinction, we also revise the former definition of “long term incentive plan” to eliminate any distinction between a “long term” plan and one that may provide for periods shorter than one year. Like the captions, the former approach created distinctions that may have been confusing to users and preparers. As proposed and adopted, the amendments define an “incentive plan” as any plan providing compensation intended to serve as incentive for performance to occur over a specified period.<sup>226</sup> The related definition of “incentive plan award” as an award provided under an incentive plan is also adopted as proposed.<sup>227</sup>

Noting that companies formerly reported as “bonuses” awards that would be short-term incentive plan awards under this definition, commenters requested guidance as to what distinguishes items reportable as non-equity incentive plan compensation from those reportable as bonuses under the amended rules.<sup>228</sup> An award would be considered “intended to serve as an incentive for performance to occur over a specified period” if the outcome with respect to the relevant performance target is substantially uncertain at the time the performance target is established and the target is communicated to the executive. Compensation pursuant to such a non-equity award would be reported in the Summary Compensation Table as non-equity incentive plan compensation and the grant of the award would be reported as a non-equity incentive plan award in the Grants of Plan-Based Awards Table.<sup>229</sup> In contrast, a cash

<sup>226</sup> Item 402(a)(6)(iii).

<sup>227</sup> *Id.*

<sup>228</sup> See, e.g., letters from Hewitt; Mercer; NACCO Industries; and SCSCP.

<sup>229</sup> This table is described in Section II.C.2. immediately below. Further, no longer reporting compensation pursuant to these awards as “bonus” in the Summary Compensation Table does not affect the determination of named executive officers because, as described in Section II.C.6.b. below, that

award based on satisfaction of a performance target that was not pre-established and communicated, or the outcome of which is not substantially uncertain, would be reportable in the Summary Compensation Table as a bonus.

2. Supplemental Grants of Plan-Based Awards Table

Following the Summary Compensation Table, we proposed two supplemental tables to explain information in the Summary Compensation Table. The proposed

tables were derived from two tables required under the rules prior to these amendments.

The first table we proposed to supplement the Summary Compensation Table would have included information regarding non-stock grants of incentive plan awards, stock-based incentive plan awards and awards of options, restricted stock and similar instruments under plans that are performance-based (and thus provide the opportunity for future compensation if conditions are satisfied).<sup>230</sup> The second table we proposed to

supplement the Summary Compensation Table would have shown the equity-based compensation awards granted in the last fiscal year that are not performance-based, such as stock, options or similar instruments where the payout or future value is tied to the company's stock price, and not to other performance criteria.<sup>231</sup>

Because much of the information for each proposed table is consistent, we have followed the recommendation of a commenter to simplify the disclosure format by combining the proposed disclosure in a single table.<sup>232</sup>

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										

Disclosure in this table complements Summary Compensation Table disclosure of grant date fair value of stock awards and option awards by disclosing the number of shares of stock or units comprising or underlying the award. This supplemental table shows the terms of grants made during the current year, including estimated future payouts for both equity incentive plans and non-equity incentive plans, with separate disclosure for each grant.<sup>233</sup>

To simplify the presentation further, we have eliminated some of the proposed columns. Because the narrative section identifies the material terms of an award reported in this table as an example of a material factor to be described,<sup>234</sup> and thus will cover the same information, we have eliminated

the proposed columns reporting vesting date, or performance or other period until vesting or payout. As a commenter noted, vesting information typically cannot be reported easily in a single line in a table.<sup>235</sup> Similarly, because the modifications we are making to the Outstanding Equity Awards at Fiscal Year-End Table require that table to report the expiration dates of options and similar awards,<sup>236</sup> we are eliminating the proposed expiration date column. Finally, the proposed column reporting the dollar amount of consideration paid for the award, if any, is not adopted, reflecting comments that this column would be used only rarely.<sup>237</sup> Instead, in those rare instances where consideration is paid for an award, this disclosure will be provided

in a footnote to the appropriate column.<sup>238</sup>

As proposed, the Grants of All Other Equity Awards Table would have permitted aggregation of option grants with the same exercise or base price. We have not adopted such an instruction for this table, based on our belief that grant-by-grant disclosure is the most appropriate approach, particularly given our particular disclosure concerns regarding option grants. For incentive plan awards, threshold, target and maximum payout information should be provided, but if the award provides only for a single estimated payout, that amount should be reported as the target.<sup>239</sup> Where there is a tandem grant of two instruments, only one of which is granted under an incentive plan, only

determination is not limited to consideration of salary and bonus.

<sup>230</sup> Proposed Item 402(d).

<sup>231</sup> Proposed Item 402(e), containing much of the information that was required prior to these

amendments by the Option/SAR Grants Table (formerly specified in Item 402(c)).

<sup>232</sup> See letter from Hewitt.

<sup>233</sup> Instruction 1 to Item 402(d).

<sup>234</sup> Item 402(e)(1)(iii), described in Section II.C.3.a. immediately below.

<sup>235</sup> See letter from ABA.

<sup>236</sup> See Section II.C.4.a. below.

<sup>237</sup> Proposed Item 402(d)(2)(v). See, e.g., letters from Frederic W. Cook & Co. and SCSGP.

<sup>238</sup> Instruction 5 to Item 402(d).

<sup>239</sup> Instruction 2 to Item 402(d).

the instrument that is not granted under an incentive plan is reported in the table, with the tandem feature noted.<sup>240</sup> Because the rules as adopted require Summary Compensation Table disclosure of the incremental fair value, computed in accordance with FAS 123R, of options, stock appreciation rights and similar option-like instruments granted in connection with a repricing transaction, rather than the total fair value as we had proposed, grants of these instruments are not reported in this table.<sup>241</sup> Disclosure should be provided in the Compensation Discussion and Analysis and the narrative disclosures for the Summary Compensation Table and Grants of Plan-Based Awards, as appropriate, regarding awards granted in connection with repricing transactions.

As proposed and adopted, if the per-share exercise or base price of options, stock appreciation rights and similar option-like instruments is less than the market price of the underlying security on the grant date, a separate column must be added showing market price on the grant date.<sup>242</sup> Some commenters objected to our proposal to calculate grant date market price for this purpose using the closing price per share of the underlying security on that date. These commenters stated that plans requiring awards to be granted with an exercise price equal to the underlying security's grant date fair market value may define "fair market value" based on a formula related to the average market price on the grant date or a range of days either before or after the grant date.<sup>243</sup> Our proposed departure from the rule prior to these amendments, which permitted use of such formulas even for securities traded on an established market,<sup>244</sup> was considered, and along with the requirement to disclose the grant date, reflects the significance of issues in awards of option grants.<sup>245</sup> Moreover, commenters expressed concern regarding the manipulation of option grant dates to achieve below-market exercise prices.<sup>246</sup> The rule as adopted uses the measure for grant date market price of the underlying security that we proposed, modified to specify that the

grant date closing market price per share is the last sale price on the principal United States market for the security on the specified date.<sup>247</sup> Moreover, if the exercise or base price is not the grant date closing market price per share, we require a description of the methodology for determining the exercise or base price either by footnote to the table or in the accompanying narrative section.<sup>248</sup> Further reflecting the significance of grant date issues in awards of option grants and in response to comments,<sup>249</sup> we are also providing that if the date on which the compensation committee (or a committee of the board of directors performing a similar function or the full board of directors) takes action or is deemed to take action to grant equity-based awards is different from the date of grant, a column must be added to disclose the date of action.<sup>250</sup> For these purposes, the "date of grant" or "grant date" is the grant date determined for financial statement reporting purposes pursuant to FAS 123R.<sup>251</sup> Finally, in combining the proposed tables, we have adopted an instruction specifying that if a non-equity incentive plan award is denominated in units or other rights, then a separate, adjoining column would be required to disclose the units or other rights awarded.<sup>252</sup>

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

#### a. Narrative Description of Additional Material Factors

As we proposed, we are requiring narrative disclosure following the Summary Compensation Table and the Grants of Plan-Based Awards Table in order to give context to the tabular disclosure. A company will be required to provide a narrative description of any additional material factors necessary to an understanding of the information disclosed in the tables.<sup>253</sup> Unlike the Compensation Discussion and Analysis, which focuses on broader topics regarding the objectives and implementation of executive

compensation policies, the narrative disclosures following the Summary Compensation Table and other tables focus on and provide specific context to the quantitative disclosure in the tables. For example, narrative disclosure following a table might explain material aspects of a plan that are not evident from the quantitative tabular disclosure and are not addressed in the Compensation Discussion and Analysis.

The material factors that require disclosure will vary depending on the facts and circumstances. As one example, such material factors might include descriptions of the material terms in the named executive officers' employment agreements as those descriptions might provide material information necessary to an understanding of the tabular disclosure. The narrative disclosure covers written or unwritten agreements or arrangements.<sup>254</sup> Requiring this disclosure in proximity to the Summary Compensation Table is intended to make the tabular disclosure more meaningful. Mere filing of employment agreements (or summaries of oral agreements) may not be adequate to disclose material factors depending on the circumstances. As stated in the Proposing Release, provisions regarding post-termination compensation need to be addressed in the narrative section only to the extent disclosure of such compensation is required in the Summary Compensation Table; otherwise these provisions will be disclosable as post-termination compensation.<sup>255</sup>

The factors that could be material include each repricing or other material modification of any outstanding option or other equity-based award during the last fiscal year. This disclosure addresses not only option repricings, but also other significant changes to the terms of equity-based awards.<sup>256</sup> As proposed, we are eliminating the former ten-year option repricing table.<sup>257</sup> In its place, the narrative disclosure following the Summary Compensation Table will describe, to the extent material and necessary to an understanding of the tabular disclosure, repricing, extension of exercise periods, change of vesting or forfeiture conditions, change or

<sup>240</sup> Instruction 4 to Item 402(d).

<sup>241</sup> See discussion at Section II.C.1.c.i. above.

<sup>242</sup> Item 402(d)(2)(vii).

<sup>243</sup> See, e.g., letters from Cravath; Eli Lilly; and Sidley Austin LLP ("Sidley Austin").

<sup>244</sup> This requirement had been set forth in Instruction 6 to Item 402(c) prior to today's amendments.

<sup>245</sup> See the discussion of options disclosure in Section II.A. above.

<sup>246</sup> See, e.g., letter from CFA Centre for Financial Market Integrity, dated May 30, 2006 ("CFA Centre 2").

<sup>247</sup> Because the concept of closing market price is used in a number of provisions of Item 402, we are adopting a definition of the term closing market price in Item 402(a)(6)(v). A foreign company complying with this requirement may instead look to the principal foreign market in which the underlying securities trade.

<sup>248</sup> Instruction 3 to Item 402(d).

<sup>249</sup> See, e.g., letter from CFA Centre 2.

<sup>250</sup> Item 402(d)(2)(ii).

<sup>251</sup> Item 402(a)(6)(iv).

<sup>252</sup> Instruction 6 to Item 402(d).

<sup>253</sup> Item 402(e)(1). The standard of materiality that applies in Item 402(e) is that of *Basic v. Levinson*, 485 U.S. 224 (1988) and *TSC Industries v. Northway*, 426 U.S. 438 (1976).

<sup>254</sup> Item 402(e)(1)(i).

<sup>255</sup> Item 402(j), described in Section II.C.5.c.

<sup>256</sup> Item 402(e)(1)(ii).

<sup>257</sup> The ten-year option repricing table had been required by Item 402(i) prior to its elimination with these amendments. We believe that the narrative disclosure requirement will provide investors with material information regarding repricings and modifications and eliminate the arguably dated information contained in the former ten-year option repricing table.

elimination of applicable performance criteria, change of the bases upon which returns are determined, or any other material modification.<sup>258</sup>

Narrative text accompanying the tables will also describe, to the extent material and necessary to an understanding of the tabular disclosure, award terms relating to disclosure provided in the Grants of Plan-Based Awards Table. This could include, for example, a general description of the formula or criteria to be applied in determining the amounts payable, the vesting schedule, a description of the performance-based conditions and any other material conditions applicable to the award, whether dividends or other amounts would be paid, the applicable rate and whether that rate is preferential.<sup>259</sup> As noted above and consistent with current disclosure requirements, however, companies will not be required to disclose any factor, criteria, or performance-related or other condition to payout or vesting of a particular award that involves confidential trade secrets or confidential commercial or financial information, disclosure of which would result in competitive harm to the company.<sup>260</sup>

We proposed that this example also include material assumptions underlying the determination of the amount of increase in the actuarial value of defined benefit and actuarial plans. However, in light of the modifications we are adopting, we have concluded that the better place to discuss these assumptions is in the narrative section accompanying the Pension Benefits Table.<sup>261</sup>

Further, in response to commenters' concerns regarding the computation of total compensation and the expanded basis for determining the most highly

compensated officers,<sup>262</sup> we specify as an additional example an explanation of the level of salary and bonus in proportion to total compensation.<sup>263</sup>

**b. Request for Additional Comment on Compensation Disclosure for up to Three Additional Employees**

As part of this narrative disclosure requirement, we had proposed an additional item that would have required disclosure for up to three employees who were not executive officers during the last completed fiscal year and whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers.<sup>264</sup> We received extensive comment on this proposal. Some commenters supported the proposal or suggested that it should go further.<sup>265</sup> Many commenters expressed concern that the benefits of this disclosure to investors would be negligible, yet compliance might require the outlay of considerable company resources.<sup>266</sup> Some commenters expressed concern that the proposed disclosure would raise privacy issues or negatively impact competition for employees.<sup>267</sup> While we continue to consider whether to adopt such a requirement as part of the executive compensation disclosure rules, in Release No. 33-8735 we are requesting additional comment as to whether potential modifications would address the concerns that commenters have raised.

We note in particular that some commenters questioned the materiality of the information that would have been required by the proposal, given that the covered employees would not be in policy-making positions as executive

officers.<sup>268</sup> After considering the issues raised by these commenters, we remain concerned about disclosure with respect to employees, particularly within very large companies, whether or not they are executive officers, whose total compensation for the last completed fiscal year was greater than that of one or more of the named executive officers. If any of these employees exert significant policy influence at the company, at a significant subsidiary of the company or at a principal business unit, division, or function of the company, then investors seeking a fuller understanding of a company's compensation program may believe that disclosure of these employees' total compensation is important information.<sup>269</sup> Knowing the compensation, and job positions within the organization, of these highly compensated policy-makers whose total compensation for the last fiscal year was greater than that of a named executive officer, should assist in placing in context and permit a better understanding of the compensation structure of the named executive officers and directors.

Our intention is to provide investors with information regarding the most highly compensated employees who exert significant policy influence by having responsibility for significant policy decisions. Responsibility for significant policy decisions could consist of, for example, the exercise of strategic, technical, editorial, creative, managerial, or similar responsibilities. Examples of employees who might not be executive officers but who might have responsibility for significant policy decisions could include the director of the news division of a major network; the principal creative leader of the entertainment function of a media conglomerate; or the head of a principal business unit developing a significant technological innovation. By contrast, we are convinced by commenters that a

<sup>258</sup> As described in Section II.C.1.c.i. above, the tabular disclosure will report the incremental fair value of the modification for financial reporting purposes. However, narrative disclosure will not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or stock appreciation right exercise or base price, an antidilution provision, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or stock appreciation rights. Instruction 1 to Item 402(e).

<sup>259</sup> Item 402(e)(1)(iii), which combines some information that had been required by Instruction 2 to Item 402(b)(2)(iv) with information that had been required by Instruction 1 to Item 402(e) as they were stated in the rule before these amendments.

<sup>260</sup> We have adopted Instruction 2 to Item 402(e)(1), which specifically applies to the narrative disclosure of Item 402(e)(1) the same standard applicable to Compensation Discussion and Analysis for determining whether disclosure would result in competitive harm to the company. See Section II.B.2., above, for a discussion of this standard.

<sup>261</sup> See Section II.C.5.a. below.

<sup>262</sup> See Section II.C.1.a. above and Section II.C.6.b. below.

<sup>263</sup> Item 402(e)(1)(iv).

<sup>264</sup> Proposed Item 402(f)(2).

<sup>265</sup> See, e.g., letters from Corporate Library; The Greenlining Institute; Institutional Investor Group; and SBAF.

<sup>266</sup> See, e.g., letters from ABA; Chamber of Commerce; Eli Lilly; Leggett & Platt; N. Ludgus; and Mercer.

<sup>267</sup> See, e.g., letters from ABA-JCEB; BRT; jointly, CBS Corporation, The Walt Disney Company, NBC Universal, News Corporation, and Viacom, Inc. ("Entertainment Industry Group"); Committee on Corporate Finance of Financial Executives International ("FEI"); Chamber of Commerce; Cleary; CNET Networks, Inc. ("CNET Networks"); Compass Bancshares; Compensia; Cravath; DreamWorks Animation SKG ("DreamWorks"); Eli Lilly; Emerson; Fenwick; The Financial Services Roundtable ("FSR"); Professor Joseph A. Grundfest, dated April 10, 2006 ("Grundfest"); JCI; Intel Corporation ("Intel"); Kellogg Company ("Kellogg"); Kennedy & Baris, LLP ("Kennedy"); Mercer; Peabody Energy; Pearl Meyer & Partners; Securities Industry Association ("SIA"); Sullivan; SCSSGP; and WorldatWork.

<sup>268</sup> See, e.g., letters from CalSTRS; Cleary; CNET Networks; Compass Bancshares; DreamWorks; Entertainment Industry Group; Fried, Frank, Harris, Shriver & Jacobson LLP ("Fried Frank"); FSR; Hewitt; JCI; Intel; Kellogg; Kennedy; Leggett & Platt; Peabody Energy; Pearl Meyer & Partners; SCSSGP; SIA; Stradling Yocca Carlson & Rauth ("Stradling Yocca"); Top Five Data Services, Inc. ("Top Five Data"); Towers Perrin; and Walden.

<sup>269</sup> The Commission expressed similar concerns in 1978, when it stated "a key employee or director of a subsidiary might be the highest-paid person in the entire corporate structure and have managerial responsibility for major aspects of the registrant's overall operations." 1978 Release. See n. 327 for a discussion of the term "executive officer." In light of some of the comments that we received, we have clarified that the definition of "executive officer" includes all individuals in a registrant policy-making role. See, e.g., letters from SCSSGP and Cravath.

salesperson, entertainment personality, actor, singer, or professional athlete who is highly compensated but who does not have responsibility for significant policy decisions would not be the type of employee about whom we would seek disclosure. Nor, as a general matter, would investment professionals (such as a trader, or a portfolio manager for an investment adviser who is responsible for one or more mutual funds or other clients) be deemed to have responsibility for significant policy decisions at the company, at a significant subsidiary or at a principal business unit, division or function simply as a result of performing the duties associated with those positions. On the other hand, an investment professional, such as a trader or portfolio manager, who does have broader duties within a firm (such as, for example, oversight of all equity funds for an investment adviser) may be considered to have responsibility for significant policy decisions.

We continue to consider whether it is appropriate to require some level of narrative disclosure so that shareholders will have information about these most highly compensated employees. This consideration includes the appropriate level of information about these employees and their compensation in light of their roles.

As to issues regarding privacy and competition for employees, to the extent that commenters objected that the disclosure could result in a competitor stealing a company's top "talent,"<sup>270</sup> we have tried to address these concerns by focusing the disclosure on persons who exert significant policy influence within the company or significant parts of the company.

#### Request for Comment

We request additional comment on the proposal to require compensation disclosure for up to three additional employees. In addition to general comment, we encourage commenters to address the following specific questions:

- Would the rule more appropriately require disclosure of the employees described above if it were structured in the following or similar manner:

<sup>270</sup> See, e.g., letter from Entertainment Industry Group. In addition, we note our intention is not to suggest that these additional employees, whether or not they are executive officers, are individuals whose compensation is required to be reported under the Exchange Act "by reason of such employee being among the 4 highest compensated officers for the taxable year," as stated in Internal Revenue Code Section 162(m)(3)(B) [26 U.S.C. 162(m)(3)(B)]. See letter from Cleary (expressing concern that the additional individuals not fall within the purview of Section 162(m) of the Internal Revenue Code).

For each of the company's three most highly compensated employees, whether or not they were executive officers during the last completed fiscal year, whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers, disclose each such employee's total compensation for that year and describe the employee's job position, without naming the employee; *provided, however*, that employees with no responsibility for significant policy decisions within the company, a significant subsidiary of the company, or a principal business unit, division, or function of the company are not included when determining who are each of the three most highly compensated employees for the purposes of this requirement, and therefore no disclosure is required under this requirement for any employee with no responsibility for significant policy decisions within the company, a significant subsidiary of the company, or a principal business unit, division, or function of the company?

- Would it be appropriate to determine the highest paid employees in the same manner that named executive officers are determined, by calculating total compensation but excluding pension plan benefits and above-market or preferential earnings on nonqualified deferred compensation plans, and by comparing that amount to the same amount earned by the named executive officers (excluding the amount required to be disclosed for those named executive officers pursuant to paragraph (c)(2)(viii) of Item 402)? If so, should the total amount disclosed include these amounts as it does for named executive officers? Should the pension benefit and above-market earnings be separately disclosed in a footnote so investors can calculate the amounts used in determining highest paid employees?

- Would modifying the proposed rule to apply only to large accelerated filers<sup>271</sup> properly focus this disclosure obligation on companies that are more likely to have these additional highly compensated employees? Would that modification address concerns that the proposed rule would impose disproportionate compliance burdens by limiting the disclosure obligation to companies that are presumptively better able to track the covered employees? Would a different limitation as to applicability be appropriate?

- Is information regarding highly compensated employees, including

<sup>271</sup> The term large accelerated filer is defined in Exchange Act Rule 12b-2 [17 CFR 240.12b-2].

those who are not executive officers, material to investors? In answering this question, commenters are encouraged to address the following additional questions:

- Would modifications limiting the disclosure to employees who make significant policy decisions within the company, a significant subsidiary of the company, or a principal business unit, division, or function of the company appropriately focus the disclosure on employees for whom compensation information is material to investors?

- Would the approach that we are considering provide investors with material information about how policy-making responsibilities are allocated within a company? Are the examples describing responsibility for significant policy decisions too broad or too narrow?

- Would the proposed rule, with the modifications described above, provide investors with material information necessary to understand the company's compensation policies and structure? How should we address those concerns?

- What is typically the role of the compensation committee in determining or approving the compensation of the additional employees if they are not executive officers? If the compensation committee does not oversee their compensation, is the additional employee compensation information material to investors? What types of decisions would investors make based on this information?

- Would the proposed rule, with the modifications described above, raise privacy issues or negatively impact competition for employees in a manner that would outweigh the materiality of the disclosure to investors?

- Should we require that the three additional employees be named? If not, what additional information should be required? Should more information be required regarding the employee's compensation or job position?

- Should we define "responsibility for significant policy decisions"? Should we use another test to describe those employees who exert a significant policy influence on the company? Do the examples provided above help identify and delimit the number of employees whose compensation would be subject to disclosure under this provision? What would help companies identify these employees?

- What additional work and costs are involved in collecting the information necessary to identify the three additional employees? What are the types of costs, and in what amounts? In what way can the proposal be further modified to mitigate the costs?

• In connection with the original proposal, we solicited comment on all aspects of the proposal, including this one. No commenter supplied cost estimates. We are now considering whether to limit this provision to only large accelerated filers. For some large accelerated filers, the number of employees potentially subject to this requirement may already be known or easy to identify. Other, more complex companies may need to establish systems to identify such employees. Every large accelerated filer would need to evaluate whether any employees exerted significant policy influence at the company, at a significant subsidiary or at a principal business unit, division or function and would have to track their compensation in order to comply with the proposed requirement. These monitoring costs may be new to some companies. We believe the cost of actually disclosing the compensation would be incremental and minimal. The monitoring and information collection costs are likely to be greatest in the first year and significantly less in later years. We also assume that costs would largely be borne internally, although some companies may seek the advice of outside counsel in determining which employees meet the standard for

disclosure. In that event, for purposes of seeking comment, we estimate that 1,700<sup>272</sup> companies will on average retain outside counsel for 8 hours in the first year and 2 hours in each of two succeeding years, at \$400 per hour, for a total estimated average annual cost of approximately \$3 million. Assuming all large accelerated filers spend 60 hours in the first year and 10 hours in each of the two succeeding years, with an average internal cost of \$175 per hour, the total average annual burden of collecting and monitoring employee compensation would be approximately 45,000 hours, or approximately \$8 million. The total average annual cost is therefore estimated to be \$11 million. We invite comment on this estimate and its assumptions.

4. Exercises and Holdings of Previously Awarded Equity

The next section of the revised executive compensation disclosure provides investors with an understanding of the compensation in the form of equity that has previously been awarded and remains outstanding, and is unexercised or unvested. As proposed, this section also discloses amounts realized on this type of compensation during the most recent fiscal year when, for example, a named

executive officer exercises an option or his or her stock award vests. We are adopting substantially as proposed two tables: one table shows the amounts of awards outstanding at fiscal year-end, and the other shows the exercise or vesting of equity awards during the fiscal year.<sup>273</sup> In response to comment, we are requiring additional information regarding out-of-the-money awards.

a. Outstanding Equity Awards at Fiscal Year-End Table

As we noted in the Proposing Release, outstanding awards that have been granted but the ultimate outcomes of which have not yet been realized in effect represent potential amounts that the named executive officer might or might not realize, depending on the outcome for the measure or measures (for example, stock price or performance benchmarks) to which the award relates. We are adopting a table that will disclose information regarding outstanding awards, for example, under stock option (or stock appreciation rights) plans, restricted stock plans, incentive plans and similar plans and disclose the market-based values of the rights, shares or units in question as of the company's most recent fiscal year end.<sup>274</sup>

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 unearned 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 unearned shares, units or other rights that have not vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
PFO									
A									

<sup>272</sup> We estimate there are approximately 1,700 companies that are large accelerated filers. See *Revisions to Accelerated Filer Definition and Accelerated Deadlines for Reporting Periodic Reports*, Release No. 33-8644 (Dec. 21, 2005) [70 FR 76626], at Section V.A.2.

<sup>273</sup> Some of this information had been required in the Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option/SAR Value Table, which was required under Item 402(d) prior to adoption of these amendments.

<sup>274</sup> Item 402(f). Under the rules prior to today's amendments, such disclosure was provided only for holdings of outstanding stock options and stock appreciation rights.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END—Continued

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 unearned 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 unearned shares, units or other rights that have not vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
B									
C									

As proposed, the table included a column reporting aggregate dollar amounts of in-the-money unexercised options.<sup>275</sup> Some commenters believed that this table should not include information on out-of-the-money options because they believed that these awards have no value to executives at the point they are out-of-the-money.<sup>276</sup> Several other commenters recommended disclosure of the number and key terms of out-of-the-money instruments, so investors can understand the potential compensation opportunity of these awards if the market price of the underlying shares increases.<sup>277</sup> We proposed to require expiration date information in footnote disclosure. We note that some commenters expressed concern that disclosure of expiration and vesting dates of the instruments would be lengthy.<sup>278</sup> However, because we agree with other commenters that information regarding out-of-the-money options is material to investors, we have revised the columns applicable to unexercised options, stock appreciation rights and similar instruments with option-like features to require disclosure of:

- The number of securities underlying unexercised instruments that are exercisable;

- The number of securities underlying unexercised instruments that are unexercisable;
- The exercise or base price; and
- The expiration date.

After evaluating the comments received, we believe disclosure of individual exercise prices and expiration dates is required to provide a full understanding of the potential compensation opportunity. In particular, with respect to out-of-the-money awards, this allows investors to see the amount the stock price must rise and the amount of time remaining for it to happen. Consequently, this disclosure is required for each instrument, rather than on the aggregate basis that was proposed.<sup>279</sup>

As suggested by another commenter, we also modify the table to clarify that these columns apply to options and similar awards that have been transferred other than for value.<sup>280</sup> The proposal reflected interpretations of the former rule that the transfer of an option or similar award by an executive does not negate the award's status as compensation that should be

reported.<sup>281</sup> Because an award that a named executive officer transferred for value is not an award for which the outcome remains to be realized, the rules adopted today instead require disclosure in the Option Exercises and Stock Vested Table of the amounts realized upon transfer for value.<sup>282</sup>

In view of our approach in the Grants of Plan-Based Awards Table as adopted and the purposes of this table in showing all outstanding equity awards, we are adopting a column (column (d)) for reporting the number of securities underlying unexercised options awarded under equity incentive plans.<sup>283</sup> We have also revised the format of the table to more clearly delineate between the information regarding option awards and the information regarding stock awards.

The remaining disclosure, relating to numbers and market values of nonvested stock and equity incentive plan awards, is adopted on an aggregate basis, substantially as proposed. One commenter expressed the view that the table should not include unearned performance-based awards because it would be difficult to disclose a meaningful value before the performance conditions are satisfied.<sup>284</sup> Another commenter requested clarification of valuation of awards that are performance-based and nonvested, specifically whether value should be based on actual performance to date or

<sup>275</sup> Proposed Item 402(g)(2)(iii).

<sup>276</sup> See, e.g., letters from Frederic W. Cook & Co.; N. Ludgus; and SCSGP.

<sup>277</sup> See, e.g., letters from Amalgamated; Brian Foley & Company, Inc. ("Brian Foley & Co."); Buck Consultants; CII; Hodak Value Advisors; IUE-CWA; and SBAF.

<sup>278</sup> See, e.g., letters from Leggett & Platt; SCSGP; and Sidley Austin.

<sup>279</sup> Multiple awards may be aggregated where the expiration date and the exercise and/or base price of the instruments is identical. A single award consisting of a combination of options, SARs and/or similar option-like instruments must be reported as separate awards with respect to each tranche with a different exercise and/or base price or expiration date. Instruction 4 to Item 402(f)(2). We have not adopted the proposed requirements to disclose whether an option that expired after fiscal year-end had been exercised, in response to comment that this would unnecessarily deviate from the standard of reporting last fiscal year information. See letter from ABA.

<sup>280</sup> Instruction 1 to Item 402(f)(2). See letter from ABA.

<sup>281</sup> See *Registration of Securities on Form S-8*, Release No. 33-7646 (Feb. 25, 1999) [64 FR 11103], at Section III.D.

<sup>282</sup> Item 402(g), described in Section II.C.4.b. immediately below.

<sup>283</sup> Item 402(f)(2)(iv).

<sup>284</sup> See letter from Sullivan.

on achieving target performance goals.<sup>285</sup> As adopted, an instruction provides that the number of shares reported in the appropriate columns for equity incentive plan awards (columns (d) and (i)) or the payout value reported in column (j) is based on achieving threshold performance goals, except that if the previous fiscal year's performance has exceeded the threshold, the disclosure shall be based on the next higher performance measure (target or maximum) that exceeds the previous fiscal year's performance. If the award provides only for a single estimated

payout, that amount should be reported. If the target amount is not determinable, registrants must provide a representative amount based on the previous fiscal year's performance.<sup>286</sup> We have also adopted an instruction clarifying that stock or options under equity incentive plans are reported in columns (d) or (i) and (j), as appropriate, until the relevant performance condition has been satisfied. Once the relevant performance condition has been satisfied, if stock remains unvested or the option unexercised, the stock or

options are reported in columns (b) or (c), or (g) and (h), as appropriate.<sup>287</sup>

b. Option Exercises and Stock Vested Table

We are adopting substantially as proposed a table that will show the amounts received upon exercise of options or similar instruments or the vesting of stock or similar instruments during the most recent fiscal year. This table will allow investors to have a picture of the amounts that a named executive officer realizes on equity compensation through its final stage.<sup>288</sup>

OPTION EXERCISES AND STOCK VESTED

Name  (a)	Option awards		Stock awards	
	Number of shares acquired on exercise (#) (b)	Value realized on exercise (\$) (c)	Number of shares acquired on vesting (#) (d)	Value realized on vesting (\$) (e)
PEO				
PFO				
A				
B				
C				

We proposed that this table include the grant date fair value of these instruments that would have been disclosed in the Summary Compensation Table for the year in which they were awarded. We proposed this column to eliminate the possible impact of double disclosure by showing amounts previously disclosed. We have adopted the table without the grant date fair value column in response to commenters' concerns that this column would confuse investors and increase the potential for double counting.<sup>289</sup> As described in the preceding section, in response to comment that transfers of awards for value also are realization events, amounts realized upon such transfers must be included in columns (c) and (e) of this table.<sup>290</sup> Finally, we have reformatted the columns to make the presentation of stock and option

awards consistent with the presentation in other tables.

5. Post-Employment Compensation

As we proposed, we are making significant revisions to the disclosure requirements regarding post-employment compensation to provide a clearer picture of this potential future compensation. As we noted in the Proposing Release, executive retirement packages and other post-termination compensation may represent a significant commitment of corporate resources and a significant portion of overall compensation. First, we are replacing the former pension plan table, alternative plan disclosure and some of the other narrative descriptions with a table regarding defined benefit pension plans and enhanced narrative disclosure. We have revised the table

from the table proposed. Second, we are adding a table and narrative disclosure that will disclose information regarding nonqualified defined contribution plans and other deferred compensation. We have adopted this table substantially as proposed. Finally, we are adopting revised requirements substantially as proposed regarding disclosure of compensation arrangements triggered upon termination and on changes in control.

a. Pension Benefits Table

We proposed significant revisions to the rules disclosing retirement benefits to require disclosure of the estimate of retirement benefits to be payable at normal retirement age and, if available, early retirement. Disclosure under the rules prior to today's amendments frequently did not provide investors

<sup>285</sup> See, e.g., letter from Hewitt.

<sup>286</sup> Instruction 3 to Item 402(f).

<sup>287</sup> Instruction 5 to Item 402(f).

<sup>288</sup> This table is similar to a portion of the Aggregate Options/SAR Exercises in Last Fiscal

Year and FY-End Options/SAR Values Table that was required prior to these amendments, except unlike that table it also includes the vesting of restricted stock and similar instruments.

Commentators have noted a need for comparable disclosure of restricted stock vesting.

<sup>289</sup> See, e.g., letters from Foley; SCSGP; and Stradling Yocca.

<sup>290</sup> Item 402(g)(2)(iii) and (v).

useful information regarding specific potential pension benefits relating to a particular named executive officer.<sup>291</sup> In particular, it may have been difficult to understand which amounts related to any particular named executive officer, obscuring the value of a significant component of compensation.

We therefore proposed a new table that would have required disclosure of the estimated retirement benefits payable at normal retirement age and, if available, early retirement, under defined benefit plans. Under the proposal, benefits would have been quantified based on the form of benefit currently elected by the named executive officer, such as joint and survivor annuity or single life annuity.

Some commenters objected that the proposed revisions would result in disclosure that would not be comparable and could be manipulated.<sup>292</sup> In particular, the calculation of benefits would depend on such factors as the form of benefit payment, the named executive officer's marital status, and the actuarial assumptions applied, which would vary from company to company and plan to plan. Explanations of the complicated methodologies involved could hinder transparency.

Some commenters suggested that the Commission prescribe standard assumptions for calculating annual benefits for disclosure purposes, such as a single life annuity and retirement at age 65, in order to facilitate comparability.<sup>293</sup> Other commenters

suggested disclosure of the present value of the current accrued benefit computed as of the end of the company's last completed fiscal year,<sup>294</sup> achieving comparability by reporting the economic value of the benefit that the executive has accumulated through the plan.

Because the latter approach achieves comparability and transparency by disclosing a benefit that already has accrued, we view it as preferable to an approach that would "normalize" disclosure based on hypothetical annual benefit assumptions prescribed by the Commission that might bear no relationship to the assumptions that the company actually applies with respect to the plan. Furthermore, this approach will make clearer the relationship of this table to the Summary Compensation Table disclosure of increase in pension value. This approach will also lessen the burden on companies, since they are required to calculate the present value for the Summary Compensation Table. Accordingly, the table we adopt today requires disclosure of the actuarial present value of the named executive officer's accumulated benefit under the plan and the number of years of service credited to the named executive officer under the plan reported in the table, each computed as of the same pension plan measurement date for financial statement reporting purposes with respect to the audited financial statements for the company's last completed fiscal year.<sup>295</sup> This disclosure applies without regard to the particular

form(s) of benefit payment available under the plan.

Whether or not the plan allows for a lump-sum payment, presentation of the present value of the accrued plan benefit provides investors an understanding of the cost of promised future benefits in present value terms.<sup>296</sup> Companies must use the same assumptions, such as interest rate assumptions, that they use to derive the amounts disclosed in conformity with generally accepted accounting principles, but would assume that retirement age is normal retirement age as defined in the plan, or if not so defined, the earliest time at which a participant may retire under the plan without any benefit reduction due to age.<sup>297</sup> The estimates are to be based on current compensation, and as such, future levels of compensation need not be estimated for purposes of the calculation. The valuation method and all material assumptions applied will be described in the narrative section accompanying this table.<sup>298</sup> A separate row will be provided for each plan in which a named executive officer participates.<sup>299</sup> For purposes of allocating the current accrued benefit between tax qualified defined benefit plans and related supplemental plans, a company will apply the applicable Internal Revenue Code limitations in effect as of the pension plan measurement date.<sup>300</sup> At the suggestion of a commenter, we have simplified the name of the table.<sup>301</sup>

PENSION BENEFITS

Name  (a)	Plan name  (b)	Number of years credited service (#)  (c)	Present value of accumulated benefit (\$)  (d)	Payments during last fiscal year (\$)  (e)
PEO				

<sup>291</sup> The rules prior to today's amendments provided that, for defined benefit or actuarial plans, disclosure was required under Item 402(f) by way of a general table showing estimated annual benefits under the plan payable upon retirement (including amounts attributable to supplementary or excess pension award plans) for specified compensation levels and years of service. This table did not provide disclosure for any specific named executive officer. This requirement applied to plans under which benefits were determined primarily by final compensation (or average final compensation) and years of service, and included narrative disclosure. If named executive officers were subject to other plans under which benefits were not determined primarily by final compensation (or average final compensation), narrative disclosure had been required prior to these amendments of the benefit

formula and estimated annual benefits payable to the officers upon retirement at normal retirement age.  
<sup>292</sup> See, e.g., letters from BRT; Chadbourne & Parke LLP ("Chadbourne"); Cleary; and ABA-JCEB.  
<sup>293</sup> See, e.g., letters from ABA and NACCO Industries.  
<sup>294</sup> See, e.g., letters from Buck Consultants; Frederic W. Cook & Co.; Professor Bebchuk, *et al.*; and SBAF.  
<sup>295</sup> Item 402(h)(2)(iv). If the number of years of credited service for a plan differs from the named executive officer's number of actual years of service with the company, footnote quantification of the difference and any resulting benefit augmentation is required. Instruction 4 to Item 402(h)(2).  
<sup>296</sup> Further, basing pension plan disclosure on the accumulated benefit is consistent with nonqualified

deferred compensation plan disclosure, which, as described in Section II.C.5.b, immediately below, reports an aggregate account balance.  
<sup>297</sup> Instruction 2 to Item 402(h)(2). Of course, the benefits included in the plan document or the executive's contract itself is not an assumption.  
<sup>298</sup> Item 402(h)(3) and Instruction 2 to Item 402(h)(2). This requirement could be satisfied by reference to a discussion of those assumptions in the company's financial statements, footnotes to the financial statements, or Management's Discussion and Analysis. The sections so referenced would be deemed a part of the disclosure provided by this item.  
<sup>299</sup> Instruction 1 to Item 402(h)(2).  
<sup>300</sup> Instruction 3 to Item 402(h).  
<sup>301</sup> See letter from ABA.

PENSION BENEFITS—Continued

Name (a)	Plan name (b)	Number of years credited service (#) (c)	Present value of accumulated benefit (\$) (d)	Payments during last fiscal year (\$) (e)
PFO				
A				
B				
C				

We have moved the disclosure proposed to be included in the Summary Compensation Table of pension benefits paid to a named executive officer during the last completed fiscal year to the Pension Benefits Table so that pension benefits are disclosed only once in the Summary Compensation Table.<sup>302</sup> We remain of the view that disclosure of these payments would be material to investors, particularly where the named executive officer receives them while still employed by the company.<sup>303</sup>

The table will be followed by a narrative description of material factors necessary to an understanding of each plan disclosed in the table. Examples of such factors may include, in given cases, among other things:

- The material terms and conditions of benefits available under the plan, including the plan's retirement benefit formula and eligibility standards, and early retirement arrangements;<sup>304</sup>

- The specific elements of compensation, such as salary and various forms of bonus, included in applying the benefit formula, identifying each such element;
  - Regarding participation in multiple plans, the different purposes for each plan; and
  - Company policies with regard to such matters as granting extra years of credited service.

b. Nonqualified Deferred Compensation Table

In order to provide a more complete picture of potential post-employment compensation, we are adopting substantially as proposed a new table to disclose contributions, earnings and balances under each defined contribution or other plan that provides for the deferral of compensation on a basis that is not tax-qualified. These plans may be a significant element of retirement and post-termination compensation. Prior to these amendments, the rules had elicited

disclosure of the compensation when earned and only the above-market or preferential earnings on nonqualified deferred compensation.<sup>305</sup> The full value of those earnings and the accounts on which they are payable was not subject to disclosure, nor were investors informed regarding the rate at which these amounts, and the corresponding cost to the company, grow.<sup>306</sup>

As noted above, we are requiring disclosure in the Summary Compensation Table only of the above-market or preferential portion of earnings on compensation that is deferred on a basis that is not tax-qualified. To provide investors with disclosure of the full amount of nonqualified deferred compensation accounts that the company is obligated to pay named executive officers, including the full amount of earnings for the last fiscal year, we are also requiring new tabular and narrative disclosure of nonqualified deferred compensation, as we proposed.<sup>307</sup>

NONQUALIFIED DEFERRED COMPENSATION

Name (a)	Executive contributions in last FY (\$) (b)	Registrant contributions in last FY (\$) (c)	Aggregate earnings in last FY (\$) (d)	Aggregate withdrawals/distributions (\$) (e)	Aggregate balance at last FYE (\$) (f)
PEO					
PFO					

<sup>302</sup> Item 402(h)(2)(v). See also Instruction 1 to Item 402(c)(2)(viii). We have included these amounts in this table rather than the Summary Compensation Table since the increase in the value of the pension benefit would have been previously disclosed in the Summary Compensation Table.

<sup>303</sup> Item 402(a)(5) as amended provides that a column may be omitted if there is no compensation

required to be reported in that column in any fiscal year covered by that table.

<sup>304</sup> For this purpose, "normal retirement age" means the normal retirement age defined in the plan, or if not so defined, the earliest time at which a participant may retire under the plan without any benefit reduction due to age. "Early retirement age" means early retirement age as defined in the plan.

or otherwise available to the executive under the plan. Item 402(h)(3)(i) and (ii).

<sup>305</sup> See Section II.C.1.d.i. above.

<sup>306</sup> See Lucian A. Bebchuk and Jesse M. Fried, *Stealth Compensation via Retirement Benefits*, 1 Berkeley Bus. L.J. 291, 314-316 (2004).

<sup>307</sup> Item 402(i).

## NONQUALIFIED DEFERRED COMPENSATION—Continued

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)
A					
B					
C					

One commenter noted that the title proposed—Nonqualified Defined Contribution and Other Deferred Compensation Plans—suggested that tax qualified plans that provide for deferral of compensation, such as Section 401(k) plans, would be covered.<sup>308</sup> We have adopted the commenter's recommendation to modify the title to clarify that the table covers only deferred compensation that is not tax-qualified, and we have also shortened the title consistent with our amendments regarding the Pension Benefits Table.

As proposed and adopted, an instruction requires footnote quantification of the extent to which amounts in the contributions and earnings columns are reported as compensation in the year in question and other amounts reported in the table in the aggregate balance column were reported previously in the Summary Compensation Table for prior years.<sup>309</sup> This footnote provides information so that investors can avoid "double counting" of deferred amounts by clarifying the extent to which amounts payable as deferred compensation represent compensation previously reported, rather than additional currently earned compensation.<sup>310</sup>

The table will be followed by a narrative description of material factors necessary to an understanding of the disclosure in the table.<sup>311</sup> Examples of such factors may include, in given cases, among other things:

- The type(s) of compensation permitted to be deferred, and any limitations (by percentage of compensation or otherwise) on the extent to which deferral is permitted;

- The measures of calculating interest or other plan earnings (including whether such measure(s) are selected by the named executive officer or the company and the frequency and manner in which such selections may be changed), quantifying interest rates and other earnings measures applicable during the company's last fiscal year; and

- material terms with respect to payouts, withdrawals and other distributions.

Where plan earnings are calculated by reference to actual earnings of mutual funds or other securities, such as company stock, it is sufficient to identify the reference security and quantify its return. This disclosure may be aggregated to the extent the same measure applies to more than one named executive officer.

#### c. Other Potential Post-Employment Payments

We are adopting the significant revisions that we proposed to our requirements to describe termination or change in control provisions. The Commission has long recognized that "termination provisions are distinct from other plans in both intent and scope and, moreover, are of particular interest to shareholders."<sup>312</sup> Prior to today's amendments, disclosure did not in many cases capture material information regarding these plans and potential payments under them. We therefore proposed and are adopting disclosure of specific aspects of written or unwritten arrangements that provide for payments at, following, or in connection with the resignation, severance, retirement or other termination (including constructive termination) of a named executive officer, a change in his or her

responsibilities,<sup>313</sup> or a change in control of the company.

Our amendments call for narrative disclosure of the following information regarding termination and change in control provisions:<sup>314</sup>

- the specific circumstances that would trigger payment(s) or the provision of other benefits (references to benefits include perquisites and health care benefits);
- the estimated payments and benefits that would be provided in each covered circumstance, and whether they would or could be lump sum or annual, disclosing the duration and by whom they would be provided;<sup>315</sup>
- how the appropriate payment and benefit levels are determined under the various circumstances that would trigger payments or provision of benefits;<sup>316</sup>
- any material conditions or obligations applicable to the receipt of payments or benefits, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality covenants; and

<sup>313</sup> We confirm that this aspect of the disclosure requirement is not limited to a change in responsibilities in connection with a change in control.

<sup>314</sup> Item 402(j).

<sup>315</sup> We have eliminated the \$100,000 disclosure threshold that was specified in the rule prior to today's amendments. For post-termination perquisites, however, the same disclosure and itemization thresholds used for the amended Summary Compensation Table apply. See Section II.C.1.e.i. above. We have modified Item 402(j)(2) from the proposal in response to comments to clarify that the required description covers both annual and lump sum payments. See letter from ABA.

<sup>316</sup> We have modified Item 402(j)(3) from the proposal to clarify the scope of the required disclosure. The proposal would have required the company to describe and explain the specific factors used to determine the appropriate payment and benefit levels under the various triggering circumstances. A commenter suggested that the proposed language was overly broad and ambiguous and could result in mere repetition of the pension payout formula and actuarial assumptions. See letter from ABA.

<sup>308</sup> See letter from Foley.

<sup>309</sup> Instruction to Item 402(i)(2).

<sup>310</sup> As described in Section II.C.1.b. above, the rules as adopted do not include the corresponding footnote that was proposed for the Summary Compensation Table.

<sup>311</sup> Item 402(i)(3).

<sup>312</sup> 1983 Release, at Section III.E.

• any other material factors regarding each such contract, agreement, plan or arrangement.<sup>317</sup>

The item contemplates disclosure of the duration of non-compete and similar agreements, and provisions regarding waiver of breach of these agreements, and disclosure of tax gross-up payments.

A company will be required to provide quantitative disclosure under these requirements even where uncertainties exist as to amounts payable under these plans and arrangements. We clarify that in the event uncertainties exist as to the provision of payments and benefits or the amounts involved, the company is required to make a reasonable estimate (or a reasonable estimated range of amounts), and disclose material assumptions underlying such estimates or estimated ranges in its disclosure. In such event, the disclosure will be considered forward-looking information as appropriate that falls within the safe harbors for disclosure of such information.<sup>318</sup>

We have modified the requirement somewhat in response to comments that compliance with the proposal would involve multiple complex calculations and projections based on circumstantial and variable assumptions.<sup>319</sup> We adopt commenters' suggestions that the quantitative disclosure required be calculated applying the assumptions that:

- the triggering event took place on the last business day of the company's last completed fiscal year; and
- the price per share of the company's securities is the closing market price as of that date.<sup>320</sup>

We have also revised the rule to provide that if a triggering event has occurred for a named executive officer who was not serving as a named executive officer at the end of the last completed fiscal year, disclosure under this provision is required for that named executive officer only with respect to the actual triggering event that occurred.<sup>321</sup> These modifications will both facilitate company compliance and provide investors with disclosure that is more meaningful. We further clarify that

<sup>317</sup> This would include, for example, disclosure of whether an executive simultaneously receives both severance and retirement benefits, a practice commonly known as a "double dip." See letter from WorldatWork.

<sup>318</sup> See, e.g., Securities Act Section 27A and Exchange Act Section 21E.

<sup>319</sup> See, e.g., letters from Cleary; Foley; HRP; and Top Five Data.

<sup>320</sup> Instruction 1 to Item 402(j). See, e.g., letters from Emerson; Foley; and Frederic W. Cook & Co.

<sup>321</sup> Instruction 4 to Item 402(j). See letter from ABA.

health care benefits are included in this requirement, and quantifiable based on the assumptions used for financial reporting purposes under generally accepted accounting principles.<sup>322</sup>

We further clarify in response to comments that to the extent that the form and amount of any payment or benefit that would be provided in connection with any triggering event is fully disclosed in the Pension Benefits Table or the Nonqualified Deferred Compensation Table and the narrative disclosure related to those tables, reference may be made to that disclosure.<sup>323</sup> However, to the extent that the form or amount of any such payment or benefit would be increased, or its vesting or other provisions accelerated upon any triggering event, such increase or acceleration must be specifically disclosed in this section.<sup>324</sup> In addition, we have added an instruction that companies need not disclose payments or benefits under this requirement to the extent such payments or benefits do not discriminate in scope, terms or operation, in favor of a company's executive officers and are available generally to all salaried employees.<sup>325</sup>

## 6. Officers Covered

### a. Named Executive Officers

As proposed, we are amending the disclosure rules so that the principal executive officer, the principal financial officer<sup>326</sup> and the three most highly compensated executive officers other than the principal executive officer and principal financial officer comprise the named executive officers.<sup>327</sup> In addition,

<sup>322</sup> Item 402(j)(1) and Instruction 2 to Item 402(j). These would be the assumptions applied under Financial Accounting Standards Board Statement of Financial Accounting Standards No. 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions* (FAS 106). See, e.g., letters from Peabody Energy and WorldatWork.

<sup>323</sup> See letter from Academy of Actuaries.

<sup>324</sup> Instruction 3 to Item 402(j).

<sup>325</sup> Instruction 5 to Item 402(j).

<sup>326</sup> We are adopting the nomenclature used in Item 5.02 of Form 8-K, which refers to "principal executive officer" and "principal financial officer."

<sup>327</sup> Item 402(a)(3). As defined in Securities Act Rule 405 [17 CFR 230.405] and Exchange Act Rule 3b-7 [17 CFR 240.3b-7], "the term 'executive officer,' when used with reference to a registrant, means its president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the registrant. Executive officers of subsidiaries may be deemed executive officers of the registrant if they perform such policy-making functions for the registrant." Therefore, as was formerly the case, a named executive officer may be an executive officer of a subsidiary or an employee of a subsidiary who performs such policy-making functions for the registrant. We have clarified this point in the

as was the case prior to these amendments, up to two additional individuals for whom disclosure would have been required but for the fact that they were no longer serving as executive officers at the end of the last completed fiscal year shall be included.

As we noted in the Proposing Release, we believe that compensation of the principal financial officer is important to shareholders because, along with the principal executive officer, the principal financial officer provides the certifications required with the company's periodic reports and has important responsibility for the fair presentation of the company's financial statements and other financial information.<sup>328</sup> Like the principal executive officer, disclosure about the principal financial officer will be required even if he or she was no longer serving in that capacity at the end of the last completed fiscal year.<sup>329</sup> As was the case for the chief executive officer prior to today's amendments, all persons who served as the company's principal executive officer or principal financial officer during the last completed fiscal year are named executive officers.

We are not requiring compensation disclosure for all of the officers listed in Items 5.02(b) and (c) of Form 8-K.<sup>330</sup> Those Form 8-K Items were adopted to provide current disclosure in the event of an appointment, resignation, retirement or termination of the specified officers, based on the principle that changes in employment status of these particular officers are unquestionably or presumptively material. At the time when a decision is made regarding the employment status of a particular officer, it will not always be clear who will be the named executive officers for the current year.

provision describing the determination of named executive officer. Instruction 2 to Item 402(a)(3).

<sup>328</sup> Exchange Act Rules 13a-14 and 15d-14.

<sup>329</sup> Paragraphs (a)(3)(i) and (a)(3)(ii) of Item 402 provide that all individuals who served as a principal executive officer and principal financial officer or in similar capacities during the last completed fiscal year must be considered named executive officers. Item 402(a)(4) specifies that if the principal executive officer or principal financial officer served in that capacity for only part of a fiscal year, information must be provided as to all of the individual's compensation for the full fiscal year. Item 402(a)(4) also specifies that if a named executive officer (other than the principal executive officer or principal financial officer) served as an executive officer of the company (whether or not in the same position) during any part of the fiscal year, then information is required as to all compensation of that individual for the full fiscal year.

<sup>330</sup> These are the registrant's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or any person performing similar functions. As described in Section III.A. below, the rules we adopt today also amend Item 5.02 of Form 8-K.

Given these factors, it is reasonable for the two groups not to be identical.

**b. Identification of Most Highly Compensated Executive Officers; Dollar Threshold for Disclosure**

In the rule prior to today's amendments, the determination of the most highly compensated executive officers was based solely on total annual salary and bonus for the last fiscal year, subject to a \$100,000 disclosure threshold. We proposed to revise the dollar threshold for disclosure of named executive officers other than the principal executive officer and the principal financial officer to \$100,000 of total compensation for the last fiscal year. Given the proliferation of various forms of compensation other than salary and bonus, we believe that total compensation would more accurately identify those officers who are, in fact, the most highly compensated.

Several commenters objected to using total compensation to identify named executive officers.<sup>331</sup> In particular, commenters stated that this measure would minimize the importance of the compensation committee's compensation decisions for the most recent year and include significant elements beyond the committee's control, such as the increase in pension value and earnings on nonqualified deferred compensation. Some commenters recommended continuing to rely solely on salary and bonus, stating that these measures more accurately reflect the executives who are most highly valued in the company and permit greater year-to-year consistency.<sup>332</sup> Other commenters expressed concern that including episodic option awards would result in more frequent changes to the named executive officer roster.<sup>333</sup>

We are persuaded that it is appropriate to exclude from the named executive officer determination compensation elements that principally reflect executives' decisions to defer compensation and wealth accumulation in pension plans, or are unduly influenced by age or years of service. However, as we stated in the Proposing Release, basing identification of named executive officers solely on the compensation reportable in the salary and bonus categories may provide an incentive to re-characterize compensation. Further, limiting the determination to salary and bonus is not

consistent with our decision to eliminate the distinction between "annual" and "long-term" compensation in the Summary Compensation Table.<sup>334</sup> We realize that this may result in more frequent changes to the officers designated as named executive officers, but believe that it will provide a clearer picture of compensation at a company. Accordingly, we require the most highly compensated executive officers to be determined based on total compensation, reduced by the sum of the increase in pension values and nonqualified deferred compensation above-market or preferential earnings reported in column (h) of the Summary Compensation.<sup>335</sup>

Prior to these amendments, companies were permitted to exclude an executive officer (other than the chief executive officer) due to either an unusually large amount of cash compensation that was not part of a recurring arrangement and was unlikely to continue, or cash compensation relating to overseas assignments attributed predominantly to such assignments.<sup>336</sup> Because payments attributed to overseas assignments have the potential to skew the application of Item 402 disclosure away from executives whose compensation otherwise properly would be disclosed, we are retaining this basis for exclusion, as we proposed. However, we believe that other compensation that is "not recurring and unlikely to continue" should be considered compensation for disclosure purposes. There has been inconsistent interpretation of the "not recurring and unlikely to continue" standard, and it is susceptible to manipulation. We therefore are eliminating this basis for exclusion, as we proposed.<sup>337</sup>

**7. Interplay of Items 402 and 404**

We are amending Item 402 so that it requires disclosure of all transactions between the company and a third party where the primary purpose of the transaction is to furnish compensation to a named executive officer as proposed. Also as proposed, amended Item 402 will no longer exclude from its disclosure requirements information about compensatory transaction that had been disclosed under the related person transaction disclosure

requirements of Item 404.<sup>338</sup> Further, instructions to amended Item 404 clarify what compensatory transactions with executive officers and directors need not be disclosed under Item 404.<sup>339</sup>

As noted in the Proposing Release, the result of these amendments may be that in some cases compensation information will be required to be disclosed under Item 402, while the related person transaction giving rise to that compensation is also disclosed under Item 404. We believe that the possibility of additional disclosure in the context of each of these respective items is preferable to the possibility that compensation is not properly and fully disclosed under Item 402.

**8. Other Changes**

Before today's amendments, a company was permitted to omit from Item 402 disclosure of "information regarding group life, health, hospitalization, medical reimbursement or relocation plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees."<sup>340</sup> Because relocation plans, even when available generally to all salaried employees, are susceptible to operation in a discriminatory manner that favors executive officers, this exclusion may have deprived investors of disclosure of significant compensatory benefits. For this reason, we are deleting relocation plans from this exclusion, as we proposed. For the same reason, as we proposed, we are also deleting relocation plans from the exclusion from portfolio manager compensation in forms used by management investment companies to register under the Investment Company Act and offer securities under the Securities Act.<sup>341</sup> We also are revising the definition of "plan" so that it is more principles-based, as we proposed.<sup>342</sup> Finally, in order to

<sup>338</sup> These relevant provisions were set forth in paragraphs (a)(2) and (a)(5) of Item 402 before today's amendments. Because paragraph (a)(5) of Item 402 as it had been stated prior to these amendments was otherwise redundant with paragraph (a)(2) of Item 402 as that provision had been stated, we are eliminating the language that had been set forth in paragraph (a)(5) in its entirety and making a conforming amendment to paragraph (a)(2) of Item 402.

<sup>339</sup> See Instruction 5 to Item 404(a), discussed in Section V.A.3., below.

<sup>340</sup> This language appeared in Item 402(a)(7)(ii) prior to today's amendments, which generally defined the term "plan."

<sup>341</sup> Amendment to Instruction 2 to Item 15(b) of Form N-1A; amendment to Instruction 2 to Item 21.2 of Form N-2; amendment to Instruction 2 to Item 22(b) of Form N-3.

<sup>342</sup> Item 402(a)(6)(ii).

<sup>331</sup> See, e.g., letters from ACC; Emerson; Leggett & Platt; SCSGP; and Unitrin.

<sup>332</sup> See, e.g., letters from Frederic W. Cook & Co. and Intel.

<sup>333</sup> See, e.g., letter from Intel.

<sup>334</sup> See Section II.C.1.f. above, discussing the effect of this change on compensation formerly reported as "bonus."

<sup>335</sup> Instruction 1 to Item 402(a)(3).

<sup>336</sup> This exclusion had been set forth in Instruction 3 to Item 402(a)(3) prior to these amendments.

<sup>337</sup> Instruction 3 to Item 402(a)(3).

simplify the language of the individual requirements, we have consolidated into one provision the definitions for the terms stock, option and equity as used in Item 402.<sup>343</sup>

9. Compensation of Directors

Director compensation has continued to evolve from simple compensation packages mostly involving cash compensation and attendance fees to more complex packages, which can also include equity-based compensation, incentive plans and other forms of

compensation.<sup>344</sup> In light of this complexity, we proposed to require formatted tabular disclosure for director compensation, accompanied by narrative disclosure of additional material information. In doing so, we revisited an approach that the Commission proposed in 1995 but did not adopt at that time.<sup>345</sup>

Director compensation has continued to evolve since 1995 so that we are today adopting a Director Compensation Table, which resembles the revised Summary Compensation Table, but

presents information only with respect to the company's last completed fiscal year. Consistent with the modifications to the Summary Compensation Table, this table moves pension and nonqualified deferred compensation plan disclosure from All Other Compensation to a separate column.<sup>346</sup> Because the same instructions as provided in the Summary Compensation Table govern analogous matters in the Director Compensation Table, our modifications to those instructions also apply to this table.

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)
A							
B							
C							
D							
E							

As proposed and adopted, director fees earned or paid in cash would be reported separately from fees paid in stock. The All Other Compensation column of the Director Compensation Table includes, but is not limited to:

- All perquisites and other personal benefits if the total is \$10,000 or greater;
- All tax reimbursements;
- For any security of the company or its subsidiaries purchased from the company or its subsidiaries (through deferral of fees or otherwise) at a discount from the market price of such security at the date of purchase, unless the discount is generally available to all security holders or to all salaried employees of the company, the

compensation cost, if any, computed in accordance with FAS 123R;

- Amounts paid or accrued to any director pursuant to a plan or arrangement in connection with the resignation, retirement or any other termination of such director or a change in control of the company;
- Annual company contributions to vested and unvested defined contribution plans;
- All consulting fees;
- Awards under director legacy or charitable awards programs;<sup>347</sup> and
- The dollar value of any insurance premiums paid by, or on behalf of, the company for life insurance for the director's benefit.

An additional requirement to include the dollar value of any dividends or other earnings paid in stock or option awards when the dividend or earnings were not factored into the grant date fair value has been adopted for this column as discussed above.

In addition to the disclosure specified in the columns of the table, we proposed to require, by footnote to the appropriate column, disclosure for each director of the outstanding equity awards at fiscal year end as would be required if the Outstanding Equity Awards at Fiscal Year-End table for named executive officers were required for directors. In response to a comment that this disclosure would be provided

<sup>343</sup> Item 402(a)(6)(i).

<sup>344</sup> See, e.g., National Association of Corporate Directors and Pearl Meyer & Partners. *2003-2004 Director Compensation Survey* (2004); National Association of Corporate Directors, *Report of the NACD Blue Ribbon Commission On Director Compensation* (2001); and Dennis C. Carey, et al., *How Should Corporate Directors Be Compensated?*, Investment Dealers' Digest Inc.—Special Issue: Boards and Directors (Jan. 1996).

<sup>345</sup> 1995 Release. The 1995 proposed amendment was coupled with a proposed amendment to permit companies to reduce the detailed executive compensation information provided in the proxy statement by instead furnishing that information in the Form 10-K. We did not act upon these proposed amendments.

<sup>346</sup> As noted in n. 303 above, Item 402(a)(5) provides that a column may be omitted if there is no compensation required to be reported in that column.

<sup>347</sup> Under director legacy programs, also known as charitable award programs, registrants typically agree to make a future donation to one or more charitable institutions in the director's name, payable by the company upon a designated event such as death or retirement. The amount to be disclosed in the table shall be the annual cost of such promises and payments, with footnote disclosure of the total dollar amount and other material terms of each such program. Instruction 1 to Item 402(k)(2)(vii).

in the narrative accompanying the table, we have simplified the relevant instruction to require footnote disclosure only of the aggregate numbers of stock awards and option awards outstanding at fiscal year end.<sup>348</sup> As with the Summary Compensation Table, the new rules make clear that all compensation must be included in the table.<sup>349</sup> As is the case with the current director disclosure requirement, companies will not be required to include in the director disclosure any amounts of compensation paid to a named executive officer and disclosed in the Summary Compensation Table with footnote disclosure indicating what amounts reflected in that table are compensation for services as a director.<sup>350</sup> An instruction to the Director Compensation Table permits the grouping of multiple directors in a single row of the table if all of their elements and amounts of compensation are identical.<sup>351</sup>

Following the table, narrative disclosure will describe any material factors necessary to an understanding of the table. Such factors may include, for example, a breakdown of types of fees.<sup>352</sup> In addition, as noted in Section II.A., disclosure regarding option timing or dating practices may be necessary under this narrative disclosure requirement when the recipients of the stock option grants are directors of the company. As we proposed, we are not requiring a supplemental Grants of Plan-Based Awards Table for directors.

#### D. Treatment of Specific Types of Issuers

##### 1. Small Business Issuers

The Item 402 amendments continue to differentiate between small business issuers and other issuers, as we proposed. In adopting the amendments, we recognize that the executive compensation arrangements of small business issuers typically are less complex than those of other public companies.<sup>353</sup> We also recognize that

satisfying disclosure requirements designed to capture more complicated compensation arrangements may impose new, unwarranted burdens on small business issuers.<sup>354</sup>

Some commenters addressing the proposed amendments to Item 402 of Regulation S-B expressed the view that all companies whose shares are publicly traded should have to meet the same reporting and disclosure standards, regardless of their size, or urged that exemptions for smaller public companies be limited,<sup>355</sup> suggesting that they be required to file some form of a basic Compensation Discussion and Analysis.<sup>356</sup> We are not following these recommendations, because the executive compensation arrangements of small business issuers generally are so much less complex than those of other public companies that they do not warrant the more extensive disclosure requirements imposed on companies that are not small business issuers and related regulatory burdens that could be disproportionate for small business issuers.

Other commenters who supported the Commission's proposal to require less extensive disclosure for companies subject to Regulation S-B suggested that the Commission amend the definition of small business issuer to encompass a larger group of smaller public companies, such as by adopting the definition of "smaller public company" recommended by the Advisory Committee on Smaller Public Companies, and scale back the disclosure thresholds for all such smaller companies.<sup>357</sup> We are not following this recommendation at this time, but would instead defer consideration until we can fully

available to small business issuers under Regulation S-B into Regulation S-K and make them available to all microcap companies. Final Report of the Advisory Committee on Smaller Public Companies to the United States Securities and Exchange Commission (Apr. 23, 2006). Any future consideration of this recommendation would be the subject of a separate rulemaking.

<sup>354</sup> Prior to today's amendments, under both Item 402 of Regulation S-B and Item 402 of Regulation S-K, a small business issuer was not required to provide the Compensation Committee Report, the Performance Graph, the Compensation Committee Interlocks disclosure, the Ten-Year Option/SAR Repricings Table, and the Option Grant Table columns disclosing potential realizable value or grant date value. The rules prior to today's amendments also permitted small business issuers to exclude the Pension Plan Table.

<sup>355</sup> See, e.g., letters from CII; CRPTF; IUE-CWA; SBAF; and WSIB.

<sup>356</sup> See, e.g., letters from ISS and Institutional Investors Group.

<sup>357</sup> See letters from America's Community Bankers ("ACB"); Independent Community Bankers of America ("ICBA"); and SCSGP.

consider all recommendations of the Advisory Committee.

As proposed and adopted, small business issuers will be required to provide, along with related narrative disclosure:

- The Summary Compensation Table;<sup>358</sup>
- The Outstanding Equity Awards at Fiscal Year-End Table;<sup>359</sup> and
- The Director Compensation Table.<sup>360</sup>

Small business issuers will be required to provide information in the Summary Compensation Table only for the last two fiscal years. In addition, small business issuers will be required to provide information for fewer named executive officers, namely the principal executive officer and the two most highly compensated officers other than the principal executive officer.<sup>361</sup> In light of our decision to link the Summary Compensation Table pension plan disclosure to the disclosure in the Pension Benefits Table, which is not required for small business issuers, and in response to comment,<sup>362</sup> we have decided not to require that small business issuers include pension plan disclosure in the Summary Compensation Table. Narrative discussion of a number of items to the extent material replaces tabular or footnote disclosure, for example identification of other items in the All Other Compensation column and a description of post-employment payments and other benefits.<sup>363</sup> In light of our request in Release No. 33-8735 for further comment on the proposed additional narrative disclosure requirement regarding up to three highly compensated employees so that it might apply only to large accelerated filers, we have not adopted this proposal for Item 402 of Regulation S-B. Small business issuers are not required to provide a Compensation

<sup>358</sup> Items 402(b) and 402(c) of Regulation S-B. Consistent with the instructions to the narrative disclosure required by Item 402(e) of Regulation S-K, we have added an instruction to Item 402(c) of Regulation S-B so that disclosure is not required regarding any repricing that occurs through specified provisions. Instruction to Item 402(c) of Regulation S-B.

<sup>359</sup> Item 402(d) of Regulation S-B.

<sup>360</sup> Item 402(f) of Regulation S-B.

<sup>361</sup> Item 402(a) of Regulation S-B. Item 402(c)(7) of Regulation S-B requires an identification to the extent material of any item included under All Other Compensation in the Summary Compensation Table. However, identification of an item will not be considered material if it does not exceed the greater of \$25,000 or 10% of all items included in the specified category. All items of compensation are required to be included in the Summary Compensation Table without regard to whether such items are required to be identified.

<sup>362</sup> See letter from ABA.

<sup>363</sup> Items 402(c) and 402(e) of Regulation S-B.

<sup>348</sup> Instruction to Item 402(k)(2)(iii) and (iv). See letter from ABA.

<sup>349</sup> The only exception is if all perquisites received by the director total less than \$10,000, they do not need to be disclosed. Further, as described above for the Summary Compensation Table, disclosure of nonqualified deferred compensation earnings is limited to the above-market or preferential portion.

<sup>350</sup> Instruction 3 to Item 402(c).

<sup>351</sup> Instruction to Item 402(k)(2).

<sup>352</sup> Item 402(k)(3).

<sup>353</sup> These amendments apply only to small business issuers, as defined by Item 10(a)(1) of Regulation S-B. The Commission's Advisory Committee on Smaller Public Companies has recommended that the Commission incorporate the scaled disclosure accommodations currently

Discussion and Analysis or the related Compensation Committee Report.<sup>364</sup>

## 2. Foreign Private Issuers

Prior to today's amendments, a foreign private issuer was deemed to comply with Item 402 of Regulation S-K if it provided the information required by Items 6.B. and 6.E.2. of Form 20-F, with more detailed information provided if otherwise made publicly available. We proposed to continue this treatment of these issuers and clarify that the treatment of foreign private issuers under Item 402 parallels that under Form 20-F. Commenters supported this approach, stating that it showed appropriate deference to a foreign private issuer's home country requirements.<sup>365</sup> We are adopting these requirements as proposed.<sup>366</sup>

## 3. Business Development Companies

As proposed, we are applying the same executive compensation disclosure requirements to business development companies that we are adopting for operating companies.<sup>367</sup> We received no comments on this proposal. Our amendments eliminate the inconsistency between Form 10-K, on the one hand, which requires business development companies to furnish all of the information required by Item 402 of Regulation S-K, and the proxy rules and Form N-2, on the other, which require business development companies to provide some of the information from Item 402 and other information that applies to registered investment companies.

Under the amendments, the registration statements of business development companies will be required to include all of the disclosures required by Item 402 of Regulation S-K for all of the persons covered by Item 402.<sup>368</sup> This disclosure will also be

required in the proxy and information statements of business development companies if action is to be taken with respect to the election of directors or with respect to the compensation arrangements and other matters enumerated in Items 8(b) through (d) of Schedule 14A.<sup>369</sup> Business development companies will also be required to make these disclosures in their annual reports on Form 10-K.<sup>370</sup>

As a result of these amendments, the persons covered by the compensation disclosure requirements will be changed. The compensation disclosure in the proxy and information statements and registration statements of business development companies will be required to cover the same officers as for operating companies, including the principal executive officer and principal financial officer, as well as the three most highly compensated executive officers that have total compensation exceeding \$100,000,<sup>371</sup> instead of each of the three highest paid officers of the company that have aggregate compensation for the company for the most recently completed fiscal year in excess of \$60,000. In addition, the registration statements of business development companies will no longer be required to disclose compensation of members of the advisory board or certain affiliated persons of the company.

Finally, under the amendments, the proxy and information statements and registration statements of business development companies will not be required to include compensation from the "fund complex." Previously, this information was required in some circumstances.<sup>372</sup>

### E. Conforming Amendments

The Item 402 amendments necessitate conforming amendments to the Items of Regulations S-K and S-B and the proxy rules that cross reference amended paragraphs of Item 402. On this basis, we are amending:

- the Item 201(d) of Regulations S-K and S-B and proxy rule references to the Item 402 definition of "plan;"<sup>373</sup>
- the Item 601(b)(10) of Regulation S-K reference to the Item 402 treatment of foreign private issuers;<sup>374</sup> and
- the proxy rule references to Item 402 retirement plan disclosure.<sup>375</sup>

### III. Revisions to Form 8-K and the Periodic Report Exhibit Requirements

As part of our broader effort to revise our executive and director compensation disclosure requirements, we proposed revisions to Item 1.01 of Form 8-K. This item requires real-time disclosure about an Exchange Act reporting company's entry into a material definitive agreement outside of the ordinary course of the company's business, as well as any material amendment to such an agreement. Our staff's experience since Item 1.01 became effective in 2004 suggests that this item has elicited executive compensation disclosure regarding types of matters that do not appear always to be unquestionably or presumptively material, which is the standard we set for the expanded Form 8-K disclosure events.<sup>376</sup> We therefore proposed to revise Items 1.01 and 5.02 of Form 8-K to require real-time disclosure of employee compensation events that more clearly satisfy this standard. We are adopting the revisions substantially as proposed.

In addition to the amendments to Items 1.01 and 5.02 of Form 8-K, we proposed to revise General Instruction D of Form 8-K to permit companies in most cases to omit the Item 1.01 heading if multiple items including Item 1.01 are applicable, so long as all of the substantive disclosure required by Item 1.01 is included. We are adopting this provision as proposed.

#### A. Items 1.01 and 5.02 of Form 8-K

Item 1.01 of Form 8-K requires an Exchange Act reporting company to disclose, within four business days, the company's entry into a material definitive agreement outside of its ordinary course of business, or any

<sup>364</sup> We are also eliminating a provision of Item 402 of Regulation S-K that allows small business issuers using forms that call for Regulation S-K disclosure to exclude the disclosure required by certain paragraphs of that Item. This provision had been set forth in Item 402(a)(1)(i) of Regulation S-K prior to today's amendments.

<sup>365</sup> See, e.g., letters from Federation of German Industries; DaimlerChrysler AG; and jointly, Allianz AG, Deutsche Bank AG and Siemens AG.

<sup>366</sup> Item 402(a)(1).

<sup>367</sup> Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act [15 U.S.C. 80a-2(a)(48)].

<sup>368</sup> New Item 18.14 of Form N-2. Under the amendments, business development companies will no longer be required to respond to Item 18.13 of Form N-2, and Item 18.13(c) of Form N-2 is being deleted. Items 18.14 and 18.15 of Form N-2 are being redesignated as Items 18.15 and 18.16, respectively. As a result of the redesignation of Item 18.15 of Form N-2, a change to the cross reference to this Item in Instruction 8(a) of Item 24 of the form is also being made.

<sup>369</sup> Amendment to Item 8 of Schedule 14A. Under the amendments, business development companies will no longer be required to respond to Item 22(b)(13) of Schedule 14A, and Item 22(b)(13)(iii) of Schedule 14A is being deleted. Amendments to Item 22(b)(13) of Schedule 14A.

<sup>370</sup> Item 11 of Form 10-K.

<sup>371</sup> See Section II.C.6., above.

<sup>372</sup> See instructions 4 and 6 to Item 22(b)(13)(i) of Schedule 14A; and instructions 4 and 6 to Item 18.13(a) of Form N-2 (prior to today's amendments requiring certain entries in the compensation table in the proxy and information statements and registration statements of business development companies to include compensation from the fund complex).

<sup>373</sup> Amendments to: Instruction 2 to paragraph (d) of Item 201 of Regulation S-B; Instruction 2 to paragraph (d) of Item 201 of Regulation S-K; Exchange Act Rules 14a-6(a)(4) and 14c-5(a)(4); and Instruction 1 to Item 10 of Schedule 14A.

<sup>374</sup> Amendment to Item 601(b)(10)(iii)(C)(5).

<sup>375</sup> Amendments to Item 10(b)(1)(ii) and Instruction to Item 10(b)(1)(ii) of Schedule 14A.

<sup>376</sup> We stated in Section I of *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*. Release No 33-8400 (Mar. 16, 2004) [69 FR 15594] (the "Form 8-K Adopting Release"): "The revisions that we adopt today will benefit markets by increasing the number of unquestionably or presumptively material events that must be disclosed currently."

amendment of such agreement that is material to the company. When we initially proposed this item, several commenters stated that it would be difficult to determine, within the shortened Form 8-K filing period, whether a particular definitive agreement met the materiality threshold of Item 1.01, and whether the agreement was outside of the ordinary course of business.<sup>377</sup> Some of these commenters suggested that we apply to Item 1.01 the standards used in pre-existing Item 601(b)(10) of Regulation S-K, which governs the filing as exhibits to Commission reports of material contracts entered into outside the ordinary course, because these standards had been in place for many years and were familiar to reporting companies.<sup>378</sup>

In response to the concerns raised by these comments, we adopted Item 1.01 of Form 8-K so that it uses the standards of Item 601(b)(10) to determine the types of agreements that are material to a company and not in the ordinary course of business. Item 601(b)(10) of Regulation S-K requires a company to file, as an exhibit to Securities Act and Exchange Act filings, material contracts that are not made in the ordinary course of business and are to be performed in whole or part at or after the filing of the registration statement or report, or were entered into not more than two years before the filing. Item 601(b)(10)(iii) refers specifically to employment compensation arrangements and established a company's obligation to file the following as exhibits:

- any management contract or any compensatory plan, contract or arrangement, including but not limited to plans relating to options, warrants or rights, pension, retirement or deferred compensation or bonus, incentive or profit sharing (or if not set forth in any formal document, a written description thereof) in which any director or any named executive officer (as defined by Item 402(a)(3) of Regulation S-K) participates;

- any other management contract or any other compensatory plan, contract, or arrangement in which any other executive officer of the company participates, unless immaterial in amount or significance; and
- any compensation plan, contract or arrangement adopted without the approval of security holders pursuant to which equity may be awarded, including, but not limited to, options, warrants or rights in which any employee (whether or not an executive officer of the company) participates unless immaterial in amount or significance.<sup>379</sup>

Therefore, entry into these types of contracts triggered the filing of a Form 8-K within four business days. Importantly, the requirement for directors and named executive officers does not include an exception for those that are "immaterial in amount or significance." The incorporation of the Item 601(b)(10) standards into Item 1.01 of Form 8-K has therefore significantly affected executive compensation disclosure practices. Prior to the Form 8-K amendments in 2004, it was customary for a company's annual proxy statement to be the primary vehicle for disclosure of executive and director compensation information. However, Item 1.01 of Form 8-K as originally adopted has resulted in

<sup>379</sup> Item 601(b)(10)(iii) of Regulation S-K. We note the provision in Item 601(b)(10)(iii)(A) that carves out any plan, contract or arrangement in which named executive officers and directors do not participate that is "immaterial in amount or significance." In 1980, the Commission adopted amendments to Regulation S-K that consolidated all of the exhibit requirements of various disclosure forms into a single item in Regulation S-K. *Amendments Regarding Exhibit Requirements*, Release No. 33-6230 (Aug. 27, 1980) [45 FR 58822], at Section II.B. This item was a forerunner of the current Item 601. As part of that 1980 adopting release, the definition of material contract contained in the new item was also revised in an effort to reduce the number of remunerative plans or arrangements that must be filed. Not long after, though, the staff discovered that rather than reduce the number of exhibits filed, the provision actually had the opposite effect. The staff found that the revised definition of material contract "has resulted in registrants filing a large volume of varied remunerative contracts involving directors and executive officers, contracts which are not material and which would not have been filed under the previously existing 'material in amount or significance' standard." *Technical Amendment Regarding Exhibit Requirement*, Release No. 33-6287 (Feb. 6, 1981) [46 FR 11952], at Section I. Therefore, in February 1981, the Commission added "unless immaterial in amount or significance" to the definition of "material contracts" as applied to remunerative plans, contracts or arrangements participated in by executives who are not named executive officers. *Id.* We reiterate that this phrase was intended to indicate that whether plans, contracts or arrangements in which executive officers other than named executive officers participate are required to be disclosed under Item 601(b)(10) must be determined on the basis of materiality.

executive compensation disclosures that are much more frequent and accelerated than those included in a company's proxy statement. In addition, particularly because of the terms of Item 601(b)(10), Item 1.01 of Form 8-K triggered compensation disclosure of the types of matters that, in some cases, appear to have fallen short of the "unquestionably or presumptively material" standard associated with the expanded Form 8-K disclosure items. Companies and their counsel have raised concerns that the expanded Form 8-K requirements have resulted in real-time disclosure of compensation events that should be disclosed, if at all, in a company's proxy statement for its annual meeting or as an exhibit to the company's next periodic report, such as the Form 10-Q or Form 10-K.

As we stated in the Proposing Release, we believe that much of the disclosure regarding employment compensation matters required in real-time under the Form 8-K requirements is viewed by investors as material. However, we also believe it is appropriate to restore a more balanced approach to this aspect of Form 8-K, an approach which is designed to elicit unquestionably or presumptively material information on a real-time basis, but seeks to limit Form 8-K required disclosure of information below that threshold.

Accordingly, we are adopting amendments to Form 8-K that will uncouple Item 601(b)(10)(iii) of Regulation S-K from the current disclosure requirements of Form 8-K. As proposed, we are eliminating employment compensation arrangements from the scope of Item 1.01 altogether and expanding Item 5.02 of Form 8-K to cover only those compensatory arrangements with executive officers and directors that we believe are unquestionably or presumptively material. Commenters generally supported these proposed amendments.<sup>380</sup> We are adopting these amendments substantially as proposed.

#### 1. Item 1.01—Entry Into a Material Definitive Agreement

Specifically, we are deleting the last sentence of former Instruction 1 to Item 1.01 of Form 8-K, which references the portions of Item 601(b)(10) of Regulation S-K that specifically relate to management compensation and compensatory plans. In place of the deleted sentence, we are adding a sentence specifying that agreements

<sup>377</sup> See, e.g., letters on *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, Release No. 33-8106 (June 17, 2002) [67 FR 42914] in File No. S7-22-02 from the Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association, dated September 12, 2002; Cleary, Gottlieb, Steen & Hamilton, dated August 26, 2002; Intel Corporation, dated August 26, 2002; Professor Joseph A. Grundfest, et al. dated October 3, 2002; Perkins Coie LLP, dated August 26, 2002; Shearman & Sterling, dated August 30, 2002; and Sullivan & Cromwell, dated August 26, 2002.

<sup>378</sup> See, e.g., letter in File No. S7-22-02 from the Section of Business Law of the American Bar Association.

<sup>380</sup> See, e.g., letters from ABA; Chamber of Commerce; N. Ludgus; Committee on Securities Regulation of the Business Law Section of the New York State Bar Association; SCSGP; and Sullivan.

involving the subject matter identified in Item 601(b)(10)(iii)(A) and (B) of Regulation S-K need not be disclosed under amended Item 1.01 of Form 8-K. This change also will apply to the disclosure of terminations of material definitive agreements under Item 1.02 of Form 8-K, which references the definition of "material definitive agreement" in Item 1.01 of Form 8-K.<sup>381</sup> Instead of being required to be disclosed based on the general requirements with regard to material definitive agreements in Item 1.01 and Item 1.02 of Form 8-K, employment compensation arrangements will now be covered under Item 5.02 of Form 8-K, as amended.

## 2. Item 5.02—Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers

Item 5.02 generally requires disclosure within four business days of the appointment or departure of directors and specified officers. In particular, Item 5.02(b) has required disclosure if a company's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions, retires, resigns or is terminated from that position and Item 5.02(c) has required disclosure if a company appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions. Item 5.02 has also required disclosure if a director retires, resigns, is removed, or declines to stand for re-election.<sup>382</sup> Before adopting today's amendments, the required disclosure under Item 5.02 included a brief description of the material terms of any employment agreement between the company and the officer and a description of disagreements, if any.

As proposed, we are modifying Item 5.02 to capture generally the information already required under that item, as well as additional information regarding material employment compensation arrangements involving named executive officers that, prior to today's amendments, would be called for under Item 1.01.

With respect to the additional disclosure that we are requiring for named executive officers under

<sup>381</sup> Item 1.02(b) states: "For purposes of this Item 1.02, the term *material definitive agreement* shall have the same meaning as set forth in Item 1.01(b)."

<sup>382</sup> Items 5.02(a) and (b) of Form 8-K.

amended Item 5.02, one commenter noted that because the definition of "named executive officer" is determined with reference to a company's last completed fiscal year, greater clarity is needed to determine how the standard should be applied for current Form 8-K reporting throughout the year.<sup>383</sup> The commenter suggested that companies might find it difficult to identify their named executive officers for purposes of real-time disclosure under Item 5.02 during the period following the completion of their last fiscal year but prior to preparing their proxy statements or Forms 10-K in the new fiscal year. Accordingly, we are including a new Instruction to Item 5.02 that will clarify that for purposes of this Item the named executive officers are the persons for whom disclosure was required in the most recent filing with the Commission that required disclosure under Item 402(c) of Regulation S-K or Item 402(b) of Regulation S-B, as applicable.<sup>384</sup>

In general, our revisions to Form 8-K will both modify the overall requirements for disclosure of employment compensation arrangements on Form 8-K and locate all such disclosure under a single item. We are accomplishing this by taking the following steps:

- Expanding the information regarding retirement, resignation or termination to include all persons falling within the definition of named executive officers for the company's previous fiscal year, whether or not included in the list specified in Item 5.02 prior to these amendments;<sup>385</sup>
- Expanding the disclosure items covered under Item 5.02 beyond employment agreements to require a brief description of any material plan, contract or arrangement to which a covered officer or director is a party or in which he or she participates that is entered into or materially amended in connection with any of the triggering events specified in Item 5.02(c) and (d), or any grant or award to any such covered person, or modification thereto, under any such plan, contract or arrangement in connection with any such event;<sup>386</sup>

<sup>383</sup> See letter from ABA.

<sup>384</sup> Instruction 4 to Item 5.02.

<sup>385</sup> Item 5.02(b) of Form 8-K will continue to cover the officers currently specified therein, whether or not named executive officers for the previous or current years, and all directors.

<sup>386</sup> Items 5.02(c)(3) and (d)(5). Plans, contracts or arrangements (but not material amendments or grants or awards or modifications thereto) may be denoted by reference to the description in the company's most recent annual report on Form 10-K or proxy statement.

- With respect to the principal executive officer, the principal financial officer, or persons falling within the definition of named executive officer for the company's previous fiscal year, expanding the disclosure items to include a brief description of any material new compensatory plan, contract or arrangement, or new grant or award thereunder (whether or not written), and any material amendment to any compensatory plan, contract or arrangement (or any modification to a grant or award thereunder), whether or not such occurrence is in connection with a triggering event specified in Item 5.02. Grants or awards or modifications thereto will not be required to be disclosed if they are consistent with the terms of previously disclosed plans or arrangements and they are disclosed the next time the company is required to provide new disclosure under Item 402 of Regulation S-K;<sup>387</sup> and

- Adding a requirement for disclosure of salary or bonus for the most recent fiscal year that was not available at the latest practicable date in connection with disclosure under Item 402 of Regulation S-K.<sup>388</sup> This disclosure will also require a new total compensation recalculation to reflect the new salary or bonus information.

In the case of each of these disclosure items for amended Item 5.02, we emphasize that we are requiring that a brief description of the specified matter be included. We have observed that in response to the requirements to disclose the entry into material definitive agreements under Item 1.01, some companies have included disclosure that resembles an updating of the disclosure required under former Item 402 of Regulation S-K. In the context of current disclosure under Form 8-K, we are seeking disclosure that informs investors of specified material events and developments. However, the information we are seeking does not require the information necessary to comply with Item 402.

In response to comments received,<sup>389</sup> we have revised Instruction 2 to new Item 5.02(e) from the text we proposed and created a new Item 5.02(f), as described above. The revised Instruction 2 to Item 5.02(e) that we are adopting: (i) Changes or eliminates prior references to "original terms" and uses instead the phrase "previously disclosed terms," in order to minimize

<sup>387</sup> Item 5.02(e) and Instruction 2 to Item 5.02(e).

<sup>388</sup> Item 5.02(f). See Section II.C.1.b. above for a discussion of the reporting delay that exists under the current disclosure rules when bonus and salary are not determinable at the most recent practicable date.

<sup>389</sup> See letter from ABA.

ambiguity; and (ii) clarifies that, for purposes of the Instruction, no distinction should be made between awards granted under cash or equity-based plans. New Item 5.02(f) responds to comments we received that our proposed Instruction 3 to 5.02(e) should be codified as a separate item because it called for disclosure (determining salary or bonus amounts for a completed fiscal year) that otherwise may not be required under Item 5.02(e).<sup>390</sup>

*B. Extension of Limited Safe Harbor Under Section 10(b) and Rule 10b-5 to Item 5.02(e) of Form 8-K and Exclusion of Item 5.02(e) From Form S-3 Eligibility Requirements*

We are extending the safe harbors regarding Section 10(b) and Rule 10b-5 and Form S-3 eligibility in the event that a company fails to timely file reports required by Item 5.02(e) of Form 8-K.

In March 2004, we adopted a limited safe harbor from liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder for failure to timely file reports required by Form 8-K Items 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a) and 6.03. Because we believed that these items may require management to make rapid materiality and similar judgments within the condensed timeframe required for filing of a Form 8-K, we established a safe harbor that applies until the filing due date of the company's quarterly or annual report for the period in question. We concluded that the risk of liability under these provisions for the failure to timely file was disproportionate to the benefit of real-time disclosure and therefore justified the need for a limited safe harbor of a fixed duration. For the same reasons, we believe that the safe harbor should also extend to Item 5.02(e) of Form 8-K. We therefore are amending Exchange Act Rules 13a-11(c) and 15d-11(c) accordingly.

In addition, a company forfeits its eligibility to use Form S-3 if it fails to timely file all reports required under Exchange Act Section 13(a) or 15(d) during the 12 month period prior to filing of the registration statement.<sup>391</sup> For the same reasons, when adopting the expanded Form 8-K rules in 2004, we revised the Form S-3 eligibility requirements so that a company would not lose its eligibility to use Form S-3 registration statements if it failed to timely file reports required by the Form 8-K items to which the Section 10(b) and Rule 10b-5 safe harbor applies.<sup>392</sup>

In particular, the burden resulting from a company's sudden loss of eligibility to use Form S-3 could be a disproportionately large negative consequence of an untimely Form 8-K filing under one of the specified items.<sup>393</sup> We believe that this safe harbor should be extended to Item 5.02(e) of Form 8-K and, therefore, we are amending General Instruction I.A.3.(b) of Form S-3, which pertains to the eligibility requirements for use of Form S-3 to reflect this position.

*C. General Instruction D to Form 8-K*

We are adopting the revision to General Instruction D as proposed. Frequently, an event may trigger a Form 8-K filing under multiple items, particularly under both Item 1.01 and another item. General Instruction D to Form 8-K permits a company to file a single Form 8-K to satisfy one or more disclosure items, provided that the company identifies by item number and caption all applicable items being satisfied and provides all of the substantive disclosure required by each of the items. In order to promote prompt filings on Form 8-K and avoid potential non-compliance with Form 8-K due to inadvertent exclusions of captions, we are amending General Instruction D to permit companies to omit the Item 1.01 heading in a Form 8-K that also discloses any other item, so long as the substantive disclosure required by Item 1.01 is included in the Form 8-K. This would not extend to allowing a company to omit any other caption if the Item 1.01 caption is included.

*D. Foreign Private Issuers*

We are amending the exhibit instructions to Form 20-F so that foreign private issuers will be required to file an employment or compensatory plan with management or directors (or portion of such plan) only when the foreign private issuer either is required to publicly file the plan (or portion of it) in its home country or if the foreign private issuer has otherwise publicly disclosed the plan.<sup>394</sup>

Under Item 6.B.1 of Form 20-F, a foreign private issuer must disclose the compensation of directors and management on an aggregate basis and, additionally, on an individual basis, unless individual disclosure is not required in the issuer's home country and is not otherwise publicly disclosed by the foreign private issuer. Under the exhibit instructions to Form 20-F prior to our amendments, management

contracts or compensatory plans in which directors or members of management participate generally were required to be filed as exhibits, unless the foreign private issuer provided compensation information on an aggregate basis and not on an individual basis. Under those pre-amendment provisions, an issuer that provided any individualized compensation disclosure was required to file as an exhibit to Form 20-F management employment agreements that potentially relate to matters that have not otherwise been disclosed.

Our amendment of the exhibit instructions to Form 20-F<sup>395</sup> is intended to be consistent with the existing disclosure requirements under Form 20-F relating to executive compensation matters for foreign private issuers. In the same way that executive compensation disclosure under Form 20-F largely mirrors the disclosure that a foreign private issuer makes under home country requirements or voluntarily, so too the public filing of management employment agreements as an exhibit to Form 20-F under our amendments will mirror the public availability of such agreements under home country requirements or otherwise. In addition, we believe that the amendments may encourage foreign private issuers to provide more compensation disclosure in their filings with the Commission by eliminating privacy concerns associated with filing an individual's employment agreement when such agreement is not required to be made public by a home country exchange or securities regulator. As foreign disclosure related to executive remuneration varies in different countries but continues to improve,<sup>396</sup> the revisions recognize that trend and provide for greater harmonization of international disclosure standards with respect to executive compensation in a manner consistent with other requirements of Form 20-F.

**IV. Beneficial Ownership Disclosure**

Item 403 requires disclosure of company voting securities beneficially owned by more than five percent holders,<sup>397</sup> and company equity securities beneficially owned by

<sup>395</sup> New Instruction 4(c)(v) to Exhibits to Form 20-F.

<sup>396</sup> Many jurisdictions now require or encourage disclosure of executive compensation information. For example, enhanced disclosure of executive remuneration is included as part of the European Commission's 2003 Company Law Action Plan. See Guido Ferrarini and Niamh Moloney, *Executive Remuneration in the EU: The Context for Reform*, European Corporate Governance Institute, Law Working Paper N. 32/2005 (April 2005).

<sup>397</sup> Item 403(a).

<sup>390</sup> See letter from ABA.

<sup>391</sup> General Instruction I.A.3 to Form S-3.

<sup>392</sup> Form 8-K Adopting Release, at Section II.E.

<sup>393</sup> *Id.*

<sup>394</sup> We are also making a similar revision to Item 601(b)(10)(iii)(C)(5) of Regulation S-K.

directors, director nominees and named executive officers.<sup>398</sup> These disclosure requirements provide investors with information regarding concentrated holdings of voting securities and management's equity stake in the company, including securities for which these holders have the right to acquire beneficial ownership within 60 days.<sup>399</sup> Item 403 also requires disclosure of arrangements known to the company that may result in a change in control of the company.<sup>400</sup>

As proposed, we are amending Item 403(b)<sup>401</sup> by adding a requirement for footnote disclosure of the number of shares pledged as security by named executive officers, directors and director nominees.<sup>402</sup> To the extent that shares beneficially owned by named executive officers, directors and director nominees are used as collateral, these shares may be subject to material risk or contingencies that do not apply to other shares beneficially owned by these persons. These circumstances have the potential to influence management's performance and decisions.<sup>403</sup> As a result, we believe that the existence of these securities pledges could be material to shareholders. Because significant shareholders who are not members of management are in a different relationship with other shareholders and have different obligations to them, the amendments do not require disclosure of their pledges pursuant to Item 403(a), other than pledges that may result in a change of control currently required to be disclosed.<sup>404</sup> The amendments also specifically require disclosure of beneficial ownership of directors' qualifying shares, which was not required prior to these amendments, because we believe the beneficial ownership disclosure should include a

complete tally of the securities beneficially owned by directors.

One commenter recommended that we expand this section to also require disclosure of hedging arrangements whereby the executive has altered his or her economic interest in the securities that he or she beneficially owns.<sup>405</sup> These transactions frequently involve the purchase or sale of a derivative security that the named executive officer would be required to report within two business days under Section 16(a) of the Exchange Act.<sup>406</sup> Because information concerning these transactions frequently would be available on a prompt basis in the Section 16(a) filings and companies would disclose their policies regarding these transactions in Compensation Discussion and Analysis,<sup>407</sup> we have not followed the commenter's recommendation.

#### V. Certain Relationships and Related Transactions Disclosure

As we explained in the Proposing Release, we believe that, in addition to disclosure regarding executive compensation, a materially complete picture of financial relationships with a company involves disclosure regarding related party transactions. Therefore, we are also adopting significant revisions to Item 404 of Regulation S-K, previously titled "Certain Relationships and Related Transactions." In 1982, various provisions that had been adopted in a piecemeal fashion and had been subject to frequent amendment were consolidated into Item 404 of Regulation S-K.<sup>408</sup> Today we are amending Item 404 of Regulation S-K and S-B to streamline and modernize this disclosure requirement, while making it more principles-based. Although the amendments significantly modify this disclosure requirement, its purpose—to elicit disclosure regarding transactions and relationships, including indebtedness, involving the company and related persons and the independence of directors and nominees for director and the interests of management—remains unchanged.

As discussed in greater detail below, the amendments have four parts:<sup>409</sup>

- Item 404(a) contains a general disclosure requirement for related person transactions, including those involving indebtedness.

- Item 404(b) requires disclosure regarding the company's policies and procedures for the review, approval or ratification of related person transactions.

- Item 404(c) requires disclosure regarding promoters and certain control persons of a company.<sup>410</sup>

- Item 407 consolidates corporate governance disclosure requirements.<sup>411</sup> Also, Item 407(a) requires disclosure regarding the independence of directors, including whether each director and nominee for director of the company is independent, as well as a description by specific category or type of any transactions, relationships or arrangements not disclosed under paragraph (a) of Item 404 that were considered when determining whether each director and nominee for director is independent.

#### A. Transactions With Related Persons

We are adopting amendments to Item 404 to make the certain relationships and related transactions disclosure requirements clearer and easier to follow. The revisions retain the principles for disclosure of related person transactions that were previously specified in Item 404(a), but no longer include all of the instructions that served to delineate what transactions are reportable or excludable from disclosure based on bright lines that can depart from a more appropriate materiality analysis. Instead, Item 404(a) as amended consists of a general statement of the principle for disclosure, followed by specific disclosure requirements and instructions. The instructions to Item 404(a) explain the related persons covered by the Item, the scope of transactions covered by the Item, the method for computation of the amount involved in the transaction, special requirements regarding indebtedness, the interaction with Item 402, the materiality of certain interests, and the circumstances in which disclosure need not be provided.

to Items of Regulation S-K, unless otherwise indicated.

<sup>410</sup> Prior to adoption of these amendments, disclosure regarding promoters was required under Item 404(d).

<sup>411</sup> These matters previously were required to be disclosed pursuant to various provisions, including Item 7 of Schedule 14A and Items 306, 401(h), (i) and (j), 402(j) and 404(b). We are eliminating as proposed the requirement for disclosure regarding specific director and director nominee relationships that had been set forth in Item 404(b) prior to today's amendments, in favor of the disclosures regarding director independence required by Item 407(a).

<sup>398</sup> Item 403(b).

<sup>399</sup> As specified in Exchange Act Rule 13d-3(d)(1) [17 CFR 240.13d-3(d)(1)].

<sup>400</sup> Item 403(c).

<sup>401</sup> Item 403(b) of Regulation S-K and Item 403(b) of Regulation S-B are both amended in the same manner.

<sup>402</sup> This was similar to a proposal the Commission made in 2002. See *Form 8-K Disclosure of Certain Management Transactions*, Release No. 33-8090 (Apr. 12, 2002) [67 FR 19914].

<sup>403</sup> See, e.g., Marianne M. Jennings, *The Disconnect Between and Among Legal Ethics, Business Ethics, Law, and Virtue: Learning Not to Make Ethics So Complex*, 1 U. St. Thomas L.J. 995, 1010 (Spring 2004) (arguing that the extension of loans to the CEO of WorldCom, which were collateralized by WorldCom shares owned by the CEO, contributed to WorldCom's financial demise). Regarding commenters' views, contrast letters from Frederic W. Cook & Co.; PB-UCC; and SBAF with letters from FSR; NACCO Industries; Unitrin; and Compass Bancshares.

<sup>404</sup> Item 403(c) of Regulation S-K. See also Items 6 and 7(3) of Schedule 13D [17 CFR 240.13d-101].

<sup>405</sup> See letter from ABA.

<sup>406</sup> 15 U.S.C. 78p(a).

<sup>407</sup> See Item 402(b)(2)(xiii) of Regulation S-K, discussed in Section II.B.1., above.

<sup>408</sup> See the 1982 Release. For a discussion of these provisions, see also *Disclosure of Certain Relationships and Transactions Involving Management*, Release No. 33-6416 (July 9, 1982) [47 FR 31394], at Section II.

<sup>409</sup> The discussion that follows focuses on changes to Regulation S-K, with Section V.E.1. explaining the modifications to Regulation S-B. References throughout the following discussion are

Item 404(a) as adopted extends to disclosure of indebtedness, by consolidating the disclosure formerly required under Item 404(a) regarding transactions involving the company and related persons with the disclosure regarding indebtedness which had been separately required by Item 404(c) prior to these amendments. We have consolidated these two provisions substantially as proposed in order to eliminate confusion regarding the circumstances in which each item applied and to streamline duplicative portions of Item 404.

#### 1. Broad Principle for Disclosure

Item 404(a) as proposed and adopted articulates a broad principle for disclosure; it states that a company must provide disclosure regarding:

- Any transaction since the beginning of the company's last fiscal year, or any currently proposed transaction;
- In which the company was or is to be a participant;
- In which the amount involved exceeds \$120,000; and
- In which any related person had or will have a direct or indirect material interest.

As proposed, amended Item 404(a) no longer includes an instruction that is repetitive of the general materiality standard applicable to the Item.<sup>412</sup> By omitting this instruction, we do not intend to change the materiality standard applicable to Item 404(a). The materiality standard for disclosure embodied in Item 404(a) prior to these amendments is retained; a company must disclose based on whether the related person had or will have a direct or indirect material interest in the transaction. The materiality of any interest will continue to be determined on the basis of the significance of the information to investors in light of all the circumstances.<sup>413</sup> As was the case before adoption of amended Item 404(a), the relationship of the related persons to the transaction, and with each other, the importance of the interest to the person having the interest and the amount involved in the transaction are among the factors to be considered in

<sup>412</sup> Prior to today's amendments, Instruction 1 to Item 404(a) had stated that "[t]he materiality of any interest is to be determined on the basis of the significance of the information to investors in light of all the circumstances of the particular case. The importance of the interest to the person having the interest, the relationship of the parties to the transaction with each other and the amount involved in the transactions are among the factors to be considered in determining the significance of the information to investors."

<sup>413</sup> See *Basic v. Levinson* and *TSC Industries v. Northway*.

determining the materiality of the information to investors.

We are also eliminating as proposed an instruction to Item 404(a) which had indicated that the dollar threshold is not a bright line materiality standard.<sup>414</sup> It remains true, however, that when the amount involved in a transaction exceeds the prescribed threshold (\$120,000 under the amended rule we adopt today), a company should evaluate whether the related person has a direct or indirect material interest in the transaction to determine if disclosure is required. We eliminated the instruction because it was repetitive of the general materiality standard applicable to the Item. We believe that application of the materiality principles under the Item are more consistent with a principles-based approach and will lead to more appropriate disclosure outcomes than application of the instruction that was eliminated. By deleting this instruction, we do not intend to change the materiality standard applicable to item 404(a). As was the case with Item 404(a) prior to adoption of these amendments, there may be situations where, although the instructions to Item 404(a) do not expressly provide that disclosure is not required, the interest of a related person in a particular transaction is not a direct or indirect material interest. In that case, information regarding such interest and transaction is not required to be disclosed under Item 404(a).

In addition, as proposed the amendments:

- Call for disclosure if a company is a "participant" in a transaction, rather than if it is "a party" to the transaction, as "participant" more accurately connotes the company's involvement;
- Modify the \$60,000 threshold for disclosure to \$120,000 to adjust for inflation;
- Include a defined term for "transaction" to provide that it includes a series of similar transactions and to make clear its broad scope; and
- Include a defined term for "related persons."<sup>415</sup>

As was the case before these amendments, disclosure is required for three years in registration statements

<sup>414</sup> Prior to today's amendments, Instruction 9 to Item 404(a) had stated that "There may be situations where, although these instructions do not expressly authorize nondisclosure, the interest of a person specified in paragraphs (a)(1) through (4) in a particular transaction or series of transactions is not a direct or indirect material interest. In that case, information regarding such interest and transaction is not required to be disclosed in response to this paragraph."

<sup>415</sup> The "related persons" covered by the amended Item are discussed below in Section V.A.1.b.

filed pursuant to the Securities Act or the Exchange Act.<sup>416</sup>

One commenter questioned whether changing the test of company involvement from being a "party" to a transaction to being a "participant" in a transaction is intended to be a substantive change.<sup>417</sup> The purpose of this change is to more accurately connote the company's involvement in a transaction by clarifying that being a "participant" encompasses situations where the company benefits from a transaction but is not technically a contractual "party" to the transaction.<sup>418</sup>

Commenters expressed diverse views on the appropriate disclosure threshold. While some commenters supported increasing the threshold for disclosure from \$60,000 to \$120,000,<sup>419</sup> others recommended retaining the \$60,000 threshold,<sup>420</sup> using a minimal dollar threshold,<sup>421</sup> not including any *de minimis* dollar threshold,<sup>422</sup> or increasing the threshold even further through use of a sliding scale.<sup>423</sup> We believe that a fixed dollar amount for the disclosure threshold will provide the most certainty as to the size of transactions that must be tracked for disclosure purposes under Item 404,<sup>424</sup> and that increasing the dollar amount of the threshold based on inflation is appropriate given the amount of time that has elapsed since it was last set nearly twenty-five years ago.

Finally, the rule changes include as proposed a technical modification. Prior to today's amendments, Item 404(a) stated that disclosure was required

<sup>416</sup> However, if the disclosure is being incorporated by reference into a registration statement on Form S-4, the additional two years of disclosure will not be required, as specified in Instruction 1 to Item 404.

<sup>417</sup> See letter from Sullivan. See also letter from SCSGP.

<sup>418</sup> For example, disclosure would be required if a company benefits from a transaction with a related person that the company has arranged and in which it participates, notwithstanding the fact that it is not a party to a contract.

<sup>419</sup> See, e.g., letters from BRT and Sullivan.

<sup>420</sup> See, e.g., letters from Amalgamated and CalSTRS.

<sup>421</sup> See letter from Teamsters (recommending a \$250 disclosure threshold).

<sup>422</sup> See, e.g., letters from CII and ISS.

<sup>423</sup> See letter from SCSGP recommending a disclosure threshold for companies that are not small business issuers of the greater of \$120,000 or a percentage (which it believes could be as low as two percent) of consolidated gross revenues of the recipient for certain types of transactions.

<sup>424</sup> The disclosure threshold in amended Item 404(a) of Regulation S-B is the lesser of \$120,000 or one percent of the average of the small business issuer's total assets at year-end for the last three completed fiscal years because we believe that transactions that are below \$120,000 can be significant for small business issuers given their relative size.

regarding situations involving "the registrant or any of its subsidiaries." Because companies must include subsidiaries in making materiality determinations in all circumstances, the reference to "subsidiaries" is superfluous, and we have therefore eliminated it. This modification does not change the scope of disclosure required under the Item.<sup>425</sup>

#### a. Indebtedness

Section 402 of the Sarbanes-Oxley Act prohibits most personal loans by a company to its officers and directors.<sup>426</sup> This development raises the issue of whether disclosure of indebtedness of the sort required under our rules prior to the amendments should be maintained. We believe that the approach to disclosure of indebtedness involving related persons that we adopt today is appropriate because of the scope of the direct and indirect interests covered by our disclosure requirements, because related persons include persons not covered by the prohibitions, and because there are certain exceptions to the prohibitions. We have, however, eliminated the distinction between indebtedness and other types of related person transactions.

As a result of integrating what had been required to be disclosed under paragraph (c) of Item 404 into paragraph (a) of Item 404, the rule proposals would have changed the situations in which indebtedness disclosure is necessary by requiring disclosure of indebtedness transactions with regard to all related persons covered by the related person transaction disclosure requirement, including significant shareholders.<sup>427</sup> Some commenters questioned whether disclosure of indebtedness of significant shareholders would be useful to investors and whether companies would have access to the information necessary to provide this disclosure.<sup>428</sup> In response to these comments, the amendments do not require disclosure

of indebtedness transactions of significant shareholders (or their immediate family members).<sup>429</sup> Another result of integrating the disclosure requirements that had been specified in paragraph (c) of Item 404 into paragraph (a) of Item 404, is that the rule changes set a \$120,000 threshold and require disclosure if there is a direct or indirect material interest in an indebtedness transaction, while prior to these amendments Item 404(c) required disclosure of all indebtedness exceeding \$60,000.<sup>430</sup> For example, under amended Item 404(a) disclosure is required if an executive officer had a material indirect interest in an indebtedness transaction (exceeding \$120,000) between the company and another entity due to that executive officer's ownership interest in the other entity. Disclosure of material indirect interests of related persons in transactions involving the company will be required by Item 404(a) as amended, just as it was prior to adoption of these amendments. We believe that disclosure requirements for indebtedness and for other related person transactions should be congruent. In particular, we believe that loans by companies other than financial institutions should be treated like any other related person transactions; however, as discussed below,<sup>431</sup> we address certain ordinary course loans by financial institutions in an instruction to Item 404(a).

#### b. Definitions

We have defined the terms "transaction," "related person" and "amount involved" substantially as proposed in order to streamline Item 404(a) and to clarify the broad scope of financial transactions and relationships covered by the rule.

The term "transaction" has a broad scope in Item 404(a).<sup>432</sup> This term is not to be interpreted narrowly, but rather broadly includes, but is not limited to, any financial transaction, arrangement

or relationship or any series of similar transactions, arrangements or relationships. The definition of "transaction" also specifically notes that the term includes indebtedness and guarantees of indebtedness.

The definition of "related person" identifies the persons covered, and clarifies the time periods during which they are covered. The term "related person"<sup>433</sup> means any person who was in any of the following categories at any time during the specified period for which disclosure under paragraph (a) of Item 404 is required:

- Any director or executive officer of the company and his or her immediate family members; and
- If disclosure were provided in a proxy or information statement relating to the election of directors, any nominee for director and the immediate family members of any nominee for director.

In addition, a security holder known to the company to beneficially own more than five percent of any class of the company's voting securities or any immediate family member of any such person, when a transaction in which such security holder or family member had a direct or indirect material interest occurred or existed, is also a related person.

The definition of "related person" that we have adopted will require disclosure of related person transactions involving the company and a person (other than a significant shareholder or immediate family member of such shareholder) that occurred during the last fiscal year, if the person was a "related person" during any part of that year.<sup>434</sup> A person who had a position or relationship giving rise to the person being a "related person" during only part of the last fiscal year may have had a material interest in a transaction with the company during that year. While prior to these amendments Item 404(a) did not indicate whether disclosure was required for the transaction in this situation, the history of Item 404 suggests that disclosure was required if the requisite relationship existed at the time of the transaction, even if the person was no longer a related person at the end of the year.<sup>435</sup> We believe

<sup>425</sup> For the same reason, we have eliminated as proposed the references to "subsidiaries" in the "compensation committee interlocks and insider participation in compensation decisions" disclosure requirement adopted in Item 407(e)(4). This revision does not change the scope of disclosure required under the rule.

<sup>426</sup> Codified in Section 13(k) of the Exchange Act [15 U.S.C. 78m(k)].

<sup>427</sup> Prior to today's amendments, the related person transaction disclosure requirement in Item 404(a) covered significant shareholders, while the indebtedness disclosure requirement in Item 404(c) did not. The significant shareholders covered by Item 404(a) as adopted will continue to be any security holder who is known to the company to beneficially own more than five percent of any class of the company's voting securities. See Instruction 1.b.i. to Item 404(a).

<sup>428</sup> See, e.g., letter from Sullivan. See also, letter from SCSGP.

<sup>429</sup> See Instruction 4.b. to Item 404(a). Disclosure would be required, however, if the significant shareholder (or such shareholder's immediate family member) was also a related person specified in Instruction 1.a. to Item 404(a), for example, if the significant shareholder was also an executive officer.

<sup>430</sup> Prior to these amendments, Item 404(c) also had required disclosure of some specific indirect interests of directors, nominees for director, and executive officers of the company in indebtedness through corporations, organizations, trusts, and estates. Disclosure of these specific interests had been required by subparagraphs (c)(4) and (c)(5) of Item 404. Under the amendments, these subparagraphs have been eliminated as duplicative and the need for disclosure in these situations will be determined using a materiality analysis under the principle for disclosure in Item 404(a).

<sup>431</sup> See Section V.A.3. below.

<sup>432</sup> Instruction 2 to Item 404(a).

<sup>433</sup> Instruction 1 to Item 404(a).

<sup>434</sup> As proposed, the principle for disclosure that we have adopted only applies to nominees for director if disclosure is being provided in a proxy or information statement involving the election of directors. Also, as proposed, ongoing disclosure is not required regarding nominees for director who were not elected (unless a nominee has been nominated again for director).

<sup>435</sup> This position, which had been included in the proxy rule provisions that were the precursor to Item 404, was deleted from those provisions in 1967

that, because of the potential for abuse and the close proximity in time between the transaction and the person's status as a "related person," it is appropriate to require disclosure for transactions in which the person had a material interest occurring at any time during the fiscal year. For example, it is possible that a material interest of a person in a transaction during this timeframe could influence the person's performance of his or her duties.

We believe that transactions with persons who have been or who will become significant shareholders (or their immediate family members), but are not at the time of the transaction, raise different considerations and are harder to track, and thus we are excluding them as proposed. Disclosure will be required, however, regarding a transaction that begins before a significant shareholder becomes a significant shareholder, and continues (for example, through the on-going receipt of payments) on or after the time that the person becomes a significant shareholder.

We are adopting the definition of "immediate family member" as proposed. Under Item 404(a), the term "immediate family member" means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company. The amended definition differs from the former definition in that it includes stepchildren, stepparents, and any person (other than a tenant or employee) sharing the household of a director, nominee for director, executive officer, or significant shareholder of the company.<sup>436</sup>

The amended definition of "amount involved" is adopted as proposed.<sup>437</sup> The definition incorporates two concepts that were included in Item 404

prior to these amendments regarding how to determine the "amount involved" in transactions, and clarifies that the amounts reported must be in dollars even if the amount was set or expensed in a different currency. As adopted, the term "amount involved" means the dollar value of the transaction, or series of similar transactions, and includes:

- In the case of any lease or other transaction providing for periodic payments or installments, the aggregate amount of all periodic payments or installments due on or after the beginning of the company's last fiscal year, including any required or optional payments due during or at the conclusion of the lease or other transaction providing for periodic payments or installments;<sup>438</sup> and
- In the case of indebtedness, the largest aggregate amount of all indebtedness outstanding at any time since the beginning of the company's last fiscal year and all amounts of interest payable on it during the last fiscal year.<sup>439</sup>

## 2. Disclosure Requirements

Subparagraphs of Item 404(a) as adopted provide the disclosure requirements for related person transactions. The company will be required to describe the transaction, including:

- The person's name and relationship to the company;
- The person's interest in the transaction with the company, including the related person's position or relationship with, or ownership in, a firm, corporation, or other entity that is a party to or has an interest in the transaction; and
- The approximate dollar value of the amount involved in the transaction and of the related person's interest in the transaction.<sup>440</sup>

Companies will also be required to disclose any other information regarding the transaction or the related person in

the context of the transaction that is material to investors in light of the circumstances of the particular transaction.

As was the case prior to adoption of these amendments, the dollar value of the related person's interest in the transaction will be computed without regard to the amount of the profit or loss involved in the transaction.<sup>441</sup> One commenter pointed out that the proposals expanded the application of this provision to also cover the computation of the "amount involved" when the provision was moved from an instruction into the body of Item 404(a).<sup>442</sup> In streamlining Item 404(a), we did not intend to change the scope of the prior instruction. Therefore, the final rule clarifies the context in which profit or loss is not to be considered.

Consistent with the principles-based approach that we are applying to related person transaction disclosure, we are eliminating an instruction that, in the case of a related person transaction involving a purchase or sale of assets by or to the company otherwise than in the ordinary course of business, called for specific disclosure of the cost of the assets to the purchaser, and if acquired within two years of the transaction, the cost of the assets to the seller and related information about the price of the assets. We note, however, that if such information is material under the revised standards of Item 404(a), because, for example, the recent purchase price to the related person is materially less than the sale price to the company, or the sale price to the related person is materially more than the recent purchase price to the company, disclosure of such prior purchase price and related information about the prices could be required.

Prior to adoption of today's amendments, disclosure was required under Item 404(c) regarding amounts possibly owed to the company under Section 16(b) of the Exchange Act.<sup>443</sup> We believe that the purpose of related person transaction disclosure differs from the purpose of Section 16(b), and one commenter expressed support for eliminating this requirement.<sup>444</sup> Accordingly, the rule amendments eliminate this former Section 16(b)-related disclosure requirement.

## 3. Exceptions

Some categories of transactions do not fall within the principle for disclosure

as duplicative of a note that applied to all of the disclosure required in Schedule 14A (including the related party disclosure requirement in Schedule 14A). *Adoption of Amendments to Proxy Rules and Information Rules*, Release No. 34-8206 (Dec. 14, 1967) [32 FR 20960], at "Schedule 14A—Item 7(f)." Before today's amendments, Note C to Schedule 14A provided that "[i]nformation need not be included for any portion of the period during which such person did not hold any such position or relationship, provided a statement to that effect is made." We have amended Note C to Schedule 14A as proposed so that it will no longer apply to disclosure of related person transactions.

<sup>436</sup> The persons included in these additions to the definition are also included in the definition of "family member" in General Instruction A.1.(a)(5) to Securities Act Form S-8.

<sup>437</sup> Instruction 3 to Item 404(a).

<sup>438</sup> Prior to today's amendments, Instruction 3 to Item 404(a) had provided guidance regarding computing the amount involved in lease or other agreements providing for periodic payments or installments.

<sup>439</sup> Prior to today's amendments, the basis for determining the amount involved in indebtedness transactions had been set forth in Item 404(c).

<sup>440</sup> Because of the manner in which the amount involved in the transaction is calculated for indebtedness, as discussed above, disclosure with respect to indebtedness will include the largest aggregate amount of principal outstanding during the period for which disclosure is provided, as well as the amount of principal and interest paid during the period for which disclosure is provided, the aggregate amount of principal outstanding as of the latest practicable date, and the rate or amount of interest payable on the indebtedness. Item 404(a)(5).

<sup>441</sup> Item 404(a)(4).

<sup>442</sup> See letter from Sullivan.

<sup>443</sup> This requirement had been set forth in Instruction 4 to Item 404(c) prior to these amendments.

<sup>444</sup> See letter from SCSEP.

and therefore Item 404(a) as amended includes disclosure exceptions that we believe are consistent with our principles-based approach.<sup>445</sup> The first category of transactions involves compensation. Disclosure of compensation to an executive officer will not be required if:

- The compensation is reported pursuant to Item 402 of Regulation S-K; or
- The executive officer is not an immediate family member and such compensation would have been reported under Item 402 as compensation earned for services to the company if the executive officer was a named executive officer, and such compensation had been approved, or recommended to the board of directors of the company for approval, by the compensation committee of the board of directors (or group of independent directors performing a similar function) of the company.<sup>446</sup>

As proposed, this disclosure exception would have required compensation committee approval of an executive officer's compensation if that executive officer's compensation was not reported under Item 402. However, one commenter noted that in accordance with listing standards, compensation committees may only need to recommend to the board of directors, rather than approve, the compensation of executive officers (other than the chief executive officer).<sup>447</sup> We believe that it is appropriate for this disclosure exception to apply a standard that is consistent with the listing standards and we have thus modified this exception from the proposal accordingly. Finally, as proposed disclosure of compensation to a director will not be required if the compensation is reported pursuant to the director compensation disclosure requirement in Item 402(k).<sup>448</sup>

As we explained in the Proposing Release, since the disclosure either would be reported under Item 402, or would not be required under Item 402, we do not believe that these particular compensation transactions fall within our Item 404 disclosure principle, or they will have already been disclosed. Transactions involving compensation that do not fall within these exceptions, such as compensation of immediate family members, are within the scope of the principle for disclosure in amended

Item 404(a).<sup>449</sup> These exceptions thus clarify the limited situations in which disclosure of compensation to related persons is not required under Item 404.

The second category of transactions involves three types of situations that we believe do not raise the potential issues underlying our principle for disclosure. First, in the case of transactions involving indebtedness, as proposed we have adopted amendments so that the following items of indebtedness may be excluded from the calculation of the amount of indebtedness and need not be disclosed because they do not have the potential to impact the parties as do the transactions for which disclosure is required: Amounts due from the related person for purchases of goods and services subject to usual trade terms, for ordinary business travel and expense payments and for other transactions in the ordinary course of business.<sup>450</sup> Also, in the case of a transaction involving indebtedness, the amendments provide, as proposed, that if the lender is a bank, savings and loan association, or broker-dealer extending credit under Federal Reserve Regulation T<sup>451</sup> and the loans are not disclosed as nonaccrual, past due, restructured or potential problems,<sup>452</sup> disclosure under paragraph (a) of Item 404 may consist of a statement, if correct, that the loans to such persons satisfied the following conditions:

- They were made in the ordinary course of business;
- They were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the lender; and
- They did not involve more than the normal risk of collectibility or present other unfavorable features.<sup>453</sup>

This exception is based on the exception that was included in Instruction 3 to Item 404(c) prior to these amendments, and has been modified as proposed to be more consistent with the prohibition of the

<sup>449</sup> One commenter believed that the proposals would have eliminated disclosure of related person transactions involving the employment of immediate family members. See letter from CRPTF. Item 404(a), as amended, continues to require disclosure of these types of related person transactions when the threshold for disclosure has been met and the immediate family member has or will have a direct or indirect material interest.

<sup>450</sup> Instruction 4.a. to Item 404(a), which is based on Instruction 2 to Item 404(c) as it was stated prior to today's amendments.

<sup>451</sup> 12 CFR part 220.

<sup>452</sup> See Item III.C.1. and 2. of Industry Guide 3, Statistical Disclosure by Bank Holding Companies [17 CFR 229.802(c)].

<sup>453</sup> Instruction 4.c. to Item 404(a).

Sarbanes-Oxley Act on personal loans to officers and directors.<sup>454</sup>

Second, we are adopting as proposed an instruction indicating that a person who has a position or relationship with a firm, corporation, or other entity that engages in a transaction with the company shall not be deemed to have an indirect material interest within the meaning of paragraph (a) of Item 404 if:

- The interest arises only: (i) From the person's position as a director of another corporation or organization that is a party to the transaction; or (ii) from the direct or indirect ownership by such person and all other related persons, in the aggregate, of less than a ten percent equity interest in another person (other than a partnership) which is a party to the transaction; or (iii) from both such position and ownership; or
- The interest arises only from the person's position as a limited partner in a partnership in which the person and all other related persons, have an interest of less than ten percent, and the person is not a general partner of and does not have another position in the partnership.<sup>455</sup>

Finally, disclosure will not be required under paragraph (a) of Item 404 in three other types of circumstances. First, disclosure will not be required under paragraph (a) of Item 404 as to any transaction where the rates or charges involved in the transaction are determined by competitive bids, or the transaction involves the rendering of services as a common or contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority.<sup>456</sup> We had proposed to eliminate this exception because we considered such bright-line presumptions as inconsistent with our principles-based approach to the rule. We are persuaded, however, by a commenter who indicated that the prior

<sup>454</sup> Specifically, the language that was in Instruction 3 to paragraph (c) of Item 404 prior to these amendments has been modified to replace the reference "comparable transactions with other persons" with the phrase "comparable loans with persons not related to the lender."

<sup>455</sup> Instruction 6 to Item 404(a). This amendment is based on the language that was in parts A and B of Instruction 8 to Item 404(a) prior to these amendments. This amendment omits the portion of that instruction (Instruction 8.C.) regarding interests arising solely from holding an equity or a creditor interest in a person other than the company that is a party to the transaction, when the transaction is not material to the other person. This exception may have resulted in inappropriate non-disclosure of transactions without regard to whether they were material to the company. In addition, we are eliminating the language that had been set forth in Instruction 6 to Item 404(a) prior to these amendments, which had covered a subset of transactions now covered by Instruction 6, as amended, and therefore was duplicative.

<sup>456</sup> Instruction 7.a. to Item 404(a).

<sup>445</sup> Instructions 4, 5, 6 and 7 to Item 404(a).

<sup>446</sup> Instruction 5.a. to Item 404(a).

<sup>447</sup> See letter from NYCBA.

<sup>448</sup> Instruction 5.b. to Item 404(a).

exception embodied a conclusion that the terms of these types of transactions would likely not be influenced by the related persons and therefore should be excluded as not material.<sup>457</sup> As a result, the instruction is retained in the rule as adopted.

Second, disclosure need not be provided under paragraph (a) of Item 404 if the transaction involves services as a bank depository of funds, transfer agent, registrar, trustee under a trust indenture, or similar services.<sup>458</sup> We had proposed to eliminate this exception. We are persuaded by commenters' concerns that eliminating this exception may be detrimental to financial institutions and may not result in additional meaningful disclosure.<sup>459</sup> Accordingly, we are retaining this exception.

Third, we are adopting an exception indicating that disclosure need not be provided pursuant to paragraph (a) of Item 404 if the interest of the related person arises solely from the ownership of a class of equity securities of the company and all holders of that class of equity securities of the company received the same benefit on a *pro rata* basis.<sup>460</sup> Commenters expressed concern that our proposal to eliminate the former exception<sup>461</sup> would require disclosure if a related person receives over \$120,000 in dividends on company stock in a year, even though those dividends are paid on the same terms as for all other stockholders.<sup>462</sup> We are persuaded by the commenters that related person transaction disclosure is not necessary for transactions where a related person receives *pro rata* dividends or returns on the ownership of equity securities, and therefore we have adopted an instruction to provide an exception from disclosure in these limited circumstances.<sup>463</sup>

Some commenters requested that we create a new exception for transactions

undertaken in the ordinary course of business of the company and conducted on the same terms that the company offers generally in transactions with persons who are not related persons.<sup>464</sup> Former Item 404(a) did not include such an "ordinary course of business" disclosure exception, and we are not persuaded that it should be expanded to include one. In this regard, we note that transactions which should properly be disclosed under Item 404(a) might be excluded under an ordinary course of business exception, such as employment of immediate family members of officers and directors. However, we note that whether a transaction which was not material to the company or the other entity involved and which was undertaken in the ordinary course of business of the company and on the same terms that the company offers generally in transactions with persons who are not related persons, are factors that could be taken into consideration when performing the materiality analysis for determining whether disclosure is required under the principle for disclosure.

#### B. Procedures for Approval of Related Person Transactions

We are adopting a new requirement for disclosure of the policies and procedures established by the company and its board of directors regarding related person transactions substantially as proposed. State corporate law and increasingly robust corporate governance practices support or provide for such procedures in connection with transactions involving conflicts of interest.<sup>465</sup> We believe that this type of information may be material to investors, and our amendments therefore require disclosure of policies and procedures regarding related person transactions under paragraph (b) of Item 404, as amended.

Specifically, the amendments require a description of the company's policies and procedures for the review, approval or ratification of transactions with related persons that are reportable under paragraph (a) of Item 404. The description must include the material features of these policies and procedures that are necessary to understand them. While the material features of such policies and procedures will vary depending on the particular circumstances, examples of such features may include, in given cases, among other things:

- The types of transactions that are covered by such policies and procedures, and the standards to be applied pursuant to such policies and procedures;
- The persons or groups of persons on the board of directors or otherwise who are responsible for applying such policies and procedures; and
- Whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced.

Item 404(b) requires identification of any transactions required to be reported under paragraph (a) of Item 404 where the company's policies and procedures do not require review, approval or ratification or where such policies and procedures have not been followed.

One commenter expressed concern that it is not reasonable or customary for a company's related person transaction policy to extend to transactions occurring before an individual becomes affiliated with a company.<sup>466</sup> In response, we have added an instruction indicating that disclosure need not be provided pursuant to paragraph (b) of Item 404 regarding any transaction that occurred at a time before the related person had the relationship that would trigger disclosure under Item 404(a), if the transaction did not continue after the related person had that relationship.<sup>467</sup>

#### C. Promoters and Control Persons

As proposed and adopted, the amendments require a company to provide disclosure regarding the identity of promoters and its transactions with those promoters if the company had a promoter at any time during the last five fiscal years.<sup>468</sup> The disclosure will be required in Securities Act registration statements on Form S-1 or on Form SB-2 and Exchange Act Form 10 or Form 10-SB. The disclosure includes:

- The names of the promoters;
- The nature and amount of anything of value received by each promoter from the company and the nature and amount

<sup>457</sup> Letter from SCSGP.

<sup>458</sup> Instruction 7.b. to Item 404(a).

<sup>459</sup> See, e.g., letters from American Bankers Association ("American Bankers"); Compass Bancshares; and Whitney Holding Corporation ("Whitney Holding").

<sup>460</sup> Instruction 7.c. to Item 404(a).

<sup>461</sup> Before the adoption of these amendments, Instruction 7.C. to Item 404(a) provided that no information was required under Item 404(a) for transactions where the interest of the related person arose solely from the ownership of securities of the company and such person received no extra or special benefit not shared on a *pro rata* basis.

<sup>462</sup> See, e.g., letters from SCSGP and Sullivan.

<sup>463</sup> The instruction as adopted differs from the language of Instruction 7.C. prior to these amendments in that it is limited to ownership of a class of equity securities rather than securities generally and focuses on benefits being provided *pro rata* to the holders of that class rather than the absence of certain extra or special benefits.

<sup>464</sup> See, e.g., letters from SCSGP and Sullivan.

<sup>465</sup> Del. Code Ann. tit. 8, § 144 (2004). See also NYSE, Inc. Listed Company Manual Section 307.00 and NASD Manual, Marketplace Rules 4350(h) and 4360(i).

<sup>466</sup> See letter from NYCBA.

<sup>467</sup> See Instruction to Item 404(b). For example, disclosure would not be required under Item 404(b) in a company's Form 10-K for the fiscal year ended December 31, 2005 of a transaction that occurred in March 2005 between the company and an immediate family member of a person who later became a director of the company in August 2005. However, disclosure would be required under Item 404(a) in this circumstance. This Instruction to Item 404(b) does not apply to transactions of significant shareholders of the company, because Item 404(a) does not require disclosure of transactions with significant shareholders that are completed before they become significant shareholders.

<sup>468</sup> Item 404(c).

of any consideration received by the company; and

- Additional information regarding any assets acquired by the company from a promoter.

The amendments are consistent with the previous disclosure requirements regarding promoters. However, prior to these amendments this disclosure was not required if the company had been organized more than five years ago, even if the company otherwise had a promoter within the last five years. Our staff's experience in reviewing registration statements, especially of smaller companies, suggests that the more appropriate five-year test for which the disclosure should be provided relates to the period of time during which the company had a promoter, as our revision provides, rather than the date of organization of the company.<sup>469</sup> We are also requiring the same disclosure that is required for promoters for any person who acquired control, or is part of a group that acquired control, of an issuer that is a shell company.<sup>470</sup> We are revising the title of this item to include the term control persons in order to clarify the scope of the disclosure requirement.

#### D. Corporate Governance Disclosure

We are consolidating our disclosure requirements regarding director independence and related corporate governance disclosure requirements under a single disclosure item and updating such disclosure requirements regarding director independence to reflect our current requirements and current listing standards.<sup>471</sup> Prior to

these amendments, Item 404(b) had required disclosure of specific business relationships between a director or nominee for director and the company that could bear on the ability of directors and nominees for director to exercise independent judgment in the performance of their duties. We proposed to eliminate the disclosure requirement that was stated under paragraph (b) of Item 404 in favor of more direct disclosure about the determination of the independence of directors and nominees for director, including information supplementing the amended related person transaction disclosure that would permit qualitative assessment of those independence determinations. While one commenter suggested that we retain a revised version of paragraph (b) to Item 404 as it was stated prior to these amendments,<sup>472</sup> we continue to believe that disclosure focused on the determinations made regarding director independence is the appropriate approach. The comprehensive director independence disclosure requirement that we are adopting today recognizes the significant development of independence requirements since the disclosure requirements in former paragraph (b) of Item 404 were originally adopted. As directed by the Sarbanes-Oxley Act of 2002, we adopted a rule requiring national securities exchanges and national securities associations to adopt listing standards requiring independent audit committees meeting the standards of our rule.<sup>473</sup> Further, in 2003 and 2004, we approved amendments to additional listing standards, including those of the New York Stock Exchange and Nasdaq,<sup>474</sup>

Oversight Board rules. See PCAOB Rulemaking: *Public Company Accounting Oversight Board; Order Approving Proposed Technical Amendments to Interim Standards Rules*, Release No. 34-49624 (Apr. 28, 2004) [69 FR 24199]; and *Order Regarding Section 101(d) of the Sarbanes-Oxley Act of 2002*, Release No. 33-8223 (Apr. 25, 2003) [68 FR 2336].

<sup>472</sup> Letter from Fenwick.

<sup>473</sup> See Section 10A(m) of the Exchange Act [15 U.S.C. 78j-1(m)]; Exchange Act Rule 10A-3 [17 CFR 240.10A-3]; and *Standards Relating to Listed Company Audit Committees*, Release No. 33-8220 (Apr. 9, 2003) (the "Audit Committee Release") [68 FR 18788].

<sup>474</sup> NASD and NYSE Listing Standards Release. The other exchanges have also adopted corporate governance listing standards. See *Order Granting Approval of Proposed Rule Change by the American Stock Exchange LLC and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 2 Relating to Enhanced Corporate Governance Requirements Applicable to Listed Companies*, Release No. 34-48863 (Dec. 1, 2003) [68 FR 68432]; *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Philadelphia Stock Exchange, Inc. Relating to Corporate Governance*, Release No. 34-49881 (June 17, 2004) [69 FR 35408]; *Order Approving Proposed*

that imposed specific additional independence standards for boards of directors, and the compensation and nominating committees or persons performing similar functions. Each listed company (unless exempt) determines whether its directors and committee members are independent based on definitions that it adopts which, at a minimum, are required to comply with the listing standards applicable to the company.

The amendments we are adopting today, substantially as proposed, include a disclosure requirement to identify the independent directors of the company (and, in the case of disclosure in proxy or information statements relating to the election of directors, nominees for director) under the definition for determining board independence applicable to it.<sup>475</sup> The amendments also require disclosure of any members of the compensation, nominating and audit committees that the company has not identified as independent under the definition of

*Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change by the Chicago Stock Exchange, Inc. Relating to Governance of Issuers on the Exchange*, Release No. 34-49911 (June 24, 2004) [69 FR 39989]; *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Boston Stock Exchange, Inc. to Amend Chapter XXVII, Section 10 of the Rules of the Board of Governors by Adding Requirements Concerning Corporate Governance Standards of Exchange-Listed Companies*, Release No. 34-49955 (July 1, 2004) [69 FR 41555]; *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Chicago Board Options Exchange, Incorporated, Relating to Enhanced Corporate Governance Requirements for Listed Companies*, Release No. 34-49995 (July 9, 2004) [69 FR 42476]; *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by National Stock Exchange Relating to Corporate Governance*, Release No. 34-49998 (July 9, 2004) [69 FR 42788]; and *Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. to Amend the Corporate Governance Requirements for PCX Listed Companies*, Release No. 34-50677 (Nov. 16, 2004) [69 FR 68205].

The Commission has previously received a rulemaking petition submitted by the AFL/CIO, which requested the Commission to amend Items 401 and 404 of Regulation S-K to require disclosure about transactions with non-profit organizations (letter dated Dec. 12, 2001 from Richard Trumka, Secretary-Treasurer, AFL/CIO, File No. 4-499, available at [www.sec.gov/rules/petitions/petn4-499.pdf](http://www.sec.gov/rules/petitions/petn4-499.pdf)) and a rulemaking petition submitted by the Council of Institutional Investors, which requested amendments to Item 401 of Regulation S-K to require disclosure of certain transactions between directors, executive officers and nominees (letter dated Oct. 1, 1997, as amended Oct. 19, 1998, from Sarah A.B. Teslik, Executive Director, Council of Institutional Investors, File No. 4-404). We believe these requests have in large part been addressed by revised listing standards instituted by the exchanges, so that we are not now taking additional action under these petitions.

<sup>475</sup> Item 407(a).

<sup>469</sup> We also adopt as proposed similar revisions to the disclosure requirement referencing promoters in Item 401(g)(1) of Regulation S-K. In addition, as proposed our revisions add Form SB-2 to the list of registration statement forms in Item 404 for which promoter disclosure is required. While this revision updates the registration statement forms listed in Item 404, it does not change the promoter disclosure requirement of Form SB-2.

<sup>470</sup> Item 404(c)(2). The term "group" has the same meaning as in Exchange Act Rule 13d-5(b)(1) [17 CFR 240.13d-5(b)(1)], that is, any two or more persons that agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer. The term "shell company" is defined in Securities Act Rule 405 and Exchange Act Rule 12b-2.

<sup>471</sup> Item 407 of Regulations S-K and S-B. As adopted, Item 407 consolidates corporate governance disclosure requirements located in several places under our rules and the principal markets' listing standards, including in particular requirements that had been specified in Items 306, 401(h), (i) and (j), 402(f) and 404(b) of Regulation S-K and Item 7 of Schedule 14A under the Exchange Act prior to these amendments. We are not making any changes to the substance of the requirements under Item 306, Item 401(h), (i) or (j), or Item 402(j) as part of this consolidation. However, as proposed, Item 407 reorders some provisions that were specified in Item 306 and reflects the relevant Public Company Accounting

independence for that board committee applicable to it.<sup>476</sup>

More specifically, if the company is an issuer<sup>477</sup> with securities listed, or for which it has applied for listing, on a national securities exchange<sup>478</sup> or in an automated inter-dealer quotation system of a national securities association<sup>479</sup> which has requirements that a majority of the board of directors be independent, Item 407(a) requires disclosure of those directors and director nominees that the company identifies as independent (and committee members not identified as independent), using the definition for independence for directors (and for committee members) that it uses for determining compliance with the applicable listing standards. If the company is not a listed issuer, we are requiring disclosure of those directors and director nominees that the company identifies as independent (and committee members not identified as independent) using the definition for independence for directors (and for committee members) of a national securities exchange or a national securities association, specified by the company. The company will be required to apply the same definition consistently to all directors and also to use the independence standards of the same national securities exchange or national securities association for purposes of determining the independence of members of the compensation, nominating and audit committees.<sup>480</sup>

<sup>476</sup> *Id.* If the company does not have a separately designated compensation, nominating or audit committee or committee performing similar functions, it must provide this disclosure regarding independence under committee independence standards with respect to all members of the board of directors.

<sup>477</sup> Under the amendments, "listed issuer" has the same meaning as in Exchange Act Rule 10A-3.

<sup>478</sup> Under the amendments, "national securities exchange" means a national securities exchange registered pursuant to Section 6(a) of Exchange Act [15 U.S.C. 78f(a)].

<sup>479</sup> Under the amendments, "inter-dealer quotation system" means an automated inter-dealer quotation system of a national securities association registered pursuant to Section 15A(a) of the Exchange Act [15 U.S.C. 78o-3(a)], and a "national securities association" means a national securities association registered pursuant to Section 15A(a) of the Exchange Act [15 U.S.C. 78o-3(a)] that has been approved by the Commission (as that definition may be modified or supplemented). Inter-dealer quotation systems such as the OTC Bulletin Board, the Pink Sheets and the Yellow Sheets, which do not maintain or impose listing standards and do not have listing agreements or arrangements with the issuers whose securities are quoted through them, are not within this definition. See Section II.F.1. in the Audit Committee Release.

<sup>480</sup> Similar disclosure had been required pursuant to Item 7(d)(2)(ii) and Item 7(d)(3)(iv) of Schedule 14A prior to these amendments. As part of our consolidation of these provisions into new Item

One commenter pointed out the rule proposals did not make clear what disclosure would be required for listed issuers that relied upon an exemption from independence requirements, most notably a "controlled company" exemption.<sup>481</sup> To clarify the disclosure required in this situation, we added a requirement to the amendments that if the company is a listed issuer whose securities are listed on a national securities exchange or in an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, and also has exemptions to those requirements (for board or committee member independence) upon which the company relied, the company must disclose the exemption relied upon and explain the basis for its conclusion that such exemption is applicable.<sup>482</sup> Similar disclosure is required for those companies that are not listed issuers but would qualify for an exemption under the listing standards selected. In addition, this instruction clarifies that small business issuers listed on exchanges where at least half of the members of the board of directors, rather than a majority, are required to be independent must comply with the disclosure requirements specified in Item 407(a).<sup>483</sup>

The amendments require as proposed that an issuer which has adopted definitions of independence for directors and committee members must disclose whether those definitions are posted on the company's Web site, and if they are not include the definitions as an appendix to the company's proxy or information statement at least once every three years or if the policies have been materially amended since the beginning of the company's last fiscal year.<sup>484</sup> Further, if the policies are not on the company's Web site, or included as an appendix to the company's proxy or information statement, the company must disclose in which of the prior fiscal years the policies were included in the company's proxy or information statement.

In addition, the amendments require, for each director or director nominee

407, we adopt revised language for these provisions that reflects the general approach discussed above with regard to disclosure of director independence for board and committee purposes.

<sup>481</sup> Letter from NYCBA.

<sup>482</sup> Instruction 1 to Item 407(a).

<sup>483</sup> See Section 121.B.(2)(c) of the American Stock Exchange Company Guide; paragraph (g) of Chapter XXVII, Listed Securities, Section 10, Corporate Governance, of the Rules of the Board of Governors of the Boston Stock Exchange; and Rule 19(a)(1) of Article XXVIII, Listed Securities, of the Chicago Stock Exchange Rules.

<sup>484</sup> Item 407(a)(2).

identified as independent, a description, by specific category or type, of any transactions, relationships or arrangements not disclosed pursuant to paragraph (a) of Item 404 that were considered by the board of directors of the company in determining that the applicable independence standards were met. Under our proposals, disclosure of the specific details of each such transaction, relationship or arrangement would have been required. Several commenters objected to providing this disclosure, given the potential for extensive detail about these types of transactions, relationships or arrangements, and some suggested instead providing disclosure by category or type of transaction.<sup>485</sup> In response to the commenters, we have revised the disclosure requirement to permit transactions, relationships or arrangements of each director or director nominee to be described by the specific category or type. Consistent with the rule proposals, the amended rule requires that the disclosure be made on a director by director basis, with separate disclosure of categories or types of transactions, relationships or arrangements for each director and director nominee. We have also adopted an instruction indicating that the description of the category or type must be sufficiently detailed so that the nature of the transactions, relationships or arrangements is readily apparent.<sup>486</sup>

As proposed, this independence disclosure is required for any person who served as a director of the company during any part of the year for which disclosure must be provided,<sup>487</sup> even if the person no longer serves as director at the time of filing the registration statement or report or, if the information is in a proxy statement, if the director's term of office as a director will not continue after the meeting. In this regard, we believe that the independence status of a director is material while the person is serving as director, and not just as a matter of reelection.<sup>488</sup>

<sup>485</sup> See, e.g., letters from Chamber of Commerce; FSR; and Sidley Austin.

<sup>486</sup> Instruction 3 to Item 407(a).

<sup>487</sup> Instruction 2 to Item 407(a) has been revised to clarify this requirement. As proposed, disclosure under these amendments will not be required for persons no longer serving as a director in registration statements under the Securities Act or the Exchange Act filed at a time when the company is not subject to the reporting requirements of Exchange Act Section 13(a) or 15(d). As proposed, disclosure will not be required of anyone who was a director only during the time period before the company made its initial public offering if he or she was no longer a director at the time of the offering.

<sup>488</sup> For this reason, we are not incorporating the concept previously found in Instruction 4 to Item 404(b) into Item 407(a) as adopted.

We also amend the disclosure requirements regarding the audit committee and nominating committee applicable prior to these amendments in order to eliminate duplicative committee member independence disclosure and to update the required audit committee charter disclosure requirements for consistency with the more recently adopted nominating committee charter disclosure requirements.<sup>489</sup> As a result, as proposed the audit committee charter will no longer be required to be delivered to security holders if it is posted on the company's Web site.<sup>490</sup> We also are moving the disclosure required by Section 407 of the Sarbanes-Oxley Act regarding audit committee financial experts to Item 407, although as proposed we are not making any substantive changes to that requirement.<sup>491</sup>

The amendments require new disclosures regarding the compensation committee that are similar to the disclosures required regarding audit and nominating committees of the board of directors.<sup>492</sup> The company must state whether the compensation committee has a charter, and if it does make the charter available through its Web site or proxy materials in one of the ways that the audit and nominating committee charters may be made available. As proposed, the company will be required to describe its processes and procedures for the consideration and determination of executive and director compensation including:

- The scope of authority of the compensation committee (or persons performing the equivalent functions);
- The extent to which the compensation committee (or persons performing the equivalent functions) may delegate any authority to other persons, specifying what authority may be so delegated and to whom;
- Any role of executive officers in determining or recommending the amount or form of executive and director compensation; and
- Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether such consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person,

<sup>489</sup> However, we are not revising the provision that the Audit Committee Report is furnished and not filed.

<sup>490</sup> Item 407(d)(1) and Instruction 2 to Item 407.

<sup>491</sup> Item 407(d)(5).

<sup>492</sup> These compensation committee disclosure requirements are included in Item 407(e).

describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

Several commenters viewed this item as redundant with the Compensation Discussion and Analysis required under Item 402, and suggested that they be combined.<sup>493</sup> While this item and the Compensation Discussion and Analysis both involve the determination of executive officer compensation, they have different focuses. Item 407(e) focuses on the company's corporate governance structure that is in place for considering and determining executive and director compensation—such as the scope of authority of the compensation committee and others in making these determinations, as well as the resources utilized by the committee. In contrast, the Compensation Discussion and Analysis focuses on material information about the compensation policies and objectives of the company and seeks to put the quantitative disclosure about named executive officer compensation into perspective. We believe it is appropriate to discuss each of these matters separately and, accordingly, we have not combined them.

As for the required disclosure regarding compensation consultants, some commenters objected to the proposed requirements,<sup>494</sup> while other commenters suggested expanding the requirement to include, among other things, a discussion of the work performed by the compensation consultant for the company or others.<sup>495</sup> In addition, some commenters suggested deleting the requirement in proposed Item 407(e) that companies identify any executive officer of the company that the compensation consultants contacted in carrying out their assignment.<sup>496</sup> We continue to believe that the involvement of compensation consultants and their interaction with the compensation committee is material information that should be required. However, we are persuaded that disclosure regarding any executive officers of the company that the compensation consultants contacted in carrying out their assignment is not

<sup>493</sup> See, e.g., letters from J. Brill 1; Hewitt; Mercer; Pearl Meyer & Partners; and SCSCP.

<sup>494</sup> See, e.g., letters from Buck Consultants; Chamber of Commerce; Hewitt; Pearl Meyer & Partners; Mercer; and Steven Hall & Partners.

<sup>495</sup> See, e.g., letters from Brian Foley & Co.; 3C-Compensation Consulting Consortium; BCIMC; CFA Centre 1; Governance for Owners; Michelle Leder; James McFadden; Institutional Investor Group; SBAF; and Theodore Schlissel.

<sup>496</sup> See, e.g., letters from Compensia; FedEx Corporation; Hewitt; and Mercer.

necessary. Therefore, we are adopting the compensation consultant disclosure requirement in Item 407(e) as proposed, except for the required disclosure regarding contacts with executive officers, which has not been adopted.<sup>497</sup>

Further, the amendments consolidate into this compensation committee disclosure requirement the disclosure requirements regarding compensation committee interlocks and insider participation in compensation decisions, as proposed.<sup>498</sup>

Finally, for registrants other than registered investment companies, the amendments eliminate an existing proxy disclosure requirement regarding directors who have resigned or declined to stand for re-election<sup>499</sup> which is no longer necessary since it has been superseded by a disclosure requirement in Form 8-K.<sup>500</sup> For registered investment companies, which do not file current reports on Form 8-K, the requirement has been moved to Item 22(b) of Schedule 14A.<sup>501</sup> Also as proposed, the amendments combine various proxy disclosure requirements regarding board meetings and committees into one location.<sup>502</sup> In addition, we are adopting as proposed two instructions to Item 407 to combine repetitive provisions, one relating to independence disclosure, and the other relating to board committee charters.<sup>503</sup>

#### E. Treatment of Specific Types of Issuers

##### 1. Small Business Issuers

We are adopting amendments to Item 404 of Regulation S-B substantially as proposed. Amended Item 404 of Regulation S-B is substantially similar to amended Item 404 of Regulation S-K, except for the following two matters:

- Paragraph (b) of Item 404 of Regulation S-K relating to policies and procedures for reviewing related person transactions is not included in Regulation S-B, and
- Regulation S-B provides for a disclosure threshold of the lesser of

<sup>497</sup> Under the rules as adopted, disclosure would also not be required under this Item if an employee of a consulting firm met with company management to work on matters not involving compensation. See letter from Hewitt.

<sup>498</sup> Prior to these amendments, disclosure regarding compensation committee interlocks and insider participation in compensation decisions was required by Item 402(j).

<sup>499</sup> Prior to these amendments, this disclosure was required by Item 7(g) of Schedule 14A.

<sup>500</sup> Item 5.02(a) of Form 8-K.

<sup>501</sup> Item 22(b)(17) of Schedule 14A.

<sup>502</sup> Item 407(b) includes disclosure requirements previously specified in paragraphs (d)(1), (f), and (h)(3) of Item 7 of Schedule 14A.

<sup>503</sup> Instructions 1 and 2 to Item 407. Instruction 2 also includes as proposed a requirement that the charter be provided if it is materially amended.

\$120,000 or one percent of the average of the small business issuer's total assets at year-end for the last three completed fiscal years,<sup>504</sup> to require disclosure for small business issuers that may have material related person transactions even though smaller than the absolute dollar amount of \$120,000.

Both amended items consist of disclosure requirements regarding related person transactions and promoters. These provisions of Item 404 of Regulation S-B are substantially identical to those of Item 404 of Regulation S-K, except for certain changes conforming amended Item 404 of Regulation S-B to former Item 404 of Regulation S-B. These changes consist of the following:

- Retaining in amended Item 404 of Regulation S-B an instruction in former Item 404 of Regulation S-B regarding underwriting discounts and commissions;<sup>505</sup> and
- Not including an instruction in amended Item 404 of Regulation S-B regarding the treatment of foreign private issuers that is included in amended Item 404 of Regulation S-K.<sup>506</sup>

The two year time period for disclosure embodied in Item 404 of Regulation S-B prior to these amendments was retained in the principle for disclosure in proposed Item 404(a) of Regulation S-B. Amended Item 404(a) of Regulation S-B continues to require two years of disclosure, but does so by including an instruction to Item 404(a) of Regulation S-B<sup>507</sup> requiring a second year of disclosure, rather than by including the two year time period in the principle for disclosure in Item 404(a) of Regulation S-B as was proposed. This change from the proposal clarifies that for purposes of applying the definition of "related person" to determine whether disclosure is required of a transaction that occurred prior to a person having the relationship that resulted in the person becoming a related person, a one year time period should be used rather than a two year time period.<sup>508</sup> This

<sup>504</sup> We are revising Item 404(a) of Regulation S-B from the proposal to clarify that the determination of a small business issuer's total assets for purposes of this Item shall be made as of the issuer's fiscal year-end for its last three completed fiscal years.

<sup>505</sup> Instruction 8 to Item 404(a) of Regulation S-B.

<sup>506</sup> This is consistent with the requirements of Regulation S-B prior to these amendments.

<sup>507</sup> Instruction 9 to Item 404(a) of Regulation S-B.

<sup>508</sup> For example, if an employee had a material interest in a transaction with the small business issuer which occurred in February 2005 and then became an executive officer in July 2005, disclosure would be required in the small business issuer's Form 10-KSB for the fiscal year ended December

change from the proposal also results in the structure of Item 404(a) of Regulation S-B more closely resembling the structure of Item 404(a) of Regulation S-K, particularly in situations where Item 404(a) of Regulation S-K applies to time periods longer than one year.

In addition, amended Item 404 of Regulation S-B retains a paragraph requiring disclosure of a list of all parents of the small business issuer showing the basis of control and as to each parent, the percentage of voting securities owned or other basis of control by the small business issuer's immediate parent, if any.<sup>509</sup>

One conforming change that we are not making to Regulation S-B, however, concerns the calculation of a related person's interest in a given transaction. Prior to today's amendments, Item 404(a) of Regulation S-B differed from Item 404(a) of Regulation S-K with respect to, among other things, the calculation of the dollar value of a person's interest in a related person transaction. Prior to these amendments, Instruction 4 to Item 404(a) of Regulation S-K had specifically provided that the amount of such interest was to be computed without regard to the amount of profit or loss involved in the transaction. In contrast, Item 404(a) of Regulation S-B contained no such instruction prior to these amendments. We are adopting amendments as proposed so that the method of calculation of a related person's interest in a transaction will be the same for both Regulation S-B and Regulation S-K. We believe that differences, if any, between the types of transactions that small business issuers may engage in with related persons as compared to transactions of larger issuers would not warrant a different approach for calculating a related person's interest in a transaction.

As proposed, new Item 407 of Regulation S-K is substantially identical to new Item 407 of Regulation S-B,<sup>510</sup> except that it would not require disclosure regarding compensation committee interlocks and insider participation in compensation decisions or the Compensation Committee Report, since Regulation S-B did not require

31, 2005. However, if the transaction had occurred in February 2004, disclosure would not be required in the small business issuer's 2005 Form 10-KSB.

<sup>509</sup> Item 404(b) of Regulation S-B.

<sup>510</sup> The requirements that were specified in paragraphs (e), (f), and (g) of Item 401 of Regulation S-B prior to these amendments are now specified in paragraphs (d)(5), (d)(4) and (c)(3), respectively, of Item 407 of Regulation S-B.

disclosure of this information prior to adoption of these amendments.

## 2. Foreign Private Issuers

Before today's amendments, a foreign private issuer would be deemed to comply with Item 404 of Regulation S-K if it provided the information required by Item 7.B. of Form 20-F. The amendments retain this approach, but require that if more detailed information is otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded, that same information must also be disclosed pursuant to Item 404.<sup>511</sup>

## 3. Registered Investment Companies

We are revising Items 7 and 22(b) of Schedule 14A, substantially as proposed, to reflect the reorganization that we have undertaken with respect to operating companies. Under the amendments, information that was required to be provided by registered investment companies under Item 7 prior to the amendments is instead required by Item 22(b).<sup>512</sup> The requirements of Item 7 that prior to the amendments applied to registered investment companies regarding the nominating and audit committees, board meetings, the nominating process, and shareholder communications generally will be included in Item 22(b) by cross-references to the appropriate paragraphs of new Item 407 of Regulation S-K.<sup>513</sup> The substance of these requirements has not been altered. In addition, the revisions to Item 22(b) directly incorporate disclosures relating to the independence of members of

<sup>511</sup> Instruction 2 to Item 404 of Regulation S-K.

<sup>512</sup> Amendments to Item 7(e) of Schedule 14A. Business development companies will furnish the information required by Item 7 of Schedule 14A, in addition to the information required by Items 8 and 22(b) of Schedule 14A. See amendments to Items 7, 8, and 22(b) of Schedule 14A.

<sup>513</sup> Amendments to Items 22(b)(15)(i) and (ii)(A) and 22(b)(16)(i) of Schedule 14A. Amended Item 22(b)(15)(i) requires the information required by new Items 407(b)(1) and (2) and (f), corresponding to the information that registered investment companies have been required to provide pursuant to Items 7(f) and 7(h) prior to today's amendments. Amended Item 22(b)(15)(ii)(A) requires the information required by new Items 407(c)(1) and (2), corresponding to the information that registered investment companies have been required to provide pursuant to Items 7(d)(2)(i) and 7(d)(2)(ii) (other than the nominating committee independence disclosures required prior to today's amendments by Item 7(d)(2)(ii)(C)). Amended Item 22(b)(16)(i) requires closed-end investment companies to provide the information required by new Items 407(d)(1) through (3), corresponding to the information that closed-end investment companies have been required to provide prior to today's amendments pursuant to Item 7(d)(3) (other than the audit committee independence disclosures required prior to today's amendments by Items 7(d)(3)(iv)(A)(i) and (B)).

nominating and audit committees that are similar to those contained in new Item 407(a) of Regulation S-K and contained in Item 7 prior to the amendments.<sup>514</sup> We are also adding instructions that are similar to new Instruction 1 to Item 407(a).<sup>515</sup>

As proposed, we are also raising from \$60,000 to \$120,000 the threshold for disclosure of certain interests, transactions, and relationships of each director or nominee for election as director who is not or would not be an "interested person" of an investment company within the meaning of Section 2(a)(19) of the Investment Company Act.<sup>516</sup> This disclosure is required in investment company proxy and information statements and registration statements. The increase in the disclosure threshold corresponds to the increase in the disclosure threshold for amended Item 404 from \$60,000 to \$120,000.

#### F. Conforming Amendments

The changes to Item 404 necessitate conforming amendments to other rules that refer specifically to Item 404.

##### 1. Regulation Blackout Trading Restriction

We are adopting, as proposed, conforming changes to Regulation Blackout Trading Restriction,<sup>517</sup> also known as Regulation BTR, which we originally adopted to clarify the scope and operation of Section 306(a)<sup>518</sup> of the Sarbanes-Oxley Act of 2002 and to prevent evasion of the statutory trading restriction.<sup>519</sup> Rule 100 of Regulation

BTR defines terms used in Section 306(a) and Regulation BTR, including the term "acquired in connection with service or employment as a director or executive officer."<sup>520</sup> Under this definition as originally adopted, one of the specified methods by which a director or executive officer directly or indirectly acquires equity securities in connection with such service is an acquisition "at a time when he or she was a director or executive officer, as a result of any transaction or business relationship described in paragraph (a) or (b) of Item 404 of Regulation S-K."<sup>521</sup> To conform this provision of Regulation BTR to the Item 404 amendments, we are amending Rule 100(a)(2) so that it references only transactions described in paragraph (a) of Item 404, as we proposed.

##### 2. Rule 16b-3 Non-Employee Director Definition

We also are adopting conforming amendments to the definition of Non-Employee Director in Exchange Act Rule 16b-3.<sup>522</sup> Section 16(b) provides an issuer (or shareholders suing on its behalf) the right to recover from an officer, director, or ten percent shareholder profits realized from a purchase and sale of issuer equity securities within a period of less than six months. However, Rule 16b-3 exempts transactions between issuers of securities and their officers and directors if specified conditions are met. In particular, acquisitions from and dispositions to the issuer are exempt if the transaction is approved in advance by the issuer's board of directors, or board committee composed solely of two or more Non-Employee Directors.<sup>523</sup>

Before adoption of these amendments, the definition of "Non-Employee Director," among other things, limited these directors to those who:

- Do not directly or indirectly receive compensation from the issuer, its parent or subsidiary for consulting or other

equity security, if the director or executive officer acquires the equity security in connection with his or her service or employment as a director or executive officer. This provision equalizes the treatment of corporate executives and rank-and-file employees with respect to their ability to engage in transactions involving issuer equity securities during a pension plan blackout period if the securities were acquired in connection with their service to, or employment with, the issuer.

<sup>520</sup> This term is defined in Rule 100(a) of Regulation BTR.

<sup>521</sup> Rule 100(a)(2) of Regulation BTR.

<sup>522</sup> Exchange Act Rule 16b-3(b)(3)(iii), which defines a Non-Employee Director of a closed-end investment company as "a director who is not an 'interested person' of the issuer, as that term is defined in Section 2(a)(19) of the Investment Company Act of 1940," is not amended.

<sup>523</sup> Exchange Act Rules 16b-3(d)(1) and 16b-3(e).

non-director services, except for an amount that does not exceed the Item 404(a) dollar disclosure threshold;

- Do not possess an interest in any other transaction for which Item 404(a) disclosure would be required; and
- Are not engaged in a business relationship required to be disclosed under Item 404(b).

As described above, the Item 404 amendments substantially revise or rescind the Item 404 provisions on which the Non-Employee Director definition was based. To minimize potential disruptions and because no problems were brought to our attention regarding any aspect of the definition as it was stated before adoption of these amendments, we proposed a conforming amendment that would delete the provision referring to business relationships subject to disclosure under Item 404(b) as it was stated prior to today's amendments, without otherwise revising the text of the rule.

In the interest of providing certainty regarding Non-Employee Director status and to recognize corporate governance changes since the definition was adopted, one commenter suggested basing the definition instead on whether a director meets the independence standards under the rules of the principal national securities exchange where the company's securities are traded.<sup>524</sup> If the company has no securities traded on an exchange, the commenter suggested relying on the director's eligibility to serve on the issuer's audit committee under Exchange Act Section 10A(m) and Exchange Act Rule 10A-3.<sup>525</sup> We are not following the suggested approach. As we stated in the Proposing Release, the standards for an exemption from Section 16(b) liability should be readily determinable by reference to the exemptive rule, and not variable depending upon where the issuer's securities are listed.<sup>526</sup> Further, basing the Non-Employee Director definition on eligibility to serve on the issuer's audit committee could burden the audit committee with a compensation committee function.

As proposed and adopted, the Non-Employee Director definition continues to permit consulting and similar arrangements subject to limits measured by reference to the revised Item 404(a) disclosure requirements. Because the disclosure threshold of Item 404(a) is raised from \$60,000 to \$120,000, however, the effect in some cases may be to permit previously ineligible

<sup>524</sup> See Letter from Sullivan.

<sup>525</sup> 15 U.S.C. 78j-1(m) and 17 CFR 240.10A-3.

<sup>526</sup> Proposing Release at n. 309.

<sup>514</sup> Amendments to Items 22(b)(15)(ii)(B) and (16)(ii) of Schedule 14A. Amended Item 22(b)(15)(ii)(B) requires disclosure about the independence of nominating committee members that is similar to those required by Item 7(d)(2)(ii)(C) prior to today's amendments and amended Item 22(b)(16)(ii) requires disclosure about the independence of audit committee members that is similar to those required by Items 7(d)(3)(iv)(A)(1) and (B) prior to today's amendments.

<sup>515</sup> Instruction to Item 22(b)(15)(ii)(B) of Schedule 14A; Instruction to Item 22(b)(16)(ii) of Schedule 14A.

<sup>516</sup> Amendments to Items 22(b)(7), 22(b)(8), and 22(b)(9) of Schedule 14A; amendments to Items 12(b)(6), 12(b)(7), and 12(b)(8) of Form N-1A; amendments to Items 18.9, 18.10, and 18.11 of Form N-2; amendments to Items 20(h), 20(i), and 20(j) of Form N-3.

<sup>517</sup> 17 CFR 245.100-104.

<sup>518</sup> 15 U.S.C. 7244(a), entitled "Prohibition of Insider Trading During Pension Fund Blackout Periods."

<sup>519</sup> *Insider Trades During Pension Fund Blackout Periods*, Release No. 34-47225 (Jan. 22, 2003) [68 FR 4337]. Section 306(a) makes it unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during any pension plan blackout period with respect to such

directors to be Non-Employee Directors. In other cases, where revised Item 404(a) may require disclosure of director indebtedness and disclosure of business relationships not subject to disclosure under former Item 404(b), some formerly eligible directors may become ineligible.

In response to concerns of commenters about the potential difficulty of making a determination,<sup>527</sup> we have revised the rule as it was proposed to include an additional note to Rule 16b-3.<sup>528</sup> The Non-Employee Director definition contemplates that the director must satisfy the definition's tests at the time he or she votes to approve a transaction. For purposes of determining a director's status under those tests that are based on Item 404(a), a company may rely on the disclosure provided under Item 404 of Regulation S-K for the issuer's most recent fiscal year contained in the most recent filing in which Item 404 disclosure is presented.<sup>529</sup> Where a transaction disclosed in that filing was terminated before the director's proposed service as a Non-Employee Director, that transaction will not bar such service. The issuer must believe in good faith that any current or contemplated transaction in which the director participates will not require Item 404(a) disclosure, based on information readily available to the issuer and the director at the time such director proposes to act as a Non-Employee Director. At such time as the issuer believes in good faith, based on readily available information, that a current (or contemplated) transaction with a director will require Item 404(a) disclosure in a future filing, the director no longer is eligible to serve as a Non-Employee Director. However, this determination does not result in retroactive loss of a Rule 16b-3 exemption for a transaction previously approved by the director while serving as a Non-Employee director consistent with the note. In making determinations under the note, an issuer may rely on information it obtains from the director, for example pursuant to a response to an inquiry.

### 3. Other Conforming Amendments

The changes to Item 404, along with the consolidation of provisions into Item 407, necessitate conforming amendments to various forms and schedules under the Securities Act and

the Exchange Act. The amendments modify:

- Forms that prior to these amendments required disclosure of the information required by Item 404 to instead require disclosure of the information required by amended Item 404 and new Item 407(a);<sup>530</sup>
- Some forms that prior to these amendments required disclosure of the information required by Item 404(a) or by Items 404(a) and (c), to instead require disclosure of the information required by Items 404(a) and (b) as amended, or amended Item 404(a), as appropriate;<sup>531</sup>
- A form that prior to these amendments cross-referenced an instruction in Item 404 which we are eliminating to instead include the text of this instruction;<sup>532</sup>
- Item 7 of Schedule 14A, to require disclosure of the information required by new Item 407(a) rather than the disclosure that was required prior to these amendments by Item 404(b), to eliminate paragraphs (d)-(h) of Item 7 that were duplicative of new Item 407 and replace them with a requirement to disclose information specified by corresponding paragraphs of new Item 407;
- Forms that prior to these amendments required disclosure of the information required by Item 402 to instead require disclosure of the information required by amended Item 402 and new Item 407(e)(4), and, in the case of proxy statements and annual reports on Form 10-K, new Item 407(e)(5);<sup>533</sup>
- Some forms that prior to these amendments required disclosure of the information required by Item 401 to instead require disclosure of the information required by Item 401 as amended and paragraphs (c)(3), (d)(4)

<sup>529</sup> See amendments to Item 15 of Form SB-2, Item 11(n) of Form S-1, Item 18(a)(7)(iii) and Item 19(a)(7)(iii) of Form S-4, Item 23 of Form S-11, Item 7 of Form 10, Item 13 of Form 10-K, Item 7 of Form 10-SB and Item 12 of Form 10-KSB. The amendments to Forms SB-2, 10-SB and 10-KSB require disclosure of the information required by amended Item 404 and new Item 407(a) of Regulation S-B.

<sup>530</sup> See amendment to Item 7(b) of Schedule 14A, which refers to amended Items 404(a) and (b), and Item 22(b)(11) and the Instruction to Item 22(b)(11) of Schedule 14A, and Item 5.02(c)(2) of Form 8-K, which refer to amended Item 404(a). The amendments to Form 8-K that reference Regulation S-B require disclosure of the information required by amended Item 404(a) of Regulation S-B.

<sup>531</sup> See amendments to Item 23 of Form S-11.

<sup>532</sup> See amendments to Item 8 of Schedule 14A, Item 11(l) of Form S-1, General Instruction I.B.4.(c) of Form S-3, Items 18(a)(7)(ii) and 19(a)(7)(ii) of Form S-4, Item 22 of Form S-11, Item 6 of Form 10 and Item 11 of Form 10-K.

and/or (d)(5) of new Item 407, as appropriate;<sup>534</sup>

- Forms that prior to these amendments required disclosure of the information required by Item 401(j), to instead require disclosure of the information required by new Item 407(c)(3);<sup>535</sup> and
  - Item 10 of Form N-CSR to include a cross reference to new Item 407(c)(2)(iv) of Regulation S-K and new Item 22(b)(15) of Schedule 14A, in lieu of the former reference to Item 7(d)(2)(ii)(G) of Schedule 14A.
- In addition, conforming amendments have been made to a provision in Regulation AB, which prior to these amendments required disclosure of the information required by Items 401, 402 and 404, so that instead it will require disclosure of the information required by amended Items 401, 402, 404 and paragraphs (a), (c)(3), (d)(4), (d)(5) and (e)(4) of new Item 407.<sup>536</sup>

### VI. Plain English Disclosure

We are adopting as proposed a requirement that most of the disclosure called for by amended Items 402, 403, 404 and 407 be provided in plain English. This plain English requirement will apply when information responding to these items is included (whether directly or through incorporation by reference) in reports required to be filed under Exchange Act Sections 13(a) or 15(d). Commenters were generally supportive of the plain English requirement,<sup>537</sup> and some commenters suggested extending the plain English requirements to the proxy statement as a whole and to other Commission filings.<sup>538</sup>

In 1998, we adopted rule changes requiring issuers preparing prospectuses to write the cover page, summary and

<sup>534</sup> See amendments to General Instruction I.B.4.(c) of Form S-3, and Item 10 of Form 10-K, which refer to Item 401 and paragraphs (c)(3), (d)(4) and (d)(5) of new Item 407, and Item 7(b) of Schedule 14A, which refers to Item 401 and paragraphs (d)(4) and (d)(5) of new Item 407. The amendments to Form 10-KSB require disclosure of the information required by amended Item 401 and new Item 407(c)(3), (d)(4) and (d)(5) of Regulation S-B. We are not making any changes to the reference to Item 401 in Note G to Form 10-K, however, because the portion of Item 401 applicable in Note G (certain disclosure regarding executive officers) does not include the part of Item 401 that we are combining into new Item 407.

<sup>535</sup> See amendments to Item 5 in Part II of Form 10-Q, and Item 5 in Part II of Form 10-QSB. The amendments to Item 5 in Part II of Form 10-QSB require disclosure of the information required by new Item 407(c)(3) of Regulation S-B.

<sup>536</sup> See amendments to Item 1107(e) of Regulation AB.

<sup>537</sup> See, e.g., letters from SCSGP; jointly, Angela Chappa, Annie Gabel and Michelle Prater; SBAF; and Standard Life.

<sup>538</sup> See, e.g., letters from SCSGP; Foley; and Mercer.

<sup>527</sup> See, e.g., letter from SCSGP.

<sup>528</sup> Note 4 to Rule 16b-3.

<sup>529</sup> As under Rule 16b-3 prior to these amendments, each test referring to Item 404 is measured by reference to Regulation S-K, even if the disclosure requirements applicable to the company are governed by Regulation S-B.

risk factors section of prospectuses in plain English and apply plain English principles to other portions of the prospectus.<sup>539</sup> These rules transformed the landscape of public offering disclosure and made prospectuses more accessible to investors. We believe that plain English principles should apply to the disclosure requirements that we are adopting, so disclosure provided in response to those requirements is easier to read and understand. Clearer, more concise presentation of executive and director compensation, related person transactions, beneficial ownership and corporate governance matters can facilitate more informed investing and voting decisions in the face of complex information about these important areas.

We are adding Exchange Act Rules 13a-20 and 15d-20 to require that companies prepare their executive and director compensation, related person transaction, beneficial ownership and corporate governance disclosures included in Exchange Act reports using plain English, including the following principles:

- Present information in clear, concise sections, paragraphs and sentences;
  - Use short sentences;
  - Use definite, concrete, everyday words;
  - Use the active voice;
  - Avoid multiple negatives;
  - Use descriptive headings and subheadings;
- Use a tabular presentation or bullet lists for complex material, wherever possible;
- Avoid legal jargon and highly technical business and other terminology;
  - Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information;
  - Define terms in the glossary or other section of the document only if the meaning is unclear from the context;
  - Use a glossary only if it facilitates understanding of the disclosure; and
  - In designing the presentation of the information, include pictures, logos, charts, graphs, schedules, tables or other design elements so long as the design is not misleading and the required information is clear, understandable, consistent with applicable disclosure requirements and any other included

<sup>539</sup> *Plain English Disclosure*, Release No. 33-7497 (Jan. 28, 1998) [63 FR 6369] (adopting revisions to Securities Act Rule 421 [17 CFR 230.421]). We have also required that risk factor disclosure included in annual reports and Summary Term Sheets in business combination filings be in plain English. See Item 1A. to Form 10-K and Item 1001 of Regulation M-A [17 CFR 229.1001], respectively.

information, drawn to scale and not misleading.

The new rule also provides additional guidance on drafting the disclosure that would comply with plain English principles, including guidance as to the following practices that companies should avoid:

- Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;
- vague "boilerplate" explanations that are overly generic;
- complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and
- disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

Under the new rules, if disclosures about executive compensation, beneficial ownership, related person transaction or corporate governance matters are incorporated by reference into an Exchange Act report from a company's proxy or information statement, the disclosure is required to be in plain English in the proxy or information statement.<sup>540</sup> The plain English rules are part of the disclosure rules applicable to filings required under Sections 13(a) and 15(d) of the Exchange Act. We believe that these plain English requirements are best administered by the Commission under these rules, and therefore we are not at this time extending plain English requirements to the entire proxy statement or to other Commission filings.

We believe that several areas where commenters requested that information be required in a specific format, such as tables, are best addressed by application of our plain English principles. The plain English rules adopted today specifically provide that, in designing the presentation of the information, companies may include tables or other design elements, so long as the design is not misleading and the required information is clear, understandable, consistent with applicable disclosure requirements, consistent with any other included information, and not misleading.<sup>541</sup> In response to our request for comment, several

<sup>540</sup> See, e.g., General Instruction G(3) to Form 10-K and General Instruction E.3. to Form 10-KSB (specifying information that may be incorporated by reference from a proxy or information statement in an annual report on Form 10-K or 10-KSB).

<sup>541</sup> Of course, the tables required under the rules we adopt today must be included and cannot be modified except as specifically allowed for in the rules. See Item 402(a)(5) of Regulation S-K and Item 402(a)(4) of Regulation S-B.

commenters recommended using a separate supplemental table, rather than footnotes, to identify the components of All Other Compensation, including individual perquisites, reported in the Summary Compensation Table.<sup>542</sup> While we have not mandated such a separate table, we encourage companies to use additional tables wherever tabular presentation facilitates clearer, more concise disclosure. Several commenters also requested that we specifically permit tabular disclosure of the required potential post-employment payments disclosure.<sup>543</sup> Because of the difficulty of prescribing a single format that would cover all circumstances, the rule as proposed and adopted does not mandate tabular disclosure. However, consistent with the plain English principles that we adopt today, we encourage companies to develop their own tables to report post-termination compensation if such tabular presentation facilitates clearer, more concise disclosure. Similarly, while we do not require tabular presentation of the narrative disclosure following the director compensation table, such as a breakdown of director fees, consistent with the plain English rules we adopt today, we encourage tabular presentation where it facilitates an understanding of the disclosure. Companies should also consider ways in which design elements such as tables can facilitate the presentation of the related person transaction disclosure and corporate governance disclosures.

## VII. Transition

A number of commenters recommended that we adopt the rules by September or October 2006 in order for companies to have sufficient time to implement them for the 2007 proxy season.<sup>544</sup> One commenter expressed concern on how the transition would apply to Securities Act registration statements.<sup>545</sup> In keeping with these comments, we believe we have adopted the new rules and amendments in sufficient time for compliance in the 2007 proxy season. Therefore, the compliance dates are as follows:

<sup>542</sup> See, e.g., letters from Amalgamated; CFA Centre 1; CII; IUE-CWA; Mercer; and SBAF.

<sup>543</sup> See, e.g., letters from Buck Consultants; Frederic W. Cook & Co.; HRP; ISS; Mercer; and The Value Alliance and Corporate Governance Alliance.

<sup>544</sup> See, e.g., letters from ABA; ACC; Brian Foley & Co.; Jesse Brill; Chair of CompensationStandards.com and Chair of the National Association of Stock Plan Professionals, dated April 28, 2006; Buck Consultants; Foley; Frederic W. Cook & Co.; Fried Frank; Mercer; and Sullivan.

<sup>545</sup> See letter from BDO Seidman.

• For Forms 8-K, compliance is required for triggering events that occur 60 days or more after publication in the **Federal Register**;

• For Forms 10-K and 10-KSB, compliance is required for fiscal years ending on or after December 15, 2006;

• For proxy and information statements covering registrants other than registered investment companies, compliance is required for any proxy or information statements filed on or after December 15, 2006 that are required to include Item 402 and 404 disclosure for fiscal years ending on or after December 15, 2006;

• For Securities Act registration statements covering registrants other than registered investment companies and Exchange Act registration statements (including pre-effective and post-effective amendments, as applicable), compliance is required for registration statements that are filed with the Commission on or after December 15, 2006 that are required to include Item 402 and 404 disclosure for fiscal years ending on or after December 15, 2006;

• For initial registration statements and post-effective amendments that are annual updates to effective registration statements that are filed on Forms N-1A, N-2 and N-3 (except those filed by business development companies), compliance is required for registration statements and post-effective amendments that are filed with the Commission on or after December 15, 2006; and

• For proxy and information statements covering registered investment companies, compliance is required for any new proxy or information statement filed on or after December 15, 2006.<sup>546</sup>

Commenters expressed some confusion concerning the periods for which disclosure under the new rules and amendments will be required during the transition from the former rules. As we noted in the Proposing Release, companies will not be required to "restate" compensation or related person transaction disclosure for fiscal years for which they previously were required to apply our rules prior to the effective date of today's amendments. This means, for example, that only the

<sup>546</sup> The amendments to the cross-references in Item 10 of Form N-CSR will appear in the Form concurrent with the effective date of the amendments to our proxy rules, and will be effective for a particular registrant's Forms N-CSR that are filed after the filing of any proxy statement that includes a response to new Item 407(c)(2)(iv) of Regulation S-K (as required by new Item 22(b)(15) of Schedule 14A). The substance of the information required by the Item has not been changed.

most recent fiscal year will be required to be reflected in the revised Summary Compensation Table when the new rules and amendments applicable to the Summary Compensation Table become effective, and therefore the information for years prior to the most recent fiscal year will not have to be presented at all. For the subsequent year's Summary Compensation Table, companies will be required to present only the most recent two fiscal years in the Summary Compensation Table, and for the next and all subsequent years will be required to present all three fiscal years in the Summary Compensation Table.<sup>547</sup> As another example, if a calendar year-end company files its initial public offering on Form S-1 in November, the initial filing will contain compensation disclosure regarding 2005 following the prior rules. If the registration statement does not become effective until after the Item 402 disclosure must be updated, then an amendment will have to be filed that includes the 2006 compensation information that complies with the rules we adopt today. The Summary Compensation Table, however, will only contain the information for 2006 and will not need to contain the information restated from 2005.

This transition approach will result in phased-in implementation of the amended Summary Compensation Table and amended Item 404(a) disclosure over a three-year period for Regulation S-K companies, and a two-year period for Regulation S-B companies. During this phase-in period, companies will not be required to present prior years' compensation disclosure or Item 404(a) disclosure under the former rules.

## VIII. Paperwork Reduction Act

### A. Background

The new rules and amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.<sup>548</sup> We published a notice requesting comment on the collection of information requirements in the Proposing Release, and we submitted these requirements to the Office of Management and Budget for review in accordance with the Paperwork

<sup>547</sup> The other amended executive and director compensation disclosure requirements which relate to the last completed fiscal year will not be affected by this transition approach. The Summary Compensation Table will be treated differently because, as amended, it requires disclosure of compensation to the named executive officers for the last three fiscal years.

<sup>548</sup> 44 U.S.C. 3501 *et seq.*

Reduction Act.<sup>549</sup> The titles for the collection of information are:<sup>550</sup>

(1) "Regulation S-B" (OMB Control No. 3235-0417);

(2) "Regulation S-K" (OMB Control No. 3235-0071);

(3) "Form SB-2" (OMB Control No. 3235-0418);

(4) "Form S-1" (OMB Control No. 3235-0065);

(5) "Form S-4" (OMB Control Number 3235-0324);

(6) "Form S-11" (OMB Control Number 3235-0067);

(7) "Regulation 14A and Schedule 14A" (OMB Control Number 3235-0059);

(8) "Regulation 14C and Schedule 14C" (OMB Control Number 3235-0057);

(9) "Form 10" (OMB Control No. 3235-0064);

(10) "Form 10-SB" (OMB Control No. 3235-0419);

(11) "Form 10-K" (OMB Control No. 3235-0063);

(12) "Form 10-KSB" (OMB Control No. 3235-0420);

(13) "Form 8-K" (OMB Control No. 3235-0060); and

(14) "Form N-2" (OMB Control No. 3235-0026).

We adopted all of the existing regulations and forms pursuant to the Securities Act and the Exchange Act. In addition, we adopted Form N-2 pursuant to the Investment Company Act. These regulations and forms set forth the disclosure requirements for annual<sup>551</sup> and current reports, registration statements, proxy statements and information statements that are prepared by issuers to provide investors with the information they need to make informed investment decisions in registered offerings and in secondary market transactions, as well as informed voting decisions in the case of proxy statements.

Our amendments to the forms and regulations are intended to:

- Provide investors with a clearer and more complete picture of compensation awarded to, earned by or paid to principal executive officers, principal financial officers, the highest paid executive officers other than the principal executive officer and principal financial officer, and directors;

<sup>549</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>550</sup> The paperwork burden from Regulations S-K and S-B is imposed through the forms that are subject to the requirements in those Regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burdens imposed by each of Regulations S-K and S-B to be a total of one hour.

<sup>551</sup> The pertinent annual reports are those on Form 10-K or 10-KSB.

that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the small business issuer's financial statements, or experience actively supervising one or more persons engaged in such activities;

(D) An understanding of internal control over financial reporting; and  
 (E) An understanding of audit committee functions.

(iii) A person shall have acquired such attributes through:

(A) Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;

(B) Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;

(C) Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or

(D) Other relevant experience.

(iv) *Safe harbor.* (A) A person who is determined to be an audit committee financial expert will not be deemed an expert for any purpose, including without limitation for purposes of section 11 of the Securities Act (15 U.S.C. 77k), as a result of being designated or identified as an audit committee financial expert pursuant to this Item 407.

(B) The designation or identification of a person as an audit committee financial expert pursuant to this Item 407 does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification.

(C) The designation or identification of a person as an audit committee financial expert pursuant to this Item does not affect the duties, obligations or liability of any other member of the audit committee or board of directors.

*Instructions to Item 407(d)(5).*

1. The disclosure under paragraph (d)(5) of this Item is required only in a small business issuer's annual report. The small business issuer need not provide the disclosure required by paragraph (d)(5) of this Item in a proxy or information statement unless that small business issuer is electing to incorporate this information by reference from the proxy or information statement into its annual report pursuant to General Instruction E(3) to Form 10-KSB (17 CFR 249.310b).

2. If a person qualifies as an audit committee financial expert by means of having held a position described in paragraph (d)(5)(iii)(D) of this Item, the small business issuer shall provide a brief listing of that person's relevant experience. Such disclosure may be made by reference to disclosures required under Item 401(a)(4) (§ 228.401(a)(4)).

3. In the case of a foreign private issuer with a two-tier board of directors, for purposes of paragraph (d)(5) of this Item, the term *board of directors* means the supervisory or non-management board. Also, in the case of a foreign private issuer, the term *generally accepted accounting principles* in paragraph (d)(5)(ii)(A) of this Item means the body of generally accepted accounting principles used by that issuer in its primary financial statements filed with the Commission.

4. Following the effective date of the first registration statement filed under the Securities Act (15 U.S.C. 77a *et seq.*) or Exchange Act (15 U.S.C. 78a *et seq.*) by a small business issuer, the small business issuer or successor issuer need not make the disclosures required by this Item in its first annual report filed pursuant to section 13(a) or 15(d) (15 U.S.C. 78m(a) or 78o(d)) of the Exchange Act after effectiveness.

*Instructions to Item 407(d).*

1. The information required by paragraphs (d)(1)-(3) of this Item shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 through 240.14b-2 or 240.14c-1 through 240.14c-101), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the small business issuer specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act. Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the small business issuer specifically incorporates it by reference.

2. The disclosure required by paragraphs (d)(1)-(3) of this Item need only be provided one time during any fiscal year.

3. The disclosure required by paragraph (d)(3) of this Item need not be provided in any filings other than a small business issuer's proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting).

(e) *Compensation committee.* (1) If the small business issuer does not have a standing compensation committee or committee performing similar functions, state the basis for the view of the board of directors that it is appropriate for the small business issuer not to have such a committee and identify each director who participates in the consideration of executive officer and director compensation.

(2) State whether or not the compensation committee has a charter. If the compensation committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the compensation committee charter.

(3) Provide a narrative description of the small business issuer's processes and procedures for the consideration and determination of executive and director compensation, including:  
 (i) (A) The scope of authority of the compensation committee (or persons performing the equivalent functions); and

(B) The extent to which the compensation committee (or persons performing the equivalent functions) may delegate any authority described in paragraph (e)(3)(i)(A) of this Item to other persons, specifying what authority may be so delegated and to whom;

(ii) Any role of executive officers in determining or recommending the amount or form of executive and director compensation; and

(iii) Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether such consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

(f) *Shareholder communications.* (1) State whether or not the small business issuer's board of directors provides a process for security holders to send communications to the board of directors and, if the small business issuer does not have such a process for security holders to send communications to the board of directors, state the basis for the view of the board of directors that it is appropriate for the small business issuer not to have such a process.

(2) If the small business issuer has a process for security holders to send communications to the board of directors:

(i) Describe the manner in which security holders can send communications to the board and, if applicable, to specified individual directors; and

(ii) If all security holder communications are not sent directly to board members, describe the small business issuer's process for determining which communications will be relayed to board members.

*Instructions to Item 407(f).*

1. In lieu of providing the information required by paragraph (f)(2) of this Item in the proxy statement, the small business issuer may instead provide the small business issuer's Web site address where such information appears.

2. For purposes of the disclosure required by paragraph (f)(2)(ii) of this Item, a small business issuer's process for collecting and organizing security holder communications, as well as similar or related activities, need not be disclosed provided that the small business issuer's process is approved by a majority of the independent directors.

3. For purposes of this paragraph, communications from an officer or director of the small business issuer will not be viewed as "security holder communications." Communications from an employee or agent of the small business issuer will be viewed as "security holder communications" for purposes of this paragraph only if those communications are made solely in such employee's or agent's capacity as a security holder.

4. For purposes of this paragraph, security holder proposals submitted pursuant to § 240.14a-8 of this chapter, and communications made in connection with such proposals, will not be viewed as "security holder communications."

*Instructions to Item 407.*

1. For purposes of this Item:

a. *Listed issuer* means a listed issuer as defined in § 240.10A-3 of this chapter;

b. *National securities exchange* means a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a));

c. *Inter-dealer quotation system* means an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)); and

d. *National securities association* means a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that has been approved by the Commission (as that definition may be modified or supplemented).

2. With respect to paragraphs (c)(2)(i), (d)(1) and (e)(2) of this Item, disclose whether a current copy of the applicable committee charter is available to security holders on the small business issuer's Web site, and if so, provide the small business issuer's Web site address. If a current copy of the charter is not available to security holders on the small business issuer's Web site, include a copy of the charter in an appendix to the small business issuer's proxy or information statement that is provided to security holders at least once every three fiscal years, or if the charter has been materially amended since the beginning of the small business issuer's last fiscal year. If a current copy of the charter is not available to security holders on the small business issuer's Web site, and is not included as an appendix to the small business issuer's proxy or information statement, identify in which of the prior fiscal years the charter was so included in satisfaction of this requirement.

**PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K**

■ 9. The authority citation for part 229 continues to read in part as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 79e, 79j, 79n, 79t, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

■ 10. Amend § 229.201 by revising Instruction 2 to paragraph (d) and adding paragraph (e) before the Instructions to Item 201 to read as follows:

**§ 229.201 (Item 201) Market price of and dividends on the registrant's common equity and related stockholder matters.**

*Instructions to paragraph (d).*

1. \* \* \* \* \*  
2. For purposes of this paragraph, an "individual compensation arrangement" includes, but is not limited to, the following: a written compensation contract within the meaning of "employee benefit plan" under § 230.405 of this chapter and a plan (whether or not set forth in any formal document) applicable to one person as provided under Item 402(a)(6)(ii) of Regulation S-K (§ 229.402(a)(6)(ii)).

(e) *Performance graph.* (1) Provide a line graph comparing the yearly percentage change in the registrant's cumulative total shareholder return on a class of common stock registered under section 12 of the Exchange Act (as measured by dividing the sum of the cumulative amount of dividends for the measurement period, assuming dividend reinvestment, and the difference between the registrant's share price at the end and the beginning of the measurement period; by the share price at the beginning of the measurement period) with:

(i) The cumulative total return of a broad equity market index assuming reinvestment of dividends, that includes companies whose equity securities are traded on the same exchange or are of comparable market capitalization; *provided, however,* that if the registrant is a company within the Standard & Poor's 500 Stock Index, the registrant must use that index; and

(ii) The cumulative total return, assuming reinvestment of dividends, of:

(A) A published industry or line-of-business index;

(B) Peer issuer(s) selected in good faith. If the registrant does not select its peer issuer(s) on an industry or line-of-business basis, the registrant shall disclose the basis for its selection; or

(C) Issuer(s) with similar market capitalization(s), but only if the registrant does not use a published industry or line-of-business index and does not believe it can reasonably identify a peer group. If the registrant uses this alternative, the graph shall be accompanied by a statement of the reasons for this selection.

(2) For purposes of paragraph (e)(1) of this Item, the term "measurement period" shall be the period beginning at the "measurement point" established by the market close on the last trading day before the beginning of the registrant's fifth preceding fiscal year, through and including the end of the registrant's last completed fiscal year. If the class of securities has been registered under section 12 of the Exchange Act (15 U.S.C. 78l) for a shorter period of time, the period covered by the comparison may correspond to that time period.

(3) For purposes of paragraph (e)(1)(ii)(A) of this Item, the term "published industry or line-of-business index" means any index that is prepared by a party other than the registrant or an affiliate and is accessible to the registrant's security holders; *provided, however,* that registrants may use an index prepared by the registrant or affiliate if such index is widely recognized and used.

(4) If the registrant selects a different index from an index used for the immediately preceding fiscal year, explain the reason(s) for this change and also compare the registrant's total return with that of both the newly selected index and the index used in the immediately preceding fiscal year.

*Instructions to Item 201(e):*

1. In preparing the required graphic comparisons, the registrant should:

a. Use, to the extent feasible, comparable methods of presentation and assumptions for the total return calculations required by paragraph (e)(1) of this Item; *provided, however,* that if the registrant constructs its own peer group index under paragraph (e)(1)(ii)(B), the same methodology must be used in calculating both the registrant's total return and that on the peer group index; and

b. Assume the reinvestment of dividends into additional shares of the same class of equity securities at the frequency with which dividends are paid on such securities during the applicable fiscal year.

2. In constructing the graph:

a. The closing price at the measurement point must be converted into a fixed investment, stated in dollars, in the

registrant's stock (or in the stocks represented by a given index) with cumulative returns for each subsequent fiscal year measured as a change from that investment; and

b. Each fiscal year should be plotted with points showing the cumulative total return as of that point. The value of the investment as of each point plotted on a given return line is the number of shares held at that point multiplied by the then-prevailing share price.

3. The registrant is required to present information for the registrant's last five fiscal years, and may choose to graph a longer period; but the measurement point, however, shall remain the same.

4. Registrants may include comparisons using performance measures in addition to total return, such as return on average common shareholders' equity.

5. If the registrant uses a peer issuer(s) comparison or comparison with issuer(s) with similar market capitalizations, the identity of those issuers must be disclosed and the returns of each component issuer of the group must be weighted according to the respective issuer's stock market capitalization at the beginning of each period for which a return is indicated.

6. A registrant that qualifies as a "small business issuer," as defined by Item 10(a)(1) of Regulation S-B (17 CFR 228.10(a)(1)) is not required to provide the information required by paragraph (e) of this Item.

7. The information required by paragraph (e) of this Item need not be provided in any filings other than an annual report to security holders required by Exchange Act Rule 14a-3 (17 CFR 240.14a-3) or Exchange Act Rule 14c-3 (17 CFR 240.14c-3) that precedes or accompanies a registrant's proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

8. The information required by paragraph (e) of this Item shall not be deemed to be "soliciting material" or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1-240.14a-104 or 240.14c-1-240.14c-101), other than as provided in this item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically requests that such information be treated as soliciting material or specifically incorporates it by reference into a filing under the Securities Act or the Exchange Act.

\* \* \* \* \*

**§ 229.306 [Removed and Reserved]**

■ 11. Remove and reserve § 229.306.

■ 12. Amend § 229.401 by removing paragraphs (h), (i) and (j) and by revising paragraph (g)(1) to read as follows:

**§ 229.401 (Item 401) Directors, executive officers, promoters and control persons.**

\* \* \* \* \*

(g) *Promoters and control persons.* (1) Registrants, which have not been subject to the reporting requirements of section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) for the twelve months immediately prior to the filing of the registration statement, report, or statement to which this Item is applicable, and which had a promoter at any time during the past five fiscal years, shall describe with respect to any promoter, any of the events enumerated in paragraphs (f)(1) through (f)(6) of this Item that occurred during the past five years and that are material to a voting or investment decision.

■ 13. Revise § 229.402 to read as follows:

**§ 229.402 (Item 402) Executive compensation.**

(a) *General*—(1) *Treatment of foreign private issuers.* A foreign private issuer will be deemed to comply with this Item if it provides the information required by Items 6.B and 6.E.2 of Form 20-F (17 CFR 249.220f), with more detailed information provided if otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded.

(2) *All compensation covered.* This Item requires clear, concise and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers designated under paragraph (a)(3) of this Item, and directors covered by paragraph (k) of this Item, by any person for all services rendered in all capacities to the registrant and its subsidiaries, unless otherwise specifically excluded from disclosure in this Item. All such compensation shall be reported pursuant to this Item, even if also called for by another requirement, including transactions between the registrant and a third party where a purpose of the transaction is to furnish compensation to any such named executive officer or director. No amount reported as compensation for one fiscal year need be reported in the same manner as compensation for a subsequent fiscal year; amounts reported as compensation for one fiscal year may be required to be reported in a different manner pursuant to this Item.

(3) *Persons covered.* Disclosure shall be provided pursuant to this Item for each of the following (the "named executive officers"):

(i) All individuals serving as the registrant's principal executive officer or acting in a similar capacity during the

last completed fiscal year ("PEO"), regardless of compensation level;

(ii) All individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year ("PFO"), regardless of compensation level;

(iii) The registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year; and

(iv) Up to two additional individuals for whom disclosure would have been provided pursuant to paragraph (a)(3)(iii) of this Item but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year.

*Instructions to Item 402(a)(3).*

1. *Determination of most highly compensated executive officers.* The determination as to which executive officers are most highly compensated shall be made by reference to total compensation for the last completed fiscal year (as required to be disclosed pursuant to paragraph (c)(2)(x) of this Item) reduced by the amount required to be disclosed pursuant to paragraph (c)(2)(viii) of this Item, provided, however, that no disclosure need be provided for any executive officer, other than the PEO and PFO, whose total compensation, as so reduced, does not exceed \$100,000.

2. *Inclusion of executive officer of subsidiary.* It may be appropriate for a registrant to include as named executive officers one or more executive officers or other employees of subsidiaries in the disclosure required by this Item. See Rule 3b-7 under the Exchange Act (17 CFR 240.3b-7).

3. *Exclusion of executive officer due to overseas compensation.* It may be appropriate in limited circumstances for a registrant not to include in the disclosure required by this Item an individual, other than its PEO or PFO, who is one of the registrant's most highly compensated executive officers due to the payment of amounts of cash compensation relating to overseas assignments attributed predominantly to such assignments.

(4) *Information for full fiscal year.* If the PEO or PFO served in that capacity during any part of a fiscal year with respect to which information is required, information should be provided as to all of his or her compensation for the full fiscal year. If a named executive officer (other than the PEO or PFO) served as an executive officer of the registrant (whether or not in the same position) during any part of the fiscal year with respect to which information is required, information shall be provided as to all compensation of that individual for the full fiscal year.

(5) *Omission of table or column.* A table or column may be omitted if there has been no compensation awarded to, earned by, or paid to any of the named executive officers or directors required to be reported in that table or column in any fiscal year covered by that table.

(6) *Definitions.* For purposes of this Item:

(i) The term *stock* means instruments such as common stock, restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or any similar instruments that do not have option-like features, and the term *option* means instruments such as stock options, stock appreciation rights and similar instruments with option-like features. The term *stock appreciation rights* ("SARs") refers to SARs payable in cash or stock, including SARs payable in cash or stock at the election of the registrant or a named executive officer. The term *equity* is used to refer generally to stock and/or options.

(ii) The term *plan* includes, but is not limited to, the following: Any plan, contract, authorization or arrangement, whether or not set forth in any formal document, pursuant to which cash, securities, similar instruments, or any other property may be received. A plan may be applicable to one person. Registrants may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees.

(iii) The term *incentive plan* means any plan providing compensation intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the registrant or an affiliate, the registrant's stock price, or any other performance measure. An *equity incentive plan* is an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, as modified or supplemented ("FAS 123R"). A *non-equity incentive plan* is an incentive plan or portion of an incentive plan that is not an equity incentive plan. The term *incentive plan award* means an award provided under an incentive plan.

(iv) The terms *date of grant* or *grant date* refer to the grant date determined for financial statement reporting purposes pursuant to FAS 123R.

(v) *Closing market price* is defined as the price at which the registrant's security was last sold in the principal United States market for such security as of the date for which the closing market price is determined.

(b) *Compensation discussion and analysis.*

(1) Discuss the compensation awarded to, earned by, or paid to the named executive officers. The discussion shall explain all material elements of the registrant's compensation of the named executive officers. The discussion shall describe the following:

(i) The objectives of the registrant's compensation programs;

(ii) What the compensation program is designed to reward;

(iii) Each element of compensation;

(iv) Why the registrant chooses to pay each element;

(v) How the registrant determines the amount (and, where applicable, the formula) for each element to pay; and

(vi) How each compensation element and the registrant's decisions regarding that element fit into the registrant's overall compensation objectives and affect decisions regarding other elements.

(2) While the material information to be disclosed under Compensation Discussion and Analysis will vary depending upon the facts and circumstances, examples of such information may include, in a given case, among other things, the following:

(i) The policies for allocating between long-term and currently paid out compensation;

(ii) The policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation;

(iii) For long-term compensation, the basis for allocating compensation to each different form of award (such as relationship of the award to the achievement of the registrant's long-term goals, management's exposure to downside equity performance risk, correlation between cost to registrant and expected benefits to the registrant);

(iv) How the determination is made as to when awards are granted, including awards of equity-based compensation such as options;

(v) What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions;

(vi) How specific forms of compensation are structured and implemented to reflect these items of the registrant's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal(s) or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified named executive officers or to all compensation subject to the relevant performance goal(s);

(vii) How specific forms of compensation are structured and implemented to reflect the named executive officer's individual performance and/or individual contribution to these items of the registrant's performance, describing the elements of individual performance and/or contribution that are taken into account;

(viii) Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;

(ix) The factors considered in decisions to increase or decrease compensation materially;

(x) How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g., how gains from prior option or stock awards are considered in setting retirement benefits);

(xi) With respect to any contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) at, following, or in connection

with any termination or change-in-control, the basis for selecting particular events as triggering payment (e.g., the rationale for providing a single trigger for payment in the event of a change-in-control);

(xii) The impact of the accounting and tax treatments of the particular form of compensation;

(xiii) The registrant's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership), and any registrant policies regarding hedging the economic risk of such ownership;

(xiv) Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies); and

(xv) The role of executive officers in determining executive compensation.

*Instructions to Item 402(b).*

1. The purpose of the Compensation Discussion and Analysis is to provide to investors material information that is necessary to an understanding of the registrant's compensation policies and decisions regarding the named executive officers.

2. The Compensation Discussion and Analysis should be of the information contained in the tables and otherwise disclosed pursuant to this Item. The Compensation Discussion and Analysis should also cover actions regarding executive compensation that were taken after the registrant's last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.

3. The Compensation Discussion and Analysis should focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions. The Compensation Discussion and Analysis shall reflect the individual circumstances of the registrant and shall avoid boilerplate language and repetition of the more detailed information set forth in the tables and narrative disclosures that follow.

4. Registrants are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant. The standard to use when determining whether disclosure would cause competitive harm for the registrant is the same standard that would apply when a registrant requests confidential treatment of confidential trade

secrets or confidential commercial or financial information pursuant to Securities Act Rule 406 (17 CFR 230.406) and Exchange Act Rule 24b-2 (17 CFR 240.24b-2), each of which incorporates the criteria for non-disclosure when relying upon Exemption 4 of the Freedom of Information Act (5 U.S.C. 552(b)(4) and Rule 80(b)(4) (17 CFR 200.80(b)(4)) thereunder. A registrant is not required to seek confidential treatment under the procedures in Securities Act Rule 406 and Exchange Act Rule 24b-2 if it determines

that the disclosure would cause competitive harm in reliance on this instruction; however, in that case, the registrant must discuss how difficult it will be for the executive or how likely it will be for the registrant to achieve the undisclosed target levels or other factors.

5. Disclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G (17 CFR 244.100-102) and Item 10(e) (§ 229.10(e)); however, disclosure must be provided as to how the number is

calculated from the registrant's audited financial statements.

(c) *Summary compensation table—(1) General.* Provide the information specified in paragraph (c)(2) of this Item, concerning the compensation of the named executive officers for each of the registrant's last three completed fiscal years, in a Summary Compensation Table in the tabular format specified below.

SUMMARY COMPENSATION TABLE

Name and principal position	Year	Salary (\$)	Bonus (\$)	Stock awards (\$)	Option awards (\$)	Non-equity incentive plan compensation (\$)	Change in pension value and non-qualified deferred compensation earnings (\$)	All other compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO.									
PFO.									
A.									
B.									
C.									

(2) The Table shall include:

- (i) The name and principal position of the named executive officer (column (a));
- (ii) The fiscal year covered (column (b));
- (iii) The dollar value of base salary (cash and non-cash) earned by the named executive officer during the fiscal year covered (column (c));
- (iv) The dollar value of bonus (cash and non-cash) earned by the named executive officer during the fiscal year covered (column (d));

*Instructions to Item 402(c)(2)(iii) and (iv).*

1. If the amount of salary or bonus earned in a given fiscal year is not calculable through the latest practicable date, a footnote shall be included disclosing that the amount of salary or bonus is not calculable through the latest practicable date and providing the date that the amount of salary or bonus is expected to be determined, and such amount must then be disclosed in a filing under Item 5.02(f) of Form 8-K (17 CFR 249.308).

2. Registrants need not include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer pursuant to a registrant's program under which stock, equity-based or other forms of non-cash compensation may be received by a named executive officer instead of a portion of annual compensation earned in a covered fiscal year. However, the receipt of any such form of non-cash compensation instead of salary or bonus earned for a covered fiscal year must be disclosed in the appropriate column of the Summary Compensation Table corresponding to that fiscal year (e.g., stock awards (column (e)); option awards (column (f)); all other compensation (column (i))), or, if made pursuant to a non-equity incentive plan and therefore not reportable in the Summary Compensation Table when granted, a footnote must be added to the salary or bonus column so disclosing and referring to the Grants of Plan-Based Awards Table (required by paragraph (d) of this Item) where the award is reported.

- (v) For awards of stock, the aggregate grant date fair value computed in accordance with FAS 123R (column (e));
- (vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FAS 123R (column (f));

*Instructions to Item 402(c)(2)(v) and (vi).*

1. For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

2. If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement

grants, or any other means ("repriced"), or otherwise has materially modified such awards, the registrant shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R, with respect to that repriced or modified award.

(vii) The dollar value of all earnings for services performed during the fiscal year pursuant to awards under non-equity incentive plans as defined in paragraph (a)(6)(iii) of this Item, and all earnings on any outstanding awards (column (g));

*Instructions to Item 402(c)(2)(vii).*

1. If the relevant performance measure is satisfied during the fiscal year (including for a single year in a plan with a multi-year performance measure), the earnings are reportable for that fiscal year, even if not payable until a later date, and are not reportable again in the fiscal year when amounts are paid to the named executive officer.

2. All earnings on non-equity incentive plan compensation must be identified and quantified in a footnote to column (g), whether the earnings were paid during the fiscal year, payable during the period but deferred at the election of the named executive officer, or payable by their terms at a later date.

(viii) The sum of the amounts specified in paragraphs (c)(2)(viii)(A) and (B) of this Item (column (h)) as follows:

(A) The aggregate change in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans) from the pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the prior completed fiscal year to the pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the covered fiscal year; and

(B) Above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans;

*Instructions to Item 402(c)(2)(viii).*

1. The disclosure required pursuant to paragraph (c)(2)(viii)(A) of this Item applies to each plan that provides for the payment of retirement benefits, or benefits that will be paid primarily following retirement, including but not limited to tax-qualified defined benefit plans and supplemental executive retirement plans, but excluding tax-qualified defined contribution plans and nonqualified defined contribution plans. For purposes of this disclosure, the registrant

should use the same amounts required to be disclosed pursuant to paragraph (h)(2)(iv) of this Item for the covered fiscal year and the amounts that were or would have been required to be reported for the executive officer pursuant to paragraph (h)(2)(iv) of this Item for the prior completed fiscal year.

2. Regarding paragraph (c)(2)(viii)(B) of this Item, interest on deferred compensation is above-market only if the rate of interest exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under section 1274(d) of the Internal Revenue Code, (26 U.S.C. 1274(d))) at the rate that corresponds most closely to the rate under the registrant's plan at the time the interest rate or formula is set. In the event of a discretionary reset of the interest rate, the requisite calculation must be made on the basis of the interest rate at the time of such reset, rather than when originally established. Only the above-market portion of the interest must be included. If the applicable interest rates vary depending upon conditions such as a minimum period of continued service, the reported amount should be calculated assuming satisfaction of all conditions to receiving interest at the highest rate. Dividends (and dividend equivalents) on deferred compensation denominated in the registrant's stock ("deferred stock") are preferential only if earned at a rate higher than dividends on the registrant's common stock. Only the preferential portion of the dividends or equivalents must be included. Footnote or narrative disclosure may be provided explaining the registrant's criteria for determining any portion considered to be above-market.

3. The registrant shall identify and quantify by footnote the separate amounts attributable to each of paragraphs (c)(2)(viii)(A) and (B) of this Item. Where such amount pursuant to paragraph (c)(2)(viii)(A) is negative, it should be disclosed by footnote but should not be reflected in the sum reported in column (h).

(ix) All other compensation for the covered fiscal year that the registrant could not properly report in any other column of the Summary Compensation Table (column (i)). Each compensation item that is not properly reportable in columns (c)-(h), regardless of the amount of the compensation item, must be included in column (i). Such compensation must include, but is not limited to:

(A) Perquisites and other personal benefits, or property, unless the aggregate amount of such compensation is less than \$10,000;

(B) All "gross-ups" or other amounts reimbursed during the fiscal year for the payment of taxes;

(C) For any security of the registrant or its subsidiaries purchased from the registrant or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally, either to all security holders

or to all salaried employees of the registrant, the compensation cost, if any, computed in accordance with FAS 123R;

(D) The amount paid or accrued to any named executive officer pursuant to a plan or arrangement in connection with:

(1) Any termination, including without limitation through retirement, resignation, severance or constructive termination (including a change in responsibilities) of such executive officer's employment with the registrant and its subsidiaries; or

(2) A change in control of the registrant;

(E) Registrant contributions or other allocations to vested and unvested defined contribution plans;

(F) The dollar value of any insurance premiums paid by, or on behalf of, the registrant during the covered fiscal year with respect to life insurance for the benefit of a named executive officer; and

(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in columns (e) or (f); and

*Instructions to Item 402(c)(2)(ix).*

1. Non-equity incentive plan awards and earnings and earnings on stock and options, except as specified in paragraph (c)(2)(ix)(G) of this Item, are required to be reported elsewhere as provided in this Item and are not reportable as All Other Compensation in column (i).

2. Benefits paid pursuant to defined benefit and actuarial plans are not reportable as All Other Compensation in column (i) unless accelerated pursuant to a change in control; information concerning these plans is reportable pursuant to paragraphs (c)(2)(viii)(A) and (h) of this Item.

3. Any item reported for a named executive officer pursuant to paragraph (c)(2)(ix) of this Item that is not a perquisite or personal benefit and whose value exceeds \$10,000 must be identified and quantified in a footnote to column (i). This requirement applies only to compensation for the last fiscal year. All items of compensation are required to be included in the Summary Compensation Table without regard to whether such items are required to be identified other than as specifically noted in this Item.

4. Perquisites and personal benefits may be excluded as long as the total value of all perquisites and personal benefits for a named executive officer is less than \$10,000. If the total value of all perquisites and personal benefits is \$10,000 or more for any named executive officer, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a named executive officer pursuant to this rule, then each perquisite or personal benefit

that exceeds the greater of \$25,000 or 10% of the total amount of perquisites and personal benefits for that officer must be quantified and disclosed in a footnote. The requirements for identification and quantification apply only to compensation for the last fiscal year. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the registrant. With respect to the perquisite or other personal benefit for which footnote quantification is required, the registrant shall describe in the footnote its methodology for computing the aggregate incremental cost. Reimbursements of taxes owed with respect to perquisites or other personal benefits must be included in column (i) and are subject to separate quantification and identification as tax reimbursements (paragraph (c)(2)(ix)(B) of this Item) even if the associated perquisites or other personal benefits are not required to be included because the total amount of all perquisites or personal benefits for an individual named executive officer is less than \$10,000 or are required to be identified but are not required to be separately quantified.

5. For purposes of paragraph (c)(2)(ix)(D) of this Item, an accrued amount is an amount for which payment has become due.

(x) The dollar value of total compensation for the covered fiscal year (column (j)). With respect to each named executive officer, disclose the sum of all amounts reported in columns (c) through (i).

*Instructions to Item 402(c).*

1. Information with respect to fiscal years prior to the last completed fiscal year will not be required if the registrant was not a reporting company pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) at any time during that year, except that the registrant will be required to provide information for any such year if that information previously was required to be provided in response to a Commission filing requirement.

2. All compensation values reported in the Summary Compensation Table must be reported in dollars and rounded to the nearest dollar. Reported compensation values must be reported numerically, providing a single numerical value for each grid in the table. Where compensation was paid to or received by a named executive officer in a different currency, a footnote must be provided to identify that currency and

describe the rate and methodology used to convert the payment amounts to dollars.

3. If a named executive officer is also a director who receives compensation for his or her services as a director, reflect that compensation in the Summary Compensation Table and provide a footnote identifying and itemizing such compensation and amounts. Use the categories in the Director Compensation Table required pursuant to paragraph (k) of this Item.

4. Any amounts deferred, whether pursuant to a plan established under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), or otherwise, shall be included in the appropriate column for the fiscal year in which earned.

(d) *Grants of plan-based awards table.*  
 (1) Provide the information specified in paragraph (d)(2) of this Item, concerning each grant of an award made to a named executive officer in the last completed fiscal year under any plan, including awards that subsequently have been transferred, in the following tabular format:

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										

(2) The Table shall include:

(i) The name of the named executive officer (column (a));

(ii) The grant date for equity-based awards reported in the table (column (b)). If such grant date is different than the date on which the compensation committee (or a committee of the board of directors performing a similar function or the full board of directors) takes action or is deemed to take action to grant such awards, a separate, adjoining column shall be added

between columns (b) and (c) showing such date;

(iii) The dollar value of the estimated future payout upon satisfaction of the conditions in question under non-equity incentive plan awards granted in the fiscal year, or the applicable range of estimated payouts denominated in dollars (threshold, target and maximum amount) (columns (c) through (e)).

(iv) The number of shares of stock, or the number of shares underlying options to be paid out or vested upon satisfaction of the conditions in

question under equity incentive plan awards granted in the fiscal year, or the applicable range of estimated payouts denominated in the number of shares of stock, or the number of shares underlying options under the award (threshold, target and maximum amount) (columns (f) through (h)).

(v) The number of shares of stock granted in the fiscal year that are not required to be disclosed in columns (f) through (h) (column (i));

(vi) The number of securities underlying options granted in the fiscal

year that are not required to be disclosed in columns (f) through (h) (column (j)); and

(vii) The per-share exercise or base price of the options granted in the fiscal year (column (k)). If such exercise or base price is less than the closing market price of the underlying security on the date of the grant, a separate, adjoining column showing the closing market price on the date of the grant shall be added after column (k).

*Instructions to Item 402(d).*

1. Disclosure on a separate line shall be provided in the Table for each grant of an award made to a named executive officer during the fiscal year. If grants of awards were made to a named executive officer during the fiscal year under more than one plan, identify the particular plan under which each such grant was made.

2. For grants of incentive plan awards, provide the information called for by columns (c), (d) and (e), or (f), (g) and (h), as applicable. For columns (c) and (f), *threshold* refers to the minimum amount payable for a certain level of performance under the plan. For columns (d) and (g), *target* refers to the amount payable if the specified performance target(s) are reached. For columns (e) and (h), *maximum* refers to the maximum payout possible under the plan. If the award provides only for a single estimated payout, that amount must be reported as the *target* in columns (d) and (g). In columns (d) and (g), registrants must provide a representative amount based on the previous fiscal year's performance if the target amount is not determinable.

3. In determining if the exercise or base price of an option is less than the closing market price of the underlying security on the date of the grant, the registrant may use either the closing market price as specified in paragraph (a)(6)(v) of this Item, or if no market exists, any other formula prescribed for the security. Whenever the exercise or base price reported in column (k) is not the closing market price, describe the methodology for determining the exercise or base price either by a footnote or accompanying textual narrative.

4. A tandem grant of two instruments, only one of which is granted under an incentive

plan, such as an option granted in tandem with a performance share, need be reported only in column (i) or (j), as applicable. For example, an option granted in tandem with a performance share would be reported only as an option grant in column (j), with the tandem feature noted either by a footnote or accompanying textual narrative.

5. Disclose the dollar amount of consideration, if any, paid by the executive officer for the award in a footnote to the appropriate column.

6. If non-equity incentive plan awards are denominated in units or other rights, a separate, adjoining column between columns (b) and (c) shall be added quantifying the units or other rights awarded.

(e) *Narrative disclosure to summary compensation table and grants of plan-based awards table.* (1) Provide a narrative description of any material factors necessary to an understanding of the information disclosed in the tables required by paragraphs (c) and (d) of this Item. Examples of such factors may include, in given cases, among other things:

(i) The material terms of each named executive officer's employment agreement or arrangement, whether written or unwritten;

(ii) If at any time during the last fiscal year, any outstanding option or other equity-based award was repriced or otherwise materially modified (such as by extension of exercise periods, the change of vesting or forfeiture conditions, the change or elimination of applicable performance criteria, or the change of the bases upon which returns are determined), a description of each such repricing or other material modification;

(iii) The material terms of any award reported in response to paragraph (d) of this Item, including a general description of the formula or criteria to be applied in determining the amounts payable, and the vesting schedule. For example, state where applicable that dividends will be paid on stock, and if

so, the applicable dividend rate and whether that rate is preferential. Describe any performance-based conditions, and any other material conditions, that are applicable to the award. For purposes of the Table required by paragraph (d) of this Item and the narrative disclosure required by paragraph (e) of this Item, performance-based conditions include both performance conditions and market conditions, as those terms are defined in FAS 123R; and

(iv) An explanation of the amount of salary and bonus in proportion to total compensation.

*Instructions to Item 402(e)(1).*

1. The disclosure required by paragraph (e)(1)(ii) of this Item would not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.

2. Instructions 4 and 5 to Item 402(b) apply regarding disclosure pursuant to paragraph (e)(1) of this Item of target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant.

(2) [Reserved]

(f) *Outstanding equity awards at fiscal year-end table.* (1) Provide the information specified in paragraph (f)(2) of this Item, concerning unexercised options; stock that has not vested; and equity incentive plan awards for each named executive officer outstanding as of the end of the registrant's last completed fiscal year in the following tabular format:

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 unearned 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 unearned shares, units or other rights that have not vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
PFO									
A									
B									
C									

(2) The Table shall include:

(i) The name of the named executive officer (column (a));

(ii) On an award-by-award basis, the number of securities underlying unexercised options, including awards that have been transferred other than for value, that are exercisable and that are not reported in column (d) (column (b));

(iii) On an award-by-award basis, the number of securities underlying unexercised options, including awards that have been transferred other than for value, that are unexercisable and that are not reported in column (d) (column (c));

(iv) On an award-by-award basis, the total number of shares underlying unexercised options awarded under any equity incentive plan that have not been earned (column (d));

(v) For each instrument reported in columns (b), (c) and (d), as applicable, the exercise or base price (column (e));

(vi) For each instrument reported in columns (b), (c) and (d), as applicable, the expiration date (column (f));

(vii) The total number of shares of stock that have not vested and that are not reported in column (i) (column (g));

(viii) The aggregate market value of shares of stock that have not vested and that are not reported in column (j) (column (h));

(ix) The total number of shares of stock, units or other rights awarded

under any equity incentive plan that have not vested and that have not been earned, and, if applicable the number of shares underlying any such unit or right (column (i)); and

(x) The aggregate market or payout value of shares of stock, units or other rights awarded under any equity incentive plan that have not vested and that have not been earned (column (j)).

*Instructions to Item 402(f)(2).*

1. Identify by footnote any award that has been transferred other than for value, disclosing the nature of the transfer.

2. The vesting dates of options, shares of stock and equity incentive plan awards held at fiscal-year end must be disclosed by footnote to the applicable column where the outstanding award is reported.

3. Compute the market value of stock reported in column (h) and equity incentive plan awards of stock reported in column (j) by multiplying the closing market price of the registrant's stock at the end of the last completed fiscal year by the number of shares or units of stock or the amount of equity incentive plan awards, respectively. The number of shares or units reported in columns (d) or (i), and the payout value reported in column (j), shall be based on achieving threshold performance goals, except that if the previous fiscal year's performance has exceeded the threshold, the disclosure shall be based on the next higher performance measure (target or maximum) that exceeds the previous fiscal year's performance. If the award provides only for a single estimated payout, that amount

should be reported. If the target amount is not determinable, registrants must provide a representative amount based on the previous fiscal year's performance.

4. Multiple awards may be aggregated where the expiration date and the exercise and/or base price of the instruments is identical. A single award consisting of a combination of options, SARs and/or similar option-like instruments shall be reported as separate awards with respect to each tranche with a different exercise and/or base price or expiration date.

5. Options or stock awarded under an equity incentive plan are reported in columns (d) or (i) and (j), respectively, until the relevant performance condition has been satisfied. Once the relevant performance condition has been satisfied, even if the option or stock award is subject to forfeiture conditions, options are reported in column (b) or (c), as appropriate, until they are exercised or expire, or stock is reported in columns (g) and (h) until it vests.

(g) *Option exercises and stock vested table.* (1) Provide the information specified in paragraph (g)(2) of this item, concerning each exercise of stock options, SARs and similar instruments, and each vesting of stock, including restricted stock, restricted stock units and similar instruments, during the last completed fiscal year for each of the named executive officers on an aggregated basis in the following tabular format:

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				

(2) The Table shall include:

(i) The name of the executive officer (column (a));

(ii) The number of securities for which the options were exercised (column (b));

(iii) The aggregate dollar value realized upon exercise of options, or upon the transfer of an award for value (column (c));

(iv) The number of shares of stock that have vested (column (d)); and

(v) The aggregate dollar value realized upon vesting of stock, or upon the transfer of an award for value (column (e)).

Instruction to Item 402(g)(2).

Report in column (c) the aggregate dollar amount realized by the named executive officer upon exercise of the options or upon the transfer of such instruments for value. Compute the dollar amount realized upon exercise by determining the difference between the market price of the underlying securities at exercise and the exercise or base price of the options. Do not include the value of any related payment or other consideration provided (or to be provided) by the registrant to or on behalf of a named executive officer, whether in payment of the exercise price or related taxes. (Any such payment or other consideration provided by the registrant is required to be disclosed in accordance with paragraph (c)(2)(ix) of this Item.) Report in column (e) the aggregate dollar amount realized by the named executive officer upon

the vesting of stock or the transfer of such instruments for value. Compute the aggregate dollar amount realized upon vesting by multiplying the number of shares of stock or units by the market value of the underlying shares on the vesting date. For any amount realized upon exercise or vesting for which receipt has been deferred, provide a footnote quantifying the amount and disclosing the terms of the deferral.

(h) Pension benefits. (1) Provide the information specified in paragraph (h)(2) of this Item with respect to each plan that provides for payments or other benefits at, following, or in connection with retirement, in the following tabular format:

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				

(2) The Table shall include:

(i) The name of the executive officer (column (a));

(ii) The name of the plan (column (b));

(iii) The number of years of service credited to the named executive officer under the plan, computed as of the same pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the last completed fiscal year (column (c));

(iv) The actuarial present value of the named executive officer's accumulated benefit under the plan, computed as of the same pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the last completed fiscal year (column (d)); and

(v) The dollar amount of any payments and benefits paid to the named executive officer during the registrant's last completed fiscal year (column (e)).

*Instructions to Item 402(h)(2).*

1. The disclosure required pursuant to this Table applies to each plan that provides for specified retirement payments and benefits, or payments and benefits that will be provided primarily following retirement, including but not limited to tax-qualified defined benefit plans and supplemental executive retirement plans, but excluding tax-qualified defined contribution plans and nonqualified defined contribution plans. Provide a separate row for each such plan in which the named executive officer participates.

2. For purposes of the amount(s) reported in column (d), the registrant must use the same assumptions used for financial reporting purposes under generally accepted accounting principles, except that retirement age shall be assumed to be the normal retirement age as defined in the plan, or if not so defined, the earliest time at which a

participant may retire under the plan without any benefit reduction due to age. The registrant must disclose in the accompanying textual narrative the valuation method and all material assumptions applied in quantifying the present value of the current accrued benefit. A benefit specified in the plan document or the executive's contract itself is not an assumption. Registrants may satisfy all or part of this disclosure by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

3. For purposes of allocating the current accrued benefit between tax qualified defined benefit plans and related supplemental plans, apply the limitations applicable to tax qualified defined benefit plans established by the Internal Revenue Code and the regulations thereunder that applied as of the pension plan measurement date.

4. If a named executive officer's number of years of credited service with respect to any plan is different from the named executive officer's number of actual years of service with the registrant, provide footnote disclosure quantifying the difference and any resulting benefit augmentation.

(3) Provide a succinct narrative description of any material factors necessary to an understanding of each plan covered by the tabular disclosure required by this paragraph. While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:

(i) The material terms and conditions of payments and benefits available under the plan, including the plan's normal retirement payment and benefit

formula and eligibility standards, and the effect of the form of benefit elected on the amount of annual benefits. For this purpose, normal retirement means retirement at the normal retirement age as defined in the plan, or if not so defined, the earliest time at which a participant may retire under the plan without any benefit reduction due to age;

(ii) If any named executive officer is currently eligible for early retirement under any plan, identify that named executive officer and the plan, and describe the plan's early retirement payment and benefit formula and eligibility standards. For this purpose, early retirement means retirement at the early retirement age as defined in the plan, or otherwise available to the executive under the plan;

(iii) The specific elements of compensation (e.g., salary, bonus, etc.) included in applying the payment and benefit formula, identifying each such element;

(iv) With respect to named executive officers' participation in multiple plans, the different purposes for each plan; and

(v) Registrant policies with regard to such matters as granting extra years of credited service.

(i) *Nonqualified defined contribution and other nonqualified deferred compensation plans.* (1) Provide the information specified in paragraph (i)(2) of this Item with respect to each defined contribution or other plan that provides for the deferral of compensation on a basis that is not tax-qualified in the following tabular format:

**NONQUALIFIED DEFERRED COMPENSATION**

Name  (a)	Executive contributions in last FY (\$)  (b)	Registrant contributions in last FY (\$)  (c)	Aggregate earnings in last FY (\$)  (d)	Aggregate withdrawals/distributions (\$)  (e)	Aggregate balance at last FYE (\$)  (f)
PEO					
PFO					
A					
B					
C					

(2) The Table shall include:

(i) The name of the executive officer (column (a));

(ii) The dollar amount of aggregate executive contributions during the registrant's last fiscal year (column (b));

(iii) The dollar amount of aggregate registrant contributions during the registrant's last fiscal year (column (c));

(iv) The dollar amount of aggregate interest or other earnings accrued during the registrant's last fiscal year (column (d));

(v) The aggregate dollar amount of all withdrawals by and distributions to the executive during the registrant's last fiscal year (column (e)); and

(vi) The dollar amount of total balance of the executive's account as of the end of the registrant's last fiscal year (column (f)).

*Instruction to Item 402(i)(2).*

Provide a footnote quantifying the extent to which amounts reported in the contributions and earnings columns are reported as compensation in the last completed fiscal year in the registrant's Summary Compensation Table and amounts reported in the aggregate balance at last fiscal year end (column (f)) previously were reported as compensation to the named executive officer in the registrant's Summary Compensation Table for previous years.

(3) Provide a succinct narrative description of any material factors necessary to an understanding of each plan covered by tabular disclosure required by this paragraph. While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:

(i) The type(s) of compensation permitted to be deferred, and any limitations (by percentage of compensation or otherwise) on the extent to which deferral is permitted;

(ii) The measures for calculating interest or other plan earnings (including whether such measure(s) are selected by the executive or the registrant and the frequency and manner in which selections may be changed), quantifying interest rates and other earnings measures applicable during the registrant's last fiscal year; and

(iii) Material terms with respect to payouts, withdrawals and other distributions.

(j) *Potential payments upon termination or change-in-control.*

Regarding each contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) to a named executive officer at, following, or in connection with any termination, including without limitation resignation, severance, retirement or a constructive termination of a named executive officer, or a change in control of the registrant or a change in the named executive officer's responsibilities, with respect to each named executive officer:

(1) Describe and explain the specific circumstances that would trigger payment(s) or the provision of other benefits, including perquisites and health care benefits;

(2) Describe and quantify the estimated payments and benefits that would be provided in each covered circumstance, whether they would or could be lump sum, or annual, disclosing the duration, and by whom they would be provided;

(3) Describe and explain how the appropriate payment and benefit levels are determined under the various circumstances that trigger payments or provision of benefits;

(4) Describe and explain any material conditions or obligations applicable to the receipt of payments or benefits, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, including the duration of such agreements and provisions regarding waiver of breach of such agreements; and

(5) Describe any other material factors regarding each such contract, agreement, plan or arrangement.

*Instructions to Item 402(j).*

1. The registrant must provide quantitative disclosure under these requirements, applying the assumptions that the triggering event took place on the last business day of the registrant's last completed fiscal year, and the price per share of the registrant's securities is the closing market price as of that date. In the event that uncertainties exist

as to the provision of payments and benefits or the amounts involved, the registrant is required to make a reasonable estimate (for a reasonable estimated range of amounts) applicable to the payment or benefit and disclose material assumptions underlying such estimates or estimated ranges in its disclosure. In such event, the disclosure would require forward-looking information as appropriate.

2. Perquisites and other personal benefits or property may be excluded only if the aggregate amount of such compensation will be less than \$10,000. Individual perquisites and personal benefits shall be identified and quantified as required by Instruction 4 to paragraph (c)(2)(ix) of this Item. For purposes of quantifying health care benefits, the registrant must use the assumptions used for financial reporting purposes under generally accepted accounting principles.

3. To the extent that the form and amount of any payment or benefit that would be provided in connection with any triggering event is fully disclosed pursuant to paragraph (h) or (i) of this Item, reference may be made to that disclosure. However, to the extent that the form or amount of any such payment or benefit would be enhanced or its vesting or other provisions accelerated in connection with any triggering event, such enhancement or acceleration must be disclosed pursuant to this paragraph.

4. Where a triggering event has actually occurred for a named executive officer and that individual was not serving as a named executive officer of the registrant at the end of the last completed fiscal year, the disclosure required by this paragraph for that named executive officer shall apply only to that triggering event.

5. The registrant need not provide information with respect to contracts, agreements, plans or arrangements to the extent they do not discriminate in scope, terms or operation, in favor of executive officers of the registrant and that are available generally to all salaried employees.

(k) *Compensation of directors.* (1) Provide the information specified in paragraph (k)(2) of this Item, concerning the compensation of the directors for the registrant's last completed fiscal year, in the following tabular format:

**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)
A							
B							

## DIRECTOR COMPENSATION—Continued

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)
C							
D							
E							

(2) The Table shall include:

(i) The name of each director unless such director is also a named executive officer under paragraph (a) of this Item and his or her compensation for service as a director is fully reflected in the Summary Compensation Table pursuant to paragraph (c) of this Item and otherwise as required pursuant to paragraphs (d) through (j) of this Item (column (a));

(ii) The aggregate dollar amount of all fees earned or paid in cash for services as a director, including annual retainer fees, committee and/or chairmanship fees, and meeting fees (column (b));

(iii) For awards of stock, the aggregate grant date fair value computed in accordance with FAS 123R (column (c));

(iv) For awards of stock options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FAS 123R (column (d));

*Instruction to Item 402(k)(2)(iii) and (iv).*

For each director, disclose by footnote to the appropriate column, the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end.

(v) The dollar value of all earnings for services performed during the fiscal year pursuant to non-equity incentive plans as defined in paragraph (a)(6)(iii) of this Item, and all earnings on any outstanding awards (column (e));

(vi) The sum of the amounts specified in paragraphs (k)(2)(vi)(A) and (B) of this Item (column (f)) as follows:

(A) The aggregate change in the actuarial present value of the director's accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans) from the pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the prior completed fiscal year to the pension plan measurement date used for financial statement reporting purposes with

respect to the registrant's audited financial statements for the covered fiscal year; and

(B) Above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans;

(vii) All other compensation for the covered fiscal year that the registrant could not properly report in any other column of the Director Compensation Table (column (g)). Each compensation item that is not properly reportable in columns (b)–(f), regardless of the amount of the compensation item, must be included in column (g). Such compensation must include, but is not limited to:

(A) Perquisites and other personal benefits, or property, unless the aggregate amount of such compensation is less than \$10,000;

(B) All "gross-ups" or other amounts reimbursed during the fiscal year for the payment of taxes;

(C) For any security of the registrant or its subsidiaries purchased from the registrant or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally, either to all security holders or to all salaried employees of the registrant, the compensation cost, if any, computed in accordance with FAS 123R;

(D) The amount paid or accrued to any director pursuant to a plan or arrangement in connection with:

(1) The resignation, retirement or any other termination of such director; or

(2) A change in control of the registrant;

(E) Registrant contributions or other allocations to vested and unvested defined contribution plans;

(F) Consulting fees earned from, or paid or payable by the registrant and/or its subsidiaries (including joint ventures);

(G) The annual costs of payments and promises of payments pursuant to director legacy programs and similar charitable award programs;

(H) The dollar value of any insurance premiums paid by, or on behalf of, the registrant during the covered fiscal year with respect to life insurance for the benefit of a director; and

(I) The dollar value of any dividends or other earnings paid on stock or option

awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d); and

*Instructions to Item 402(k)(2)(vii).*

1. Programs in which registrants agree to make donations to one or more charitable institutions in a director's name, payable by the registrant currently or upon a designated event, such as the retirement or death of the director, are charitable awards programs or director legacy programs for purposes of the disclosure required by paragraph (k)(2)(vii)(C) of this Item. Provide footnote disclosure of the total dollar amount payable under the program and other material terms of each such program for which tabular disclosure is provided.

2. Any item reported for a director pursuant to paragraph (k)(2)(vii) of this Item that is not a perquisite or personal benefit and whose value exceeds \$10,000 must be identified and quantified in a footnote to column (g). All items of compensation are required to be included in the Director Compensation Table without regard to whether such items are required to be identified other than as specifically noted in this Item.

3. Perquisites and personal benefits may be excluded as long as the total value of all perquisites and personal benefits for a director is less than \$10,000. If the total value of all perquisites and personal benefits is \$10,000 or more for any director, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a director pursuant to this rule, then each perquisite or personal benefit that exceeds the greater of \$25,000 or 10% of the total amount of perquisites and personal benefits for that director must be quantified and disclosed in a footnote. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the registrant. With respect to the perquisite or other personal benefit for which footnote quantification is required, the registrant shall describe in the footnote its methodology for computing the aggregate incremental cost. Reimbursements of taxes owed with respect to perquisites or other personal benefits must

be included in column (g) and are subject to separate quantification and identification as tax reimbursements (paragraph (k)(2)(vii)(B) of this Item) even if the associated prerequisites or other personal benefits are not required to be included because the total amount of all prerequisites or personal benefits for an individual director is less than \$10,000 or are required to be identified but are not required to be separately quantified.

(viii) The dollar value of total compensation for the covered fiscal year (column (h)). With respect to each director, disclose the sum of all amounts reported in columns (b) through (g).

*Instruction to Item 402(k)(2).*

Two or more directors may be grouped in a single row in the Table if all elements of their compensation are identical. The names of the directors for whom disclosure is presented on a group basis should be clear from the Table.

(3) *Narrative to director compensation table.* Provide a narrative description of any material factors necessary to an understanding of the director compensation disclosed in this Table. While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:

(i) A description of standard compensation arrangements (such as fees for retainer, committee service, service as chairman of the board or a committee, and meeting attendance); and

(ii) Whether any director has a different compensation arrangement, identifying that director and describing the terms of that arrangement.

*Instruction to Item 402(k).*

In addition to the Instructions to paragraph (k)(2)(vii) of this Item, the following apply equally to paragraph (k) of this Item: Instructions 2 and 4 to paragraph (c) of this Item; Instructions to paragraphs (c)(2)(iii) and (iv) of this Item; Instructions to paragraphs (c)(2)(v) and (vi) of this Item; Instructions to paragraph (c)(2)(vii) of this Item; and Instructions to paragraph (c)(2)(viii) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (k) of this Item that correspond to analogous disclosures provided for in paragraph (c) of this Item to which they refer.

*Instruction to Item 402.* Specify the applicable fiscal year in the title to each table required under this Item which calls for disclosure as of or for a completed fiscal year.

■ 14. Amend § 229.403 by revising paragraph (b) to read as follows:

**§ 229.403 (Item 403) Security ownership of certain beneficial owners and management.**

(b) *Security ownership of management.* Furnish the following

information, as of the most recent practicable date, in substantially the tabular form indicated, as to each class of equity securities of the registrant or any of its parents or subsidiaries, including directors' qualifying shares, beneficially owned by all directors and nominees, naming them, each of the named executive officers as defined in Item 402(a)(3) (§ 229.402(a)(3)), and directors and executive officers of the registrant as a group, without naming them. Show in column (3) the total number of shares beneficially owned and in column (4) the percent of the class so owned. Of the number of shares shown in column (3), indicate, by footnote or otherwise, the amount of shares that are pledged as security and the amount of shares with respect to which such persons have the right to acquire beneficial ownership as specified in § 240.13d-3(d)(1) of this chapter.

(1) Title of class	(2) Name of beneficial owner	(3) Amount and nature of beneficial ownership	(4) Percent of class

\* \* \* \* \*

■ 15. Revise § 229.404 to read as follows:

**§ 229.404 (Item 404) Transactions with related persons, promoters and certain control persons.**

(a) *Transactions with related persons.* Describe any transaction, since the beginning of the registrant's last fiscal year, or any currently proposed transaction, in which the registrant was or is to be a participant and the amount involved exceeds \$120,000, and in which any related person had or will have a direct or indirect material interest. Disclose the following information regarding the transaction:

(1) The name of the related person and the basis on which the person is a related person.

(2) The related person's interest in the transaction with the registrant, including the related person's position(s) or relationship(s) with, or ownership in, a firm, corporation, or other entity that is a party to, or has an interest in, the transaction.

(3) The approximate dollar value of the amount involved in the transaction.

(4) The approximate dollar value of the amount of the related person's interest in the transaction, which shall be computed without regard to the amount of profit or loss.

(5) In the case of indebtedness, disclosure of the amount involved in the transaction shall include the largest aggregate amount of principal outstanding during the period for which disclosure is provided, the amount thereof outstanding as of the latest practicable date, the amount of principal paid during the periods for which disclosure is provided, the amount of interest paid during the period for which disclosure is provided, and the rate or amount of interest payable on the indebtedness.

(6) Any other information regarding the transaction or the related person in the context of the transaction that is material to investors in light of the circumstances of the particular transaction.

*Instructions to Item 404(a).*

1. For the purposes of paragraph (a) of this Item, the term related person means:

a. Any person who was in any of the following categories at any time during the specified period for which disclosure under paragraph (a) of this Item is required:

i. Any director or executive officer of the registrant;

ii. Any nominee for director, when the information called for by paragraph (a) of this Item is being presented in a proxy or information statement relating to the election of that nominee for director; or

iii. Any immediate family member of a director or executive officer of the registrant, or of any nominee for director when the information called for by paragraph (a) of this Item is being presented in a proxy or information statement relating to the election of that nominee for director, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of such director, executive officer or nominee for director, and any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director; and

b. Any person who was in any of the following categories when a transaction in which such person had a direct or indirect material interest occurred or existed:

i. A security holder covered by Item 403(a) (§ 229.403(a)); or

ii. Any immediate family member of any such security holder, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of such security holder, and any person (other than a tenant or employee) sharing the household of such security holder.

2. For purposes of paragraph (a) of this Item, a transaction includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships.

3. The amount involved in the transaction shall be computed by determining the dollar value of the amount involved in the transaction in question, which shall include:

a. In the case of any lease or other transaction providing for periodic payments or installments, the aggregate amount of all periodic payments or installments due on or after the beginning of the registrant's last fiscal year, including any required or optional payments due during or at the conclusion of the lease or other transaction providing for periodic payments or installments; and

b. In the case of indebtedness, the largest aggregate amount of all indebtedness outstanding at any time since the beginning of the registrant's last fiscal year and all amounts of interest payable on it during the last fiscal year.

4. In the case of a transaction involving indebtedness:

a. The following items of indebtedness may be excluded from the calculation of the amount of indebtedness and need not be disclosed: Amounts due from the related person for purchases of goods and services subject to usual trade terms, for ordinary business travel and expense payments and for other transactions in the ordinary course of business;

b. Disclosure need not be provided of any indebtedness transaction for the related persons specified in Instruction 1.b. to paragraph (a) of this Item; and

c. If the lender is a bank, savings and loan association, or broker-dealer extending credit under Federal Reserve Regulation T (12 CFR part 220) and the loans are not disclosed as nonaccrual, past due, restructured or potential problems (see Item III.C.1. and 2. of Industry Guide 3, Statistical Disclosure by Bank Holding Companies (17 CFR 229.802(c))), disclosure under paragraph (a) of this Item may consist of a statement, if such is the case, that the loans to such persons:

i. Were made in the ordinary course of business;

ii. Were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the lender; and

iii. Did not involve more than the normal risk of collectibility or present other unfavorable features.

5.a. Disclosure of an employment relationship or transaction involving an executive officer and any related compensation solely resulting from that employment relationship or transaction need not be provided pursuant to paragraph (a) of this Item if:

i. The compensation arising from the relationship or transaction is reported pursuant to Item 402 (§ 229.402); or

ii. The executive officer is not an immediate family member (as specified in Instruction 1 to paragraph (a) of this Item) and such compensation would have been reported under Item 402 (§ 229.402) as compensation earned for services to the registrant if the executive officer was a named executive officer as that term is defined in Item 402(a)(3) (§ 229.402(a)(3)), and such compensation had been approved, or recommended to the board of directors of the registrant for approval, by the compensation committee of the board of

directors (or group of independent directors performing a similar function) of the registrant.

b. Disclosure of compensation to a director need not be provided pursuant to paragraph (a) of this Item if the compensation is reported pursuant to Item 402(k) (§ 229.402(k)).

6. A person who has a position or relationship with a firm, corporation, or other entity that engages in a transaction with the registrant shall not be deemed to have an indirect material interest within the meaning of paragraph (a) of this Item where:

a. The interest arises only:

i. From such person's position as a director of another corporation or organization that is a party to the transaction; or

ii. From the direct or indirect ownership by such person and all other persons specified in Instruction 1 to paragraph (a) of this Item, in the aggregate, of less than a ten percent equity interest in another person (other than a partnership) which is a party to the transaction; or

iii. From both such position and ownership; or

b. The interest arises only from such person's position as a limited partner in a partnership in which the person and all other persons specified in Instruction 1 to paragraph (a) of this Item, have an interest of less than ten percent, and the person is not a general partner of and does not hold another position in the partnership.

7. Disclosure need not be provided pursuant to paragraph (a) of this Item if:

a. The transaction is one where the rates or charges involved in the transaction are determined by competitive bids, or the transaction involves the rendering of services as a common or contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority;

b. The transaction involves services as a bank depository of funds, transfer agent, registrar, trustee under a trust indenture, or similar services; or

c. The interest of the related person arises solely from the ownership of a class of equity securities of the registrant and all holders of that class of equity securities of the registrant received the same benefit on a pro rata basis.

(b) *Review, approval or ratification of transactions with related persons.* (1) Describe the registrant's policies and procedures for the review, approval, or ratification of any transaction required to be reported under paragraph (a) of this Item. While the material features of such policies and procedures will vary depending on the particular circumstances, examples of such features may include, in given cases, among other things:

(i) The types of transactions that are covered by such policies and procedures;

(ii) The standards to be applied pursuant to such policies and procedures;

(iii) The persons or groups of persons on the board of directors or otherwise

who are responsible for applying such policies and procedures; and

(iv) A statement of whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced.

(2) Identify any transaction required to be reported under paragraph (a) of this Item since the beginning of the registrant's last fiscal year where such policies and procedures did not require review, approval or ratification or where such policies and procedures were not followed.

*Instruction to Item 404(b).*

Disclosure need not be provided pursuant to this paragraph regarding any transaction that occurred at a time before the related person became one of the enumerated persons in Instruction 1.a.i., ii., or iii. to Item 404(a) if such transaction did not continue after the related person became one of the enumerated persons in Instruction 1.a.i., ii., or iii. to Item 404(a).

(c) *Promoters and certain control persons.* (1) Registrants that are filing a registration statement on Form S-1 or Form SB-2 under the Securities Act (§ 239.11 or § 239.10 of this chapter) or on Form 10 or Form 10-SB under the Exchange Act (§ 249.210 or § 249.210b of this chapter) and that had a promoter at any time during the past five fiscal years shall:

(i) State the names of the promoter(s), the nature and amount of anything of value (including money, property, contracts, options or rights of any kind) received or to be received by each promoter, directly or indirectly, from the registrant and the nature and amount of any assets, services or other consideration therefore received or to be received by the registrant; and

(ii) As to any assets acquired or to be acquired by the registrant from a promoter, state the amount at which the assets were acquired or are to be acquired and the principle followed or to be followed in determining such amount, and identify the persons making the determination and their relationship, if any, with the registrant or any promoter. If the assets were acquired by the promoter within two years prior to their transfer to the registrant, also state the cost thereof to the promoter.

(2) Registrants shall provide the disclosure required by paragraphs (c)(1)(i) and (c)(1)(ii) of this Item as to any person who acquired control of a registrant that is a shell company, or any person that is part of a group, consisting of two or more persons that agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of a registrant, that acquired control of a registrant that is a shell

company. For purposes of this Item, *shell company* has the same meaning as in Rule 405 under the Securities Act (17 CFR 230.405) and Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2).

*Instructions to Item 404.*

1. If the information called for by this Item is being presented in a registration statement filed pursuant to the Securities Act or the Exchange Act, information shall be given for the periods specified in the Item and, in addition, for the two fiscal years preceding the registrant's last fiscal year, unless the information is being incorporated by reference into a registration statement on Form S-4 (17 CFR 239.25), in which case, information shall be given for the periods specified in the Item.

2. A foreign private issuer will be deemed to comply with this Item if it provides the information required by Item 7.B. of Form 20-F (17 CFR 249.220f) with more detailed information provided if otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded.

■ 16. Add § 229.407 to read as follows:

**§ 229.407 (Item 407) Corporate governance.**

(a) *Director independence.* Identify each director and, when the disclosure called for by this paragraph is being presented in a proxy or information statement relating to the election of directors, each nominee for director, that is independent under the independence standards applicable to the registrant under paragraph (a)(1) of this Item. In addition, if such independence standards contain independence requirements for committees of the board of directors, identify each director that is a member of the compensation, nominating or audit committee that is not independent under such committee independence standards. If the registrant does not have a separately designated audit, nominating or compensation committee or committee performing similar functions, the registrant must provide the disclosure of directors that are not independent with respect to all members of the board of directors applying such committee independence standards.

(1) In determining whether or not the director or nominee for director is independent for the purposes of paragraph (a) of this Item, the registrant shall use the applicable definition of independence, as follows:

(i) If the registrant is a listed issuer whose securities are listed on a national securities exchange or in an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, the registrant's definition of independence

that it uses for determining if a majority of the board of directors is independent in compliance with the listing standards applicable to the registrant. When determining whether the members of a committee of the board of directors are independent, the registrant's definition of independence that it uses for determining if the members of that specific committee are independent in compliance with the independence standards applicable for the members of the specific committee in the listing standards of the national securities exchange or inter-dealer quotation system that the registrant uses for determining if a majority of the board of directors are independent. If the registrant does not have independence standards for a committee, the independence standards for that specific committee in the listing standards of the national securities exchange or inter-dealer quotation system that the registrant uses for determining if a majority of the board of directors are independent.

(ii) If the registrant is not a listed issuer, a definition of independence of a national securities exchange or of an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, and state which definition is used. Whatever such definition the registrant chooses, it must use the same definition with respect to all directors and nominees for director. When determining whether the members of a specific committee of the board of directors are independent, if the national securities exchange or national securities association whose standards are used has independence standards for the members of a specific committee, use those committee specific standards.

(iii) If the information called for by paragraph (a) of this Item is being presented in a registration statement on Form S-1 (§ 239.11 of this chapter) or Form SB-2 (§ 239.10 of this chapter) under the Securities Act or on a Form 10 (§ 249.210 of this chapter) or Form 10-SB (§ 249.210b of this chapter) under the Exchange Act where the registrant has applied for listing with a national securities exchange or in an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, the definition of independence that the registrant uses for determining if a majority of the board of directors is independent, and the definition of independence that the registrant uses for determining if members of the specific committee of the board of directors are independent, that is in compliance with the independence

listing standards of the national securities exchange or inter-dealer quotation system on which it has applied for listing, or if the registrant has not adopted such definitions, the independence standards for determining if the majority of the board of directors is independent and if members of the committee of the board of directors are independent of that national securities exchange or inter-dealer quotation system.

(2) If the registrant uses its own definitions for determining whether its directors and nominees for director, and members of specific committees of the board of directors, are independent, disclose whether these definitions are available to security holders on the registrant's Web site. If so, provide the registrant's Web site address. If not, include a copy of these policies in an appendix to the registrant's proxy statement or information statement that is provided to security holders at least once every three fiscal years or if the policies have been materially amended since the beginning of the registrant's last fiscal year. If a current copy of the policies is not available to security holders on the registrant's Web site, and is not included as an appendix to the registrant's proxy statement or information statement, identify the most recent fiscal year in which the policies were so included in satisfaction of this requirement.

(3) For each director and nominee for director that is identified as independent, describe, by specific category or type, any transactions, relationships or arrangements not disclosed pursuant to Item 404(a) (§ 229.404(a)), or for investment companies, Item 22(b) of Schedule 14A (§ 240.14a-101 of this chapter), that were considered by the board of directors under the applicable independence definitions in determining that the director is independent.

*Instructions to Item 407(a).*

1. If the registrant is a listed issuer whose securities are listed on a national securities exchange or in an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, and also has exemptions to those requirements (for independence of a majority of the board of directors or committee member independence) upon which the registrant relied, disclose the exemption relied upon and explain the basis for the registrant's conclusion that such exemption is applicable. The same disclosure should be provided if the registrant is not a listed issuer and the national securities exchange or inter-dealer quotation system selected by the registrant has exemptions that are applicable to the registrant. Any national

securities exchange or inter-dealer quotation system which has requirements that at least 50 percent of the members of a small business issuer's board of directors must be independent shall be considered a national securities exchange or inter-dealer quotation system which has requirements that a majority of the board of directors be independent for the purposes of the disclosure required by paragraph (a) of this Item.

2. Registrants shall provide the disclosure required by paragraph (a) of this Item for any person who served as a director during any part of the last completed fiscal year, except that no information called for by paragraph (a) of this Item need be given in a registration statement filed at a time when the registrant is not subject to the reporting requirements of section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) respecting any director who is no longer a director at the time of effectiveness of the registration statement.

3. The description of the specific categories or types of transactions, relationships or arrangements required by paragraph (a)(3) of this Item must be provided in such detail as is necessary to fully describe the nature of the transactions, relationships or arrangements.

(b) *Board meetings and committees; annual meeting attendance.* (1) State the total number of meetings of the board of directors (including regularly scheduled and special meetings) which were held during the last full fiscal year. Name each incumbent director who during the last full fiscal year attended fewer than 75 percent of the aggregate of:

(i) The total number of meetings of the board of directors (held during the period for which he has been a director); and

(ii) The total number of meetings held by all committees of the board on which he served (during the periods that he served).

(2) Describe the registrant's policy, if any, with regard to board members' attendance at annual meetings of security holders and state the number of board members who attended the prior year's annual meeting.

*Instruction to Item 407(b)(2).*

In lieu of providing the information required by paragraph (b)(2) of this Item in the proxy statement, the registrant may instead provide the registrant's Web site address where such information appears.

(3) State whether or not the registrant has standing audit, nominating and compensation committees of the board of directors, or committees performing similar functions. If the registrant has such committees, however designated, identify each committee member, state the number of committee meetings held by each such committee during the last fiscal year and describe briefly the functions performed by each such

committee. Such disclosure need not be provided to the extent it is duplicative of disclosure provided in accordance with paragraph (c), (d) or (e) of this Item.

(c) *Nominating committee.* (1) If the registrant does not have a standing nominating committee or committee performing similar functions, state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a committee and identify each director who participates in the consideration of director nominees.

(2) Provide the following information regarding the registrant's director nomination process:

(i) State whether or not the nominating committee has a charter. If the nominating committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the nominating committee charter;

(ii) If the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, provide a description of the material elements of that policy, which shall include, but need not be limited to, a statement as to whether the committee will consider director candidates recommended by security holders;

(iii) If the nominating committee does not have a policy with regard to the consideration of any director candidates recommended by security holders, state that fact and state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a policy;

(iv) If the nominating committee will consider candidates recommended by security holders, describe the procedures to be followed by security holders in submitting such recommendations;

(v) Describe any specific minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for a position on the registrant's board of directors, and describe any specific qualities or skills that the nominating committee believes are necessary for one or more of the registrant's directors to possess;

(vi) Describe the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether the nominee is recommended by a security holder;

(vii) With regard to each nominee approved by the nominating committee

for inclusion on the registrant's proxy card (other than nominees who are executive officers or who are directors standing for re-election), state which one or more of the following categories of persons or entities recommended that nominee: Security holder, non-management director, chief executive officer, other executive officer, third-party search firm, or other specified source. With regard to each such nominee approved by a nominating committee of an investment company, state which one or more of the following additional categories of persons or entities recommended that nominee: Security holder, director, chief executive officer, other executive officer, or employee of the investment company's investment adviser, principal underwriter, or any affiliated person of the investment adviser or principal underwriter;

(viii) If the registrant pays a fee to any third party or parties to identify or evaluate or assist in identifying or evaluating potential nominees, disclose the function performed by each such third party; and

(ix) If the registrant's nominating committee received, by a date not later than the 120th calendar day before the date of the registrant's proxy statement released to security holders in connection with the previous year's annual meeting, a recommended nominee from a security holder that beneficially owned more than 5% of the registrant's voting common stock for at least one year as of the date the recommendation was made, or from a group of security holders that beneficially owned, in the aggregate, more than 5% of the registrant's voting common stock, with each of the securities used to calculate that ownership held for at least one year as of the date the recommendation was made, identify the candidate and the security holder or security holder group that recommended the candidate and disclose whether the nominating committee chose to nominate the candidate, *provided, however*, that no such identification or disclosure is required without the written consent of both the security holder or security holder group and the candidate to be so identified.

*Instructions to Item 407(c)(2)(ix).*

1. For purposes of paragraph (c)(2)(ix) of this Item, the percentage of securities held by a nominating security holder may be determined using information set forth in the registrant's most recent quarterly or annual report, and any current report subsequent thereto, filed with the Commission pursuant to the Exchange Act (or, in the case of a registrant that is an investment company

registered under the Investment Company Act of 1940, the registrant's most recent report on Form N-CSR (§§ 249.331 and 274.128 of this chapter), unless the party relying on such report knows or has reason to believe that the information contained therein is inaccurate.

2. For purposes of the registrant's obligation to provide the disclosure specified in paragraph (c)(2)(ix) of this Item, where the date of the annual meeting has been changed by more than 30 days from the date of the previous year's meeting, the obligation under that Item will arise where the registrant receives the security holder recommendation a reasonable time before the registrant begins to print and mail its proxy materials.

3. For purposes of paragraph (c)(2)(ix) of this Item, the percentage of securities held by a recommending security holder, as well as the holding period of those securities, may be determined by the registrant if the security holder is the registered holder of the securities. If the security holder is not the registered owner of the securities, he or she can submit one of the following to the registrant to evidence the required ownership percentage and holding period:

a. A written statement from the "record" holder of the securities (usually a broker or bank) verifying that, at the time the security holder made the recommendation, he or she had held the required securities for at least one year; or

b. If the security holder has filed a Schedule 13D (§ 240.13d-101 of this chapter), Schedule 13G (§ 240.13d-102 of this chapter), Form 3 (§ 249.103 of this chapter), Form 4 (§ 249.104 of this chapter), and/or Form 5 (§ 249.105 of this chapter), or amendments to those documents or updated forms, reflecting ownership of the securities as of or before the date of the recommendation, a copy of the schedule and/or form, and any subsequent amendments reporting a change in ownership level, as well as a written statement that the security holder continuously held the securities for the one-year period as of the date of the recommendation.

4. For purposes of the registrant's obligation to provide the disclosure specified in paragraph (c)(2)(ix) of this Item, the security holder or group must have provided to the registrant, at the time of the recommendation, the written consent of all parties to be identified and, where the security holder or group members are not registered holders, proof that the security holder or group satisfied the required ownership percentage and holding period as of the date of the recommendation.

Instruction to Item 407(c)(2).

For purposes of paragraph (c)(2) of this Item, the term *nominating committee* refers not only to nominating committees and committees performing similar functions, but also to groups of directors fulfilling the role of a nominating committee, including the entire board of directors.

(3) Describe any material changes to the procedures by which security holders may recommend nominees to the registrant's board of directors, where those changes were implemented after

the registrant last provided disclosure in response to the requirements of paragraph (c)(2)(iv) of this Item, or paragraph (c)(3) of this Item.

*Instructions to Item 407(c)(3).*

1. The disclosure required in paragraph (c)(3) of this Item need only be provided in a registrant's quarterly or annual reports.

2. For purposes of paragraph (c)(3) of this Item, adoption of procedures by which security holders may recommend nominees to the registrant's board of directors, where the registrant's most recent disclosure in response to the requirements of paragraph (c)(2)(iv) of this Item, or paragraph (c)(3) of this Item, indicated that the registrant did not have in place such procedures, will constitute a material change.

(d) *Audit committee.* (1) State whether or not the audit committee has a charter. If the audit committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the audit committee charter.

(2) If a listed issuer's board of directors determines, in accordance with the listing standards applicable to the issuer, to appoint a director to the audit committee who is not independent (apart from the requirements in § 240.10A-3 of this chapter), including as a result of exceptional or limited or similar circumstances, disclose the nature of the relationship that makes that individual not independent and the reasons for the board of directors' determination.

(3)(i) The audit committee must state whether:

(A) The audit committee has reviewed and discussed the audited financial statements with management;

(B) The audit committee has discussed with the independent auditors the matters required to be discussed by the statement on Auditing Standards No. 61, as amended (AICPA, *Professional Standards*, Vol. 1. AU section 380),<sup>1</sup> as adopted by the Public Company Accounting Oversight Board in Rule 3200T;

(C) The audit committee has received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*),<sup>2</sup> as adopted by the Public Company Accounting Oversight Board in Rule 3600T, and has discussed with the independent accountant the

independent accountant's independence; and

(D) Based on the review and discussions referred to in paragraphs (d)(3)(i)(A) through (d)(3)(i)(C) of this Item, the audit committee recommended to the board of directors that the audited financial statements be included in the company's annual report on Form 10-K (17 CFR 249.310) (or, for closed-end investment companies registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*), the annual report to shareholders required by section 30(e) of the Investment Company Act of 1940 (15 U.S.C. 80a-29(e)) and Rule 30d-1 (17 CFR 270.30d-1) thereunder) for the last fiscal year for filing with the Commission.

(ii) The name of each member of the company's audit committee (or, in the absence of an audit committee, the board committee performing equivalent functions or the entire board of directors) must appear below the disclosure required by paragraph (d)(3)(i) of this Item.

(4)(i) If the registrant meets the following requirements, provide the disclosure in paragraph (d)(4)(ii) of this Item:

(A) The registrant is a listed issuer, as defined in § 240.10A-3 of this chapter;

(B) The registrant is filing either an annual report on Form 10-K or 10-KSB (17 CFR 249.310 or 17 CFR 249.310b), or a proxy statement or information statement pursuant to the Exchange Act (15 U.S.C. 78a *et seq.*) if action is to be taken with respect to the election of directors; and

(C) The registrant is neither:

(1) A subsidiary of another listed issuer that is relying on the exemption in § 240.10A-3(c)(2) of this chapter; nor

(2) Relying on any of the exemptions in § 240.10A-3(c)(4) through (c)(7) of this chapter.

(ii)(A) State whether or not the registrant has a separately-designated standing audit committee established in accordance with section 3(a)(58)(A) of the Exchange Act (15 U.S.C. 78c(a)(58)(A)), or a committee performing similar functions. If the registrant has such a committee, however designated, identify each committee member. If the entire board of directors is acting as the registrant's audit committee as specified in section 3(a)(58)(B) of the Exchange Act (15 U.S.C. 78c(a)(58)(B)), so state.

(B) If applicable, provide the disclosure required by § 240.10A-3(d) of this chapter regarding an exemption from the listing standards for audit committees.

(5) *Audit committee financial expert.*

<sup>1</sup> Available at [http://www.pcaobus.org/standards/interim\\_standards/auditing\\_standards/index\\_av.asp?series=300&section=300](http://www.pcaobus.org/standards/interim_standards/auditing_standards/index_av.asp?series=300&section=300).

<sup>2</sup> Available at [http://www.pcaobus.org/Standards/Interim\\_Standards/Independence\\_Standards/ISB1.pdf](http://www.pcaobus.org/Standards/Interim_Standards/Independence_Standards/ISB1.pdf).

(i)(A) Disclose that the registrant's board of directors has determined that the registrant either:

(1) Has at least one audit committee financial expert serving on its audit committee; or

(2) Does not have an audit committee financial expert serving on its audit committee.

(B) If the registrant provides the disclosure required by paragraph (d)(5)(i)(A)(1) of this Item, it must disclose the name of the audit committee financial expert and whether that person is independent, as *independence for audit committee members* is defined in the listing standards applicable to the listed issuer.

(C) If the registrant provides the disclosure required by paragraph (d)(5)(i)(A)(2) of this Item, it must explain why it does not have an audit committee financial expert.

*Instruction to Item 407(d)(5)(i).*

If the registrant's board of directors has determined that the registrant has more than one audit committee financial expert serving on its audit committee, the registrant may, but is not required to, disclose the names of those additional persons. A registrant choosing to identify such persons must indicate whether they are independent pursuant to paragraph (d)(5)(i)(B) of this Item.

(ii) For purposes of this Item, an *audit committee financial expert* means a person who has the following attributes:

(A) An understanding of generally accepted accounting principles and financial statements;

(B) The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;

(C) Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities;

(D) An understanding of internal control over financial reporting; and

(E) An understanding of audit committee functions.

(iii) A person shall have acquired such attributes through:

(A) Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;

(B) Experience actively supervising a principal financial officer, principal

accounting officer, controller, public accountant, auditor or person performing similar functions;

(C) Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or

(D) Other relevant experience.

(iv) *Safe harbor.* (A) A person who is determined to be an audit committee financial expert will not be deemed an *expert* for any purpose, including without limitation for purposes of section 11 of the Securities Act (15 U.S.C. 77k), as a result of being designated or identified as an audit committee financial expert pursuant to this Item 407.

(B) The designation or identification of a person as an audit committee financial expert pursuant to this Item 407 does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification.

(C) The designation or identification of a person as an audit committee financial expert pursuant to this Item does not affect the duties, obligations or liability of any other member of the audit committee or board of directors.

*Instructions to Item 407(d)(5).*

1. The disclosure under paragraph (d)(5) of this Item is required only in a registrant's annual report. The registrant need not provide the disclosure required by paragraph (d)(5) of this Item in a proxy or information statement unless that registrant is electing to incorporate this information by reference from the proxy or information statement into its annual report pursuant to General Instruction G(3) to Form 10-K (17 CFR 249.310).

2. If a person qualifies as an audit committee financial expert by means of having held a position described in paragraph (d)(5)(iii)(D) of this Item, the registrant shall provide a brief listing of that person's relevant experience. Such disclosure may be made by reference to disclosures required under Item 401(e) (§ 229.401(e)).

3. In the case of a foreign private issuer with a two-tier board of directors, for purposes of paragraph (d)(5) of this Item, the term *board of directors* means the supervisory or non-management board. In the case of a foreign private issuer meeting the requirements of § 240.10A-3(c)(3) of this chapter, for purposes of paragraph (d)(5) of this Item, the term *board of directors* means the issuer's board of auditors (or similar body) or statutory auditors, as applicable. Also, in the case of a foreign private issuer, the term *generally accepted accounting principles* in paragraph (d)(5)(ii)(A) of this Item means the body of generally accepted accounting principles used by that issuer in its primary financial statements filed with the Commission.

4. A registrant that is an Asset-Backed Issuer (as defined in § 229.1101) is not required to disclose the information required by paragraph (d)(5) of this Item.

*Instructions to Item 407(d).*

1. The information required by paragraphs (d)(1)-(3) of this Item shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 through 240.14b-2 or 240.14c-1 through 240.14c-101), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act. Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

2. The disclosure required by paragraphs (d)(1)-(3) of this Item need only be provided one time during any fiscal year.

3. The disclosure required by paragraph (d)(3) of this Item need not be provided in any filings other than a registrant's proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting).

(e) *Compensation committee.* (1) If the registrant does not have a standing compensation committee or committee performing similar functions, state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a committee and identify each director who participates in the consideration of executive officer and director compensation.

(2) State whether or not the compensation committee has a charter. If the compensation committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the compensation committee charter.

(3) Provide a narrative description of the registrant's processes and procedures for the consideration and determination of executive and director compensation, including:

(i)(A) The scope of authority of the compensation committee (or persons performing the equivalent functions); and

(B) The extent to which the compensation committee (or persons performing the equivalent functions) may delegate any authority described in paragraph (e)(3)(i)(A) of this Item to other persons, specifying what authority may be so delegated and to whom;

(ii) Any role of executive officers in determining or recommending the amount or form of executive and director compensation; and

(iii) Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether such consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

(4) Under the caption "Compensation Committee Interlocks and Insider Participation":

(i) Identify each person who served as a member of the compensation committee of the registrant's board of directors (or board committee performing equivalent functions) during the last completed fiscal year, indicating each committee member who:

(A) Was, during the fiscal year, an officer or employee of the registrant;

(B) Was formerly an officer of the registrant; or

(C) Had any relationship requiring disclosure by the registrant under any paragraph of Item 404 (§ 229.404). In this event, the disclosure required by Item 404 (§ 229.404) shall accompany such identification.

(ii) If the registrant has no compensation committee (or other board committee performing equivalent functions), the registrant shall identify each officer and employee of the registrant, and any former officer of the registrant, who, during the last completed fiscal year, participated in deliberations of the registrant's board of directors concerning executive officer compensation.

(iii) Describe any of the following relationships that existed during the last completed fiscal year:

(A) An executive officer of the registrant served as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served on the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of the registrant;

(B) An executive officer of the registrant served as a director of another entity, one of whose executive officers served on the compensation committee (or other board committee performing equivalent functions or, in the absence

of any such committee, the entire board of directors) of the registrant; and

(C) An executive officer of the registrant served as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served as a director of the registrant.

(iv) Disclosure required under paragraph (e)(4)(iii) of this Item regarding a compensation committee member or other director of the registrant who also served as an executive officer of another entity shall be accompanied by the disclosure called for by Item 404 with respect to that person.

*Instruction to Item 407(e)(4).*

For purposes of paragraph (e)(4) of this Item, the term *entity* shall not include an entity exempt from tax under section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501(c)(3)).

(5) Under the caption "Compensation Committee Report":

(i) The compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) must state whether:

(A) The compensation committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) (§ 229.402(b)) with management; and

(B) Based on the review and discussions referred to in paragraph (e)(5)(i)(A) of this Item, the compensation committee recommended to the board of directors that the Compensation Discussion and Analysis be included in the registrant's annual report on Form 10-K (§ 249.310 of this chapter), proxy statement on Schedule 14A (§ 240.14a-101 of this chapter) or information statement on Schedule 14C (§ 240.14c-101 of this chapter).

(ii) The name of each member of the registrant's compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) must appear below the disclosure required by paragraph (e)(5)(i) of this Item.

*Instructions to Item 407(e)(5).*

1. The information required by paragraph (e)(5) of this Item shall not be deemed to be "soliciting material," or to be "filed" with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 through 240.14b-2 or 240.14c-1 through 240.14c-101), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically requests that the

information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

2. The disclosure required by paragraph (e)(5) of this Item need not be provided in any filings other than an annual report on Form 10-K (§ 249.310 of this chapter), a proxy statement on Schedule 14A (§ 240.14a-101 of this chapter) or an information statement on Schedule 14C (§ 240.14c-101 of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference. If the registrant elects to incorporate this information by reference from the proxy or information statement into its annual report on Form 10-K pursuant to General Instruction G(3) to Form 10-K, the disclosure required by paragraph (e)(5) of this Item will be deemed furnished in the annual report on Form 10-K and will not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act as a result of furnishing the disclosure in this manner.

3. The disclosure required by paragraph (e)(5) of this Item need only be provided one time during any fiscal year.

(f) *Shareholder communications.* (1) State whether or not the registrant's board of directors provides a process for security holders to send communications to the board of directors and, if the registrant does not have such a process for security holders to send communications to the board of directors, state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a process.

(2) If the registrant has a process for security holders to send communications to the board of directors:

(i) Describe the manner in which security holders can send communications to the board and, if applicable, to specified individual directors; and

(ii) If all security holder communications are not sent directly to board members, describe the registrant's process for determining which communications will be relayed to board members.

*Instructions to Item 407(f).*

1. In lieu of providing the information required by paragraph (f)(2) of this Item in the proxy statement, the registrant may instead provide the registrant's Web site address where such information appears.

2. For purposes of the disclosure required by paragraph (f)(2)(ii) of this Item, a registrant's process for collecting and organizing security holder communications, as well as similar or related activities, need not be disclosed provided that the registrant's process is approved by a majority of the independent directors or, in the case of a

registrant that is an investment company, a majority of the directors who are not "interested persons" of the investment company as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)).

3. For purposes of this paragraph, communications from an officer or director of the registrant will not be viewed as "security holder communications." Communications from an employee or agent of the registrant will be viewed as "security holder communications" for purposes of this paragraph only if those communications are made solely in such employee's or agent's capacity as a security holder.

4. For purposes of this paragraph, security holder proposals submitted pursuant to § 240.14a-8 of this chapter, and communications made in connection with such proposals, will not be viewed as "security holder communications."

*Instructions to Item 407.*

1. For purposes of this Item:

a. *Listed issuer* means a listed issuer as defined in § 240.10A-3 of this chapter;

b. *National securities exchange* means a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a));

c. *Inter-dealer quotation system* means an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)); and

d. *National securities association* means a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that has been approved by the Commission (as that definition may be modified or supplemented).

2. With respect to paragraphs (c)(2)(i), (d)(1) and (e)(2) of this Item, disclose whether a current copy of the applicable committee charter is available to security holders on the registrant's Web site, and if so, provide the registrant's Web site address. If a current copy of the charter is not available to security holders on the registrant's Web site, include a copy of the charter in an appendix to the registrant's proxy or information statement that is provided to security holders at least once every three fiscal years, or if the charter has been materially amended since the beginning of the registrant's last fiscal year. If a current copy of the charter is not available to security holders on the registrant's Web site, and is not included as an appendix to the registrant's proxy or information statement, identify in which of the prior fiscal years the charter was so included in satisfaction of this requirement.

■ 17. Amend § 229.601 to revise paragraph (b)(10)(iii)(C)(5) to read as follows:

**§ 229.601 (Item 601) Exhibits.**

- \* \* \*
- (b) \* \* \*
- (10) \* \* \*
- (iii) \* \* \*
- (C) \* \* \*

(5) Any compensatory plan, contract or arrangement if the registrant is a

foreign private issuer that furnishes compensatory information under Item 402(a)(1) (§ 229.402(a)(1)) and the public filing of the plan, contract or arrangement, or portion thereof, is not required in the registrant's home country and is not otherwise publicly disclosed by the registrant.

\* \* \* \* \*

■ 18. Amend § 229.1107 by revising paragraph (e) to read as follows:

**§ 229.1107 (Item 1107) Issuing entities.**

\* \* \* \* \*

(e) If the issuing entity has executive officers, a board of directors or persons performing similar functions, provide the information required by Items 401, 402, 403, 404 and 407(a), (c)(3), (d)(4), (d)(5) and (e)(4) of Regulation S-K (§§ 229.401, 229.402, 229.403, 229.404 and 229.407(a), (c)(3), (d)(4), (d)(5) and (e)(4)) for the issuing entity.

\* \* \* \* \*

**PART 232—REGULATION S-T—  
GENERAL RULES AND REGULATIONS  
FOR ELECTRONIC FILINGS**

■ 19. The authority citation for part 232 continues to read in part as follows:

*Authority:* 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78l(d), 79f(a), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 *et seq.*; and 18 U.S.C. 1350.

\* \* \* \* \*

■ 20. Amend § 232.304 to revise paragraphs (d) and (e) to read as follows:

**§ 232.304 Graphic, image, audio and video material.**

\* \* \* \* \*

(d) For electronically filed ASCII documents, the performance graph that is to appear in registrant annual reports to security holders required by Exchange Act Rule 14a-3 (§ 240.14a-3 of this chapter) or Exchange Act Rule 14c-3 (§ 240.14c-3 of this chapter) to precede or accompany proxy statements or information statements relating to annual meetings of security holders at which directors are to be elected (or special meetings or written consents in lieu of such meetings), as required by Item 201(e) of Regulation S-K (§ 229.201(e) of this chapter), and the line graph that is to appear in registrant annual reports to security holders, as required by paragraph (b)(7)(ii) of Item 22 of Form N-1A (§ 274.11A of this chapter), must be furnished to the Commission by presenting the data in tabular or chart form within the electronic ASCII document, in compliance with paragraph (a) of this section and the formatting requirements of the EDGAR Filer Manual.

(e) Notwithstanding the provisions of paragraphs (a) through (d) of this section, electronically filed HTML documents must present the following information in an HTML graphic or image file within the electronic submission in compliance with the formatting requirements of the EDGAR Filer Manual: The performance graph that is to appear in registrant annual reports to security holders required by Exchange Act Rule 14a-3 (§ 240.14a-3 of this chapter) or Exchange Act Rule 14c-3 (§ 240.14c-3 of this chapter) to precede or accompany registrant proxy statements or information statements relating to annual meetings of security holders at which directors are to be elected (or special meetings or written consents in lieu of such meetings), as required by Item 201(e) of Regulation S-K (§ 229.201(e) of this chapter); the line graph that is to appear in registrant annual reports to security holders, as required by paragraph (b)(7)(ii) of Item 22 of Form N-1A (§ 274.11A of this chapter); and any other graphic material required by rule or form to be filed with the Commission. Filers may, but are not required to, submit any other graphic material in a HTML document by presenting the data in an HTML graphic or image file within the electronic filing, in compliance with the formatting requirements of the EDGAR Filer Manual. However, filers may not present in a graphic or image file information such as text or tables that users must be able to search and/or download into spreadsheet form (e.g., financial statements); filers must present such material as text in an ASCII document or as text or an HTML table in an HTML document.

\* \* \* \* \*

**PART 239—FORMS PRESCRIBED  
UNDER THE SECURITIES ACT OF 1933**

■ 21. The authority citation for part 239 continues to read in part as follows:

*Authority:* 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78l(d), 77mm, 79e, 79f, 79g, 79j, 79l, 79m, 79n, 79q, 79t, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

■ 22. Amend Form SB-2 (referenced in § 239.10) by revising Item 15 to read as follows:

*Note:* The text of Form SB-2 does not, and this amendment will not, appear in the Code of Federal Regulations.

Form SB-2

Registration Statement Under the Securities Act of 1933

Item 15. Certain Relationships and Transactions and Corporate Governance.

Furnish the information required by Item 404 of Regulation S-B and Item 407(a) of Regulation S-B.

23. Amend Form S-1 (referenced in § 239.11) by revising Item 11, paragraphs (l) and (n) to read as follows:

Note: The text of Form S-1 does not, and this amendment will not, appear in the Code of Federal Regulations.

Form S-1

Registration Statement Under the Securities Act of 1933

Item 11. Information with Respect to the Registrant.

(l) Information required by Item 402 of Regulation S-K (§ 229.402 of this chapter), executive compensation, and information required by paragraph (e)(4) of Item 407 of Regulation S-K (§ 229.407 of this chapter), corporate governance;

(n) Information required by Item 404 of Regulation S-K (§ 229.404 of this chapter), transactions with related persons, promoters and certain control persons, and Item 407(a) of Regulation S-K (§ 229.407(a) of this chapter), corporate governance.

24. Amend Form S-3 (referenced § 239.13) by revising General Instruction I.A.3.(b) and the introductory text of General Instruction I.B.4.(c) to read as follows:

Note: The text of Form S-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

Form S-3

Registration Statement Under the Securities Act of 1933

General Instructions

I. Eligibility Requirements for Use of Form S-3

A. Registrant Requirements.

(b) has filed in a timely manner all reports required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement, other than a report that is required solely

pursuant to Item 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a) or 5.02(e) of Form 8-K (§ 249.308 of this chapter). If the registrant has used (during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b-25(b) (§ 240.12b-25(b) of this chapter) under the Exchange Act with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that rule.

B. Transaction Requirements.

(c) The issuer also must have provided, within the twelve calendar months immediately before the Form S-3 registration statement is filed, the information required by Items 401, 402, 403 and 407(c)(3), (d)(4), (d)(5) and (e)(4) of Regulation S-K (§ 229.401—§ 229.403 and § 229.407(c)(3),(d)(4), (d)(5) and (e)(4) of this chapter) to:

25. Amend Form S-4 (referenced in § 239.25) by revising Items 18(a)(7)(ii) and (iii) and 19(a)(7)(ii) and (iii) to read as follows:

Note: The text of Form S-4 does not, and this amendment will not, appear in the Code of Federal Regulations.

Form S-4

Registration Statement Under the Securities Act of 1933

Item 18. Information if Proxies, Consents or Authorizations are to be Solicited.

(ii) Item 402 of Regulation S-K (§ 229.402 of this chapter), executive compensation, and paragraph (e)(4) of Item 407 of Regulation S-K (§ 229.407(e)(4) of this chapter), corporate governance;

(iii) Item 404 of Regulation S-K (§ 229.404 of this chapter), transactions with related persons, promoters and certain control persons, and Item 407(a) of Regulation S-K (§ 229.407(a) of this chapter), corporate governance.

Item 19. Information if Proxies, Consents or Authorizations are not to be Solicited or in an Exchange Offer.

(ii) Item 402 of Regulation S-K (§ 229.402 of this chapter), executive compensation, and paragraph (e)(4) of Item 407 of Regulation S-K (§ 229.407(e)(4) of this chapter), corporate governance;

(iii) Item 404 of Regulation S-K (§ 229.404), transactions with related persons, promoters and certain controls persons, and Item 407(a) of Regulation S-K (§ 229.407(a)), corporate governance.

26. Amend Form S-11 (referenced in § 239.18) by revising Items 22 and 23 to read as follows:

Note: The text of Form S-11 does not, and this amendment will not, appear in the Code of Federal Regulations.

Form S-11

For Registration Under the Securities Act of 1933 of Securities of Certain Real Estate Companies

Item 22. Executive Compensation.

Furnish the information required by Item 402 of Regulation S-K (§ 229.402 of this chapter), and the information required by paragraph (e)(4) of Item 407 of Regulation S-K (§ 229.407(e)(4) of this chapter).

Item 23. Certain Relationships and Related Transactions and Director Independence.

Furnish the information required by Items 404 and 407(a) of Regulation S-K (§§ 229.404 and 229.407(a) of this chapter). If a transaction involves the purchase or sale of assets by or to the registrant, otherwise than in the ordinary course of business, state the cost of the assets to the purchaser and, if acquired by the seller within two years prior to the transaction, the cost thereof to the seller. Furthermore, if the assets have been acquired by the seller within five years prior to the transaction, disclose the aggregate depreciation claimed by the seller for federal income tax purposes. Indicate the principle followed in determining the registrant's purchase or sale price and the name of the person making such determination.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

27. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77mnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

28. Amend § 240.13a-11 by revising paragraph (c) to read as follows:

**§ 240.13a-11 Current reports on Form 8-K (§ 249.308 of this chapter).**

(c) No failure to file a report on Form 8-K that is required solely pursuant to Item 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) or 6.03 of Form 8-K shall be deemed to be a violation of 15 U.S.C. 78j(b) and § 240.10b-5.

■ 29. Add § 240.13a-20 to read as follows:

**§ 240.13a-20 Plain English presentation of specified information.**

(a) Any information included or incorporated by reference in a report filed under section 13(a) of the Act (15 U.S.C. 78m(a)) that is required to be disclosed pursuant to Item 402, 403, 404 or 407 of Regulation S-B (§§ 228.402, 228.403, 228.404 or 228.407 of this chapter) or Item 402, 403, 404 or 407 of Regulation S-K (§§ 229.402, 229.403, 229.404 or 229.407 of this chapter) must be presented in a clear, concise and understandable manner. You must prepare the disclosure using the following standards:

- (1) Present information in clear, concise sections, paragraphs and sentences;
- (2) Use short sentences;
- (3) Use definite, concrete, everyday words;
- (4) Use the active voice;
- (5) Avoid multiple negatives;
- (6) Use descriptive headings and subheadings;
- (7) Use a tabular presentation or bullet lists for complex material, wherever possible;
- (8) Avoid legal jargon and highly technical business and other terminology;
- (9) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and
- (10) In designing the presentation of the information you may include pictures, logos, charts, graphs and other design elements so long as the design is not misleading and the required information is clear. You are encouraged to use tables, schedules, charts and graphic illustrations that present relevant data in an understandable manner, so long as such presentations are consistent with applicable disclosure requirements and consistent with other information in the document. You must draw graphs and charts to scale. Any information you provide must not be misleading.

(b) [Reserved]

**Note to § 240.13a-20.** In drafting the disclosure to comply with this section, you should avoid the following:

- 1. Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;
- 2. Vague "boilerplate" explanations that are imprecise and readily subject to different interpretations;
- 3. Complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and
- 4. Disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

■ 30. Amend § 240.14a-3 to revise paragraph (b)(9) to read as follows:

**§ 240.14a-3 Information to be furnished to security holders.**

(9) The report shall contain the market price of and dividends on the registrant's common equity and related security holder matters required by Items 201(a), (b) and (c) of Regulation S-K (§ 229.201(a), (b) and (c) of this chapter). If the report precedes or accompanies a proxy statement or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting), furnish the performance graph required by Item 201(e) (§ 229.201(e) of this chapter).

■ 31. Amend § 240.14a-6 to revise paragraph (a)(4) to read as follows:

**§ 240.14a-6 Filing requirements.**

(4) The approval or ratification of a plan as defined in paragraph (a)(6)(ii) of Item 402 of Regulation S-K (§ 229.402(a)(6)(ii) of this chapter) or amendments to such a plan;

■ 32. Amend § 240.14a-101 by:

- a. Removing paragraphs (f), (g), and (h) of Item 7 and paragraph (b)(13)(iii) of Item 22;
- b. Revising "\$60,000" to read "\$120,000" in the introductory text of Items 22(b)(7), (b)(8), and (b)(9); Instruction 2 to Item 22(b)(7); and Instruction 6 to Item 22(b)(9);
- c. Revising Note C, Item 7(b), (c), (d), and (e), the introductory text of Item 8, the undesignated paragraph following Item 8(d), Item 10(b)(1)(ii), the Instruction to Item 10(b)(1)(ii), Instruction 1 to Item 10, the introductory text of Item 22(b), Item 22(b)(11), the Instruction to paragraph (b)(11) of Item 22, and the introductory text of Item 22(b)(13); and

■ d. Adding Items 22(b)(15), (b)(16), and (b)(17).

The revisions and additions read as follows:

**§ 240.14a-101 Schedule 14A. Information required in proxy statement.**

Notes.

C. Except as otherwise specifically provided, where any item calls for information for a specified period with regard to directors, executive officers, officers or other persons holding specified positions or relationships, the information shall be given with regard to any person who held any of the specified positions or relationship at any time during the period. Information, other than information required by Item 404 of Regulation S-B (§ 228.404 of this chapter) or Item 404 of Regulation S-K (§ 229.404 of this chapter), need not be included for any portion of the period during which such person did not hold any such position or relationship, provided a statement to that effect is made.

*Item 7. Directors and executive officers.*

(b) The information required by Items 401, 404(a) and (b), 405 and 407(d)(4) and (d)(5) of Regulation S-K (§ 229.401, § 229.404(a) and (b), § 229.405 and § 229.407(d)(4) and (d)(5) of this chapter).

(c) The information required by Item 407(a) of Regulation S-K (§ 229.407 of this chapter).

(d) The information required by Item 407(b), (c)(1), (c)(2), (d)(1), (d)(2), (d)(3), (e)(1), (e)(2), (e)(3) and (f) of Regulation S-K (§ 229.407(b), (c)(1), (c)(2), (d)(1), (d)(2), (d)(3), (e)(1), (e)(2), (e)(3) and (f) of this chapter).

(e) In lieu of the information required by this Item 7, investment companies registered under the Investment Company Act of 1940 (15 U.S.C. 80a) must furnish the information required by Item 22(b) of this Schedule 14A.

*Item 8. Compensation of directors and executive officers.*

Furnish the information required by Item 402 of Regulation S-K (§ 229.402 of this chapter) and paragraphs (e)(4) and (e)(5) of Item 407 of Regulation S-K (§ 229.407(e)(4) and (e)(5) of this chapter) if action is to be taken with regard to:

(d) \* \* \*

However, if the solicitation is made on behalf of persons other than the registrant, the information required need be furnished only as to nominees of the persons making the solicitation and associates of such nominees. In the case of investment companies registered

under the Investment Company Act of 1940 (15 U.S.C. 80a), furnish the information required by Item 22(b)(13) of this Schedule 14A.

*Item 10. Compensation Plans.* \* \* \*  
(b)(1) *Additional information regarding specified plans subject to security holder action.* \* \* \*

(ii) The estimated annual payment to be made with respect to current services. In the case of a pension or retirement plan, information called for by paragraph (a)(2) of this Item may be furnished in the format specified by paragraph (h)(2) of Item 402 of Regulation S-K (§ 229.402(h)(2) of this chapter).

*Instruction to paragraph (b)(1)(ii).*

In the case of investment companies registered under the Investment Company Act of 1940 (15 U.S.C. 80a), refer to Instruction 4 in Item 22(b)(13)(i) of this Schedule in lieu of paragraph (h)(2) of Item 402 of Regulation S-K (§ 229.402(h)(2) of this chapter).

*Instructions*

1. The term *plan* as used in this Item means any plan as defined in paragraph (a)(6)(ii) of Item 402 of Regulation S-K (§ 229.402(a)(6)(ii) of this chapter).

*Item 22. Information required in investment company proxy statement.*

(b) *Election of Directors.* If action is to be taken with respect to the election of directors of a Fund, furnish the following information in the proxy statement in addition to, in the case of business development companies, the information (and in the format) required by Item 7 and Item 8 of this Schedule 14A.

(11) Provide in tabular form, to the extent practicable, the information required by Items 401(f) and (g), 404(a), and 405 of Regulation S-K (§§ 229.401(f) and (g), 229.404(a), and 229.405 of this chapter).

*Instruction to paragraph (b)(11).*

Information provided under paragraph (b)(8) of this Item 22 is deemed to satisfy the requirements of Item 404(a) of Regulation S-K for information about directors, nominees for election as directors, and Immediate Family Members of directors and nominees, and need not be provided under this paragraph (b)(11).

(13) In the case of a Fund that is an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a), for all directors, and for each of the three highest-paid Officers that have aggregate compensation from

the Fund for the most recently completed fiscal year in excess of \$60,000 ("Compensated Persons"):

(15)(i) Provide the information (and in the format) required by Items 407(b)(1), (b)(2) and (f) of Regulation S-K (§ 229.407(b)(1), (b)(2) and (f) of this chapter); and

(ii) Provide the following regarding the requirements for the director nomination process:

(A) The information (and in the format) required by Items 407(c)(1) and (c)(2) of Regulation S-K (§ 229.407(c)(1) and (c)(2) of this chapter); and

(B) If the Fund is a listed issuer (as defined in § 240.10A-3 of this chapter) whose securities are listed on a national securities exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or in an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A of the Act (15 U.S.C. 780-3(a)) that has independence requirements for nominating committee members, identify each director that is a member of the nominating committee that is not independent under the independence standards described in this paragraph. In determining whether the nominating committee members are independent, use the Fund's definition of independence that it uses for determining if the members of the nominating committee are independent in compliance with the independence standards applicable for the members of the nominating committee in the listing standards applicable to the Fund. If the Fund does not have independence standards for the nominating committee, use the independence standards for the nominating committee in the listing standards applicable to the Fund.

*Instruction to paragraph (b)(15)(ii)(B).*

If the national securities exchange or inter-dealer quotation system on which the Fund's securities are listed has exemptions to the independence requirements for nominating committee members upon which the Fund relied, disclose the exemption relied upon and explain the basis for the Fund's conclusion that such exemption is applicable.

(16) In the case of a Fund that is a closed-end investment company:

(i) Provide the information (and in the format) required by Item 407(d)(1), (d)(2) and (d)(3) of Regulation S-K (§ 229.407(d)(1), (d)(2) and (d)(3) of this chapter); and

(ii) Identify each director that is a member of the Fund's audit committee that is not independent under the independence standards described in this paragraph. If the Fund does not have a separately designated audit

committee, or committee performing similar functions, the Fund must provide the disclosure with respect to all members of its board of directors.

(A) If the Fund is a listed issuer (as defined in § 240.10A-3 of this chapter) whose securities are listed on a national securities exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or in an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A of the Act (15 U.S.C. 780-3(a)) that has independence requirements for audit committee members, in determining whether the audit committee members are independent, use the Fund's definition of independence that it uses for determining if the members of the audit committee are independent in compliance with the independence standards applicable for the members of the audit committee in the listing standards applicable to the Fund. If the Fund does not have independence standards for the audit committee, use the independence standards for the audit committee in the listing standards applicable to the Fund.

(B) If the Fund is not a listed issuer whose securities are listed on a national securities exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or in an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A of the Act (15 U.S.C. 780-3(a)), in determining whether the audit committee members are independent, use a definition of independence of a national securities exchange registered pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A of the Act (15 U.S.C. 780-3(a)) which has requirements that a majority of the board of directors be independent and that has been approved by the Commission, and state which definition is used. Whatever such definition the Fund chooses, it must use the same definition with respect to all directors and nominees for director. If the national securities exchange or national securities association whose standards are used has independence standards for the members of the audit committee, use those specific standards.

*Instruction to paragraph (b)(16)(ii).*

If the national securities exchange or inter-dealer quotation system on which the Fund's securities are listed has exemptions to the independence requirements for nominating committee members upon which the Fund relied, disclose the exemption relied upon and explain the basis for the Fund's

conclusion that such exemption is applicable. The same disclosure should be provided if the Fund is not a listed issuer and the national securities exchange or inter-dealer quotation system selected by the Fund has exemptions that are applicable to the Fund.

(17) In the case of a Fund that is an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a), if a director has resigned or declined to stand for re-election to the board of directors since the date of the last annual meeting of security holders because of a disagreement with the registrant on any matter relating to the registrant's operations, policies or practices, and if the director has furnished the registrant with a letter describing such disagreement and requesting that the matter be disclosed, the registrant shall state the date of resignation or declination to stand for re-election and summarize the director's description of the disagreement. If the registrant believes that the description provided by the director is incorrect or incomplete, it may include a brief statement presenting its view of the disagreement.

\* \* \* \* \*

■ 33. Amend § 240.14c-5 to revise paragraph (a)(4) before the undesignated paragraph to read as follows:

**§ 240.14c-5 Filing requirements.**

(a) \* \* \*  
 (4) The approval or ratification of a plan as defined in paragraph (a)(6)(ii) of Item 402 of Regulation S-K (§ 229.402(a)(6)(ii) of this chapter) or amendments to such a plan.

\* \* \* \* \*

■ 34. Amend § 240.15d-11 by revising paragraph (c) to read as follows:

**§ 240.15d-11 Current reports on Form 8-K (§ 249.308 of this chapter).**

\* \* \* \* \*

(c) No failure to file a report on Form 8-K that is required solely pursuant to Item 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) or 6.03 of Form 8-K shall be deemed to be a violation of 15 U.S.C. 78j(b) and § 240.10b-5.

■ 35. Add § 240.15d-20 to read as follows:

**§ 240.15d-20 Plain English presentation of specified information.**

(a) Any information included or incorporated by reference in a report filed under section 15(d) of the Act (15 U.S.C. 78o(d)) that is required to be disclosed pursuant to Item 402, 403, 404 or 407 of Regulation S-B (§§ 228.402, 228.403, 228.404 or 228.407 of this chapter) or Item 402, 403, 404 or 407 of

Regulation S-K (§§ 229.402, 229.403, 229.404 or 229.407 of this chapter) must be presented in a clear, concise and understandable manner. You must prepare the disclosure using the following standards:

- (1) Present information in clear, concise sections, paragraphs and sentences;
- (2) Use short sentences;
- (3) Use definite, concrete, everyday words;
- (4) Use the active voice;
- (5) Avoid multiple negatives;
- (6) Use descriptive headings and subheadings;
- (7) Use a tabular presentation or bullet lists for complex material, wherever possible;
- (8) Avoid legal jargon and highly technical business and other terminology;
- (9) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and
- (10) In designing the presentation of the information you may include pictures, logos, charts, graphs and other design elements so long as the design is not misleading and the required information is clear. You are encouraged to use tables, schedules, charts and graphic illustrations that present relevant data in an understandable manner, so long as such presentations are consistent with applicable disclosure requirements and consistent with other information in the document. You must draw graphs and charts to scale. Any information you provide must not be misleading.

(b) [Reserved]

**Note to § 240.15d-20.** In drafting the disclosure to comply with this section, you should avoid the following:

1. Legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;
2. Vague "boilerplate" explanations that are imprecise and readily subject to different interpretations;
3. Complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and
4. Disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

■ 36. Amend § 240.16b-3 by:

- a. Adding "and" at the end of paragraph (b)(3)(i)(B);
- b. Removing "; and" at the end of paragraph (b)(3)(i)(C) and in its place adding a period;

■ c. Removing paragraph (b)(3)(i)(D); and

■ d. Adding Note (4) to read as follows:

**§ 240.16b-3 Transactions between an issuer and its officers or directors.**

\* \* \* \* \*

**Notes to § 240.16b-3:**

\* \* \* \* \*

**Note (4):** For purposes of determining a director's status under those portions of paragraph (b)(3)(i) that reference § 229.404(a) of this chapter, an issuer may rely on the disclosure provided under § 229.404(a) of this chapter for the issuer's most recent fiscal year contained in the most recent filing in which disclosure required under § 229.404(a) is presented. Where a transaction disclosed in that filing was terminated before the director's proposed service as a Non-Employee Director, that transaction will not bar such service. The issuer must believe in good faith that any current or contemplated transaction in which the director participates will not be required to be disclosed under § 229.404(a) of this chapter, based on information readily available to the issuer and the director at the time such director proposes to act as a Non-Employee Director. At such time as the issuer believes in good faith, based on readily available information, that a current or contemplated transaction with a director will be required to be disclosed under § 229.404(a) in a future filing, the director no longer is eligible to serve as a Non-Employee Director; *provided, however*, that this determination does not result in retroactive loss of a Rule 16b-3 exemption for a transaction previously approved by the director while serving as a Non-Employee Director consistent with this note. In making the determinations specified in this Note, the issuer may rely on information it obtains from the director, for example, pursuant to a response to an inquiry.

**PART 245—REGULATION BLACKOUT TRADING RESTRICTION (REGULATION BTR—BLACKOUT TRADING RESTRICTION)**

■ 37. The authority citation for Part 245 continues to read in part as follows:

**Authority:** 15 U.S.C. 78w(a), unless otherwise noted.

\* \* \* \* \*

**§ 245.100 [Amended]**

■ 38. Amend § 245.100, paragraph (a)(2), by revising the phrase "paragraph (a) or (b) of Item 404" to read "paragraph (a) of Item 404".

\* \* \* \* \*

**PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934**

■ 39. The authority citation for part 249 continues to read in part as follows:

**Authority:** 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

■ 40. Amend Form 10 (referenced in § 249.210) by revising Items 6 and 7 to read as follows:

**Note:** The text of Form 10 does not, and this amendment will not, appear in the Code of Federal Regulations.

#### Form 10

##### General Form for Registration of Securities Pursuant to Section 12(B) or (G) of the Securities Exchange Act of 1934

###### Item 6. Executive Compensation.

Furnish the information required by Item 402 of Regulation S-K (§ 229.402 of this chapter) and paragraph (e)(4) of Item 407 of Regulation S-K (§ 229.407 of this chapter).

###### Item 7. Certain Relationships and Related Transactions, and Director Independence.

Furnish the information required by Item 404 of Regulation S-K (§ 229.404 of this chapter) and Item 407(a) of Regulation S-K (§ 229.407(a) of this chapter).

■ 41. Amend Form 10-SB (referenced in § 249.210b), Information Required in Registration Statement, by revising Item 7 to read as follows:

**Note:** The text of Form 10-SB does not, and this amendment will not, appear in the Code of Federal Regulations.

#### Form 10-SB

##### General Form for Registration of Securities of Small Business Issuers

###### Information Required in Registration Statement

###### Item 7. Certain Relationships and Related Transactions, and Director Independence.

Furnish the information required by Item 404 of Regulation S-B (§ 228.404 of this chapter) and Item 407(a) of Regulation S-B (§ 228.407(a) of this chapter).

■ 42. Amend Form 20-F (referenced in § 249.220f) by revising Instruction 4.(c)(v) to the Instructions as to Exhibits to read as follows:

**Note:** The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

#### Form 20-F

##### Instructions as to Exhibits

4.(a) \* \* \*  
(c) \* \* \*  
(v) Public filing of the management contract or compensatory plan, contract or arrangement, or portion thereof, is not required in the company's home country and is not otherwise publicly disclosed by the company.

■ 43. Form 8-K (referenced in § 249.308) is amended by:  
■ a. Revising General Instruction D;  
■ b. Revising the last sentence of Instruction 1 to Item 1.01;  
■ c. Revising the heading of Item 5.02;  
■ d. Revising Item 5.02(b), the introductory text of Item 5.02(c), Item 5.02(c)(2) and (c)(3);  
■ e. Adding Items 5.02(d)(5), (e) and (f); and  
■ f. Adding Instructions 3 and 4 to Item 5.02.

The revisions and additions read as follows:

**Note:** The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

#### Form 8-K

##### Current Report

##### Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

##### General Instructions

###### D. Preparation of Report.

This form is not to be used as a blank form to be filled in, but only as a guide in the preparation of the report on paper meeting the requirements of Rule 12b-12 (17 CFR 240.12b-12). The report shall contain the number and caption of the applicable item, but the text of such item may be omitted, provided the answers thereto are prepared in the manner specified in Rule 12b-13 (17 CFR 240.12b-13). To the extent that Item 1.01 and one or more other items of the form are applicable, registrants need not provide the number and caption of Item 1.01 so long as the substantive disclosure required by Item 1.01 is disclosed in the report and the number and caption of the other applicable item(s) are provided. All items that are not required to be answered in a particular report may be omitted and no reference thereto need be made in the report. All instructions should also be omitted.

##### Item 1.01 Entry into a Material Definitive Agreement.

###### Instructions.

1. \* \* \* An agreement involving the subject matter identified in Item 601(b)(10)(iii)(A) or (B) need not be disclosed under this Item.

##### Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.

(b) If the registrant's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions, or any named executive officer, retires, resigns or is terminated from that position, or if a director retires, resigns, is removed, or refuses to stand for re-election (except in circumstances described in paragraph (a) of this Item 5.02), disclose the fact that the event has occurred and the date of the event.

(c) If the registrant appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or person performing similar functions, disclose the following information with respect to the newly appointed officer:

(1) \* \* \*  
(2) the information required by Items 401(b), (d), (e) and Item 404(a) of Regulation S-K (17 CFR 229.401(b), (d), (e) and 229.404(a)), or, in the case of a small business issuer, Items 401(a)(4), (a)(5), (c), and Item 404(a) of Regulation S-B (17 CFR 228.401(a)(4), (a)(5), (c), and 228.404(a), respectively); and

(3) a brief description of any material plan, contract or arrangement (whether or not written) to which a covered officer is a party or in which he or she participates that is entered into or material amendment in connection with the triggering event or any grant or award to any such covered person or modification thereto, under any such plan, contract or arrangement in connection with any such event.

(d) \* \* \*  
(5) a brief description of any material plan, contract or arrangement (whether or not written) to which the director is a party or in which he or she participates that is entered into or material amendment in connection with the triggering event or any grant or award to any such covered person or modification thereto, under any such plan, contract or arrangement in connection with any such event.

(e) If the registrant enters into, adopts, or otherwise commences a material compensatory plan, contract or arrangement (whether or not written), as to which the registrant's principal executive officer, principal financial officer, or a named executive officer participates or is a party, or such compensatory plan, contract or arrangement is materially amended or modified, or a material grant or award under any such plan, contract or arrangement to any such person is made or materially modified, then the registrant shall provide a brief description of the terms and conditions of the plan, contract or arrangement and the amounts payable to the officer thereunder.

*Instructions to paragraph (e).*

1. Disclosure under this Item 5.02(e) shall be required whether or not the specified event is in connection with events otherwise triggering disclosure pursuant to this Item 5.02.

2. Grants or awards (or modifications thereto) made pursuant to a plan, contract or arrangement (whether involving cash or equity), that are materially consistent with the previously disclosed terms of such plan, contract or arrangement, need not be disclosed under this Item 5.02(e), provided the registrant has previously disclosed such terms and the grant, award or modification is disclosed when Item 402 of Regulation S-K (17 CFR 229.402) requires such disclosure.

(f) If the salary or bonus of a named executive officer cannot be calculated as of the most recent practicable date and is omitted from the Summary Compensation Table as specified in Instruction 1 to Item 402(b)(2)(iii) and (iv) of Regulation S-B or Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K, disclose the appropriate information under this Item 5.02(f) when there is a payment, grant, award, decision or other occurrence as a result of which such amounts become calculable in whole or part. Disclosure under this Item 5.02(f) shall include a new total compensation figure for the named executive officer, using the new salary or bonus information to recalculate the information that was previously provided with respect to the named executive officer in the registrant's Summary Compensation Table for which the salary and bonus information was omitted in reliance on Instruction 1 to Item 402(b)(2)(iii) and (iv) of Regulation S-B (17 CFR 228.402(b)(2)(iii) and (iv)) or Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K (17 CFR 229.402(c)(2)(iii) and (iv)).

*Instructions to Item 5.02.*

\* \* \* \* \*

3. The registrant need not provide information with respect to plans, contracts, and arrangements to the extent they do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees.

4. For purposes of this Item, the term "named executive officer" shall refer to those executive officers for whom disclosure was required in the registrant's most recent filing with the Commission under the Securities Act (15 U.S.C. 77a *et seq.*) or Exchange Act (15 U.S.C. 78a *et seq.*) that required disclosure pursuant to Item 402(c) of Regulation S-K (17 CFR 229.402(c)) or Item 402(b) of Regulation S-B (17 CFR 228.402(b)), as applicable.

\* \* \* \* \*

■ 44. Amend Form 10-Q (referenced in § 249.308a) by revising Item 5(b) in Part II to read as follows:

*Note:* The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form 10-Q**

\* \* \* \* \*

**Part II—Other Information**

\* \* \* \* \*

Item 5. Other Information.

(a) \* \* \*

(b) Furnish the information required by Item 407(c)(3) of Regulation S-K (§ 229.407 of this chapter).

\* \* \* \* \*

■ 45. Amend Form 10-QSB (referenced in § 249.308b) by revising Item 5(b) in Part II to read as follows:

*Note:* The text of Form 10-QSB does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form 10-QSB**

\* \* \* \* \*

**Part II—Other Information**

\* \* \* \* \*

Item 5. Other Information.

(a) \* \* \*

(b) Furnish the information required by Item 407(c)(3) of Regulation S-B (§ 228.407 of this chapter).

\* \* \* \* \*

■ 46. Amend Form 10-K (referenced in § 249.310) by revising Item 10 before the instruction and Items 11 and 13 in Part III to read as follows:

*Note:* The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form 10-K**

\* \* \* \* \*

**Part III**

\* \* \* \* \*

Item 10. Directors, Executive Officers and Corporate Governance.

Furnish the information required by Items 401, 405, 406, and 407(c)(3), (d)(4) and (d)(5) of Regulation S-K (§§ 229.401, 229.405, 229.406, and 229.407(c)(3), (d)(4) and (d)(5) of this chapter).

\* \* \* \* \*

Item 11. Executive Compensation.

Furnish the information required by Item 402 of Regulation S-K (§ 229.402 of this chapter) and paragraphs (e)(4) and (e)(5) of Item 407 of Regulation S-K (§ 229.407(e)(4) and (e)(5) of this chapter).

\* \* \* \* \*

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Furnish the information required by Item 404 of Regulation S-K (§ 229.404 of this chapter) and Item 407(a) of Regulation S-K (§ 229.407(a) of this chapter).

\* \* \* \* \*

■ 47. Amend Form 10-KSB (referenced in § 249.310b) by revising Item 9 before the instruction and Item 12 in Part III to read as follows:

*Note:* The text of Form 10-KSB does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form 10-KSB**

\* \* \* \* \*

**Part III**

Item 9. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance With Section 16(a) of the Exchange Act.

Furnish the information required by Items 401, 405, 406, and 407(c)(3), (d)(4) and (d)(5) of Regulation S-B (§§ 228.401, 228.405, 228.406, and 228.407(c)(3), (d)(4) and (d)(5) of this chapter).

\* \* \* \* \*

Item 12. Certain Relationships and Related Transactions, and Director Independence.

Furnish the information required by Item 404 of Regulation S-B (§ 228.404 of this chapter) and Item 407(a) of Regulation S-B (§ 228.407(a) of this chapter).

\* \* \* \* \*

**PART 274—FORMS PRESCRIBED  
UNDER THE INVESTMENT COMPANY  
ACT OF 1940**

■ 48. The authority citation for Part 274 continues to read in part as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78f, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

■ 49. Amend Form N-1A (referenced in §§ 239.15A and 274.11A) by:

■ a. Revising “\$60,000” to read “\$120,000” in the introductory text of Items 12(b)(6), (b)(7), and (b)(8); Instruction 2 to Item 12(b)(6); and Instruction 5 to Item 12(b)(8); and

■ b. Removing the word “relocation,” in the second sentence of Instruction 2 to Item 15(b).

**Note:** The text of Form N-1A does not, and this amendment will not, appear in the Code of Federal Regulations.

■ 50. Amend Form N-2 (referenced in §§ 239.14 and 274.11a-1) by:

■ a. Revising “\$60,000” to read “\$120,000” in the introductory text of paragraphs 9, 10, and 11 of Item 18; Instruction 2 to paragraph 9 of Item 18; and Instruction 5 to paragraph 11 of Item 18;

■ b. Revising the introductory text of paragraph 13 of Item 18;

■ c. Removing paragraph 13(c) of Item 18;

■ d. Redesignating paragraphs 14 and 15 of Item 18 as paragraphs 15 and 16, respectively;

■ e. Adding new paragraph 14 of Item 18;

■ f. Removing “relocation,” from the second sentence of Instruction 2 to paragraph 2 of Item 21; and

■ g. Revising the cite “Item 18.15” to read “Item 18.16” in Instruction 8.a. to Item 24.

The addition and revision read as follows:

**Note:** The text of Form N-2 does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form N-2**

\* \* \* \* \*  
Item 18. Management.  
\* \* \* \* \*

13. In the case of a Registrant that is not a business development company, provide the following for all directors of the Registrant, all members of the advisory board of the Registrant, and for each of the three highest paid officers or any affiliated person of the Registrant with aggregate compensation from the Registrant for the most recently completed fiscal year in excess of \$60,000 (“Compensated Persons”).

14. In the case of a Registrant that is a business development company, provide the information required by Item 402 of Regulation S-K (17 CFR 229.402).

■ 51. Amend Form N-3 (referenced in §§ 239.17a and 274.11b) by:

■ a. Revising “\$60,000” to read “\$120,000” in the introductory text of paragraphs (h), (i), and (j) of Item 20; Instruction 2 to paragraph (h) of Item 20; and Instruction 5 to paragraph (j) of Item 20; and

■ b. Removing the word “relocation,” in the second sentence of Instruction 2 to Item 22(b).

**Note:** The text of Form N-3 does not, and this amendment will not, appear in the Code of Federal Regulations.

■ 52. Amend Form N-CSR (referenced in §§ 249.331 and 274.128) by revising Item 10 to read as follows:

**Note:** The text of Form N-CSR does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form N-CSR**

\* \* \* \* \*

Item 10. Submission of Matters to a Vote of Security Holders.

Describe any material changes to the procedures by which shareholders may recommend nominees to the registrant’s board of directors, where those changes were implemented after the registrant last provided disclosure in response to the requirements of Item 407(c)(2)(iv) of Regulation S-K (17 CFR 229.407) (as required by Item 22(b)(15) of Schedule 14A (17 CFR 240.14a-101)), or this Item.

**Instruction.** For purposes of this Item, adoption of procedures by which shareholders may recommend nominees to the registrant’s board of directors, where the registrant’s most recent disclosure in response to the requirements of Item 407(c)(2)(iv) of Regulation S-K (17 CFR 229.407) (as required by Item 22(b)(15) of Schedule 14A (17 CFR 240.14a-101)), or this Item, indicated that the registrant did not have in place such procedures, will constitute a material change.

\* \* \* \* \*

Dated: August 29, 2006.

By the Commission.

Nancy M. Morris,

Secretary.

[FR Doc. 06-6968 Filed 9-7-06; 8:45 am]

BILLING CODE 8010-01-P

**APPENDIX B-II**

**December 2006 SEC Release adopting Changes to the New  
Rules**

Indebtedness of Executive Officers and Principal Shareholders to a State Nonmember Bank and Its Correspondent Banks, and because the FDIC does not believe that the reports at issue contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse, the FDIC is repealing its regulations at part 349.

### III. Exemption From Public Comment

The Act repeals the specific statutory requirements for these reports. However, the FDIC retains authority under other provisions of law to collect information regarding insider lending by depository institutions. The FDIC does not believe these reports contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse. Under these circumstances, providing prior notice and an opportunity for public comment on whether to repeal these rules would serve no useful purpose. As a result, under authority at 5 U.S.C. 553(b)(B), FDIC finds good cause to waive such procedures. Moreover, no Federal agency's or private sector entity's interest will be adversely affected by their repeal. Further, and for the same reason, FDIC finds good cause pursuant to 553(d)(3) to waive the requirement of a 30-day delay in effect for this rule. Thus, this rule is effective immediately.

#### *Regulatory Flexibility Act*

As prior notice and an opportunity for public comment are not required under 5 U.S.C. 553 or any other law, the analytical requirements of the Regulatory Flexibility Act are inapplicable. Thus, no regulatory flexibility analysis is required and none has been prepared.

#### *Paperwork Reduction Act*

At the FDIC's request, the Office of Management and Budget (OMB) has deleted the collection of information associated with this rule (formerly approved by OMB under Control No. 3064-0023, "Reports of Indebtedness of Executive Officers and Principal Shareholders to Correspondent Banks and to Own Bank," collected using FFIEC form 004). The reduction in paperwork burden imposed on the public resulting from the elimination of this collection of information will be 47,998 hours a year. The Federal Financial Institutions Examination Council (FFIEC) is providing notice to all affected parties that they will no longer need to provide this information to the agencies.

Also, as discussed above, section 601 of the Act eliminated the requirement

that a bank include a separate report with its Call Report each quarter on any extensions of credit the bank has made to its executive officers since the date of its last Call Report. Accordingly, as of December 31, 2006, the FDIC will no longer require banks to provide the "Special Report" on loans to executive officers, which had been included after the final page of the Call Report forms in previous quarters. At the FDIC's request, OMB has approved this change in the Call Report. The resulting reduction in paperwork burden imposed on the public will be 5,247 hours a year.

#### *Small Business Regulatory Enforcement Fairness Act*

The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) (Title II, Pub. L. 104-121) provides generally for agencies to report rules to Congress and the General Accounting Office (GAO) for review. The reporting requirement is triggered when a federal agency issues a final rule. The FDIC will file the appropriate reports with Congress and the GAO as required by SBREFA. The Office of Management and Budget has determined that the rule does not constitute a "major rule" as defined by SBREFA.

#### **List of Subjects in 12 CFR Part 349**

Reports, Public disclosure, Indebtedness of principal shareholders, Indebtedness of executive officers, State nonmember banks, Correspondent banks.

■ For the reasons stated above, the Board of Directors of the Federal Deposit Insurance Corporation hereby amends title 12, chapter III of the Code of Federal Regulations under the authority of 5 U.S.C. 553 by removing and reserving part 349.

#### **PART 349—[REMOVED AND RESERVED]**

Dated at Washington, DC, this 22nd day of December, 2006.

By order of the Board of Directors,  
Federal Deposit Insurance Corporation.

**Robert E. Feldman,**  
*Executive Secretary.*

[FR Doc. E6-22260 Filed 12-28-06; 8:45 am]

BILLING CODE 6714-01-P

## **SECURITIES AND EXCHANGE COMMISSION**

### **17 CFR Parts 228 and 229**

[Release Nos. 33-8765; 34-55009; File No. S7-03-06]

RIN 3235-A180

### **Executive Compensation Disclosure**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Interim final rules with request for comments.

**SUMMARY:** The Securities and Exchange Commission is adopting, as interim final rules, amendments to the disclosure requirements for executive and director compensation. The amendments to Item 402 of Regulations S-K and S-B revise Summary Compensation Table and Director Compensation Table disclosure with respect to stock awards and option awards to provide disclosure of the compensation cost of awards over the requisite service period, as described in Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) *Share-Based Payment* (FAS 123R). FAS 123R defines a requisite service period as the period or periods over which an employee is required to provide service in exchange for a share-based payment. The revised disclosure replaces disclosure in the Summary Compensation Table and Director Compensation Table of the aggregate grant date fair value of awards computed in accordance with FAS 123R. The amendments revise the Grants of Plan-Based Awards Table to add a column showing, on a grant-by-grant basis, the full grant date fair value of awards computed in accordance with FAS 123R. The amendments also revise the Grants of Plan-Based Awards Table to include information concerning repriced or materially modified options, stock appreciation rights and similar option-like instruments, disclosing the incremental fair value computed as of the repricing or modification date computed in accordance with FAS 123R. The amendments to the Director Compensation Table in Item 402 of Regulation S-K require footnote disclosure corresponding to the new Grants of Plan-Based Awards Table fair value disclosures. The amendments are intended to provide investors with more complete and useful disclosure about executive compensation. Disclosing the compensation cost of stock and option awards over the requisite service period will give investors a better idea of the compensation earned by an executive or

director during a particular reporting period, consistent with the principles underlying the financial statement disclosure; and retaining the requirement to disclose the grant date fair value will give investors useful information about the total impact of compensation decisions made by a company in a particular reporting period.

**DATES: Effective Date:** The amendments are effective December 29, 2006.

**Comment Date:** As discussed below, we are publishing interim final regulations. We will, however, consider any comments received on or before January 29, 2007 and will revise the interim final rule amendments to Item 402 of Regulations S-K and S-B if necessary.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/final.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-03-06 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-03-06. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** David Lynn or Anne Krauskopf, at (202) 551-3500, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3010.

**SUPPLEMENTARY INFORMATION:** We are adopting amendments to Item 402<sup>1</sup> of Regulations S-K<sup>2</sup> and S-B<sup>3</sup> as interim final rules.

#### I. Background

On July 26, 2006, we voted to adopt revisions to our rules governing disclosure of executive compensation.<sup>4</sup> We intended these revisions to provide investors with a clearer and more complete picture of compensation to principal executive officers, principal financial officers, the other highest paid executive officers and directors.<sup>5</sup>

Two significant features of the amended disclosure rules were revisions to the Summary Compensation Table<sup>6</sup> and adoption of a new Grants of Plan-Based Awards Table.<sup>7</sup> Among other things, we revised the Summary Compensation Table to include a new "Total" column<sup>8</sup> that aggregates the total dollar value of each form of compensation quantified in the other columns. We also adopted a Director Compensation Table,<sup>9</sup> modeled on the revised Summary Compensation Table.

Under these rules, in order to calculate a total dollar amount of compensation in the Summary Compensation Table for a particular fiscal year, a dollar value for all equity awards—rather than the number of securities underlying an equity award—must be disclosed. We required this valuation to be based on the grant date fair value of the awards determined pursuant to FAS 123R. In particular, for both the Stock Awards and Option Awards columns,<sup>10</sup> we amended the rules to require disclosure of the

aggregate grant date fair value of the awards computed in accordance with FAS 123R.<sup>11</sup> This approach provided for Summary Compensation Table and Director Compensation Table disclosure of these awards, consistent with the timing of option and stock awards disclosure that had applied in the Summary Compensation Table since 1992.<sup>12</sup>

The comments we received regarding the dollar amount for Stock Awards and Option Awards in the Summary Compensation Table reflected differing views. Some commenters expressed support for requiring companies to report the full grant date fair value in the fiscal year of the award because it would provide a more complete representation of compensation and would be more consistent with the purpose of executive compensation disclosure.<sup>13</sup> Others stated that we should require Summary Compensation Table disclosure of the proportionate

<sup>11</sup> 2006 Executive Compensation Release at Section II.C.1.c.i.

<sup>12</sup> See *Executive Compensation Disclosure*, Release No. 33-6962 (Oct. 16, 1992) [57 FR 48126] (the "1992 Release"). Before the amendments adopted in the 2006 Executive Compensation Release, the Summary Compensation Table had required disclosure of the sum of the number of securities underlying stock options granted (including options that subsequently have been transferred), with or without tandem stock appreciation rights (SARs), and the number of free-standing SARs. The Summary Compensation Table also had required disclosure of the dollar value (net of any consideration paid by the named executive officer) of any award of restricted stock, calculated by multiplying the closing market price of the company's unrestricted stock on the date of grant by the number of shares awarded. Alternatively, restricted stock awards subject to performance-based vesting conditions could have been reported as long-term incentive plan (LTIP) awards in the separate Long-Term Incentive Plan Awards table, with vesting later reported in the Summary Compensation Table LTIP Payouts column.

<sup>13</sup> See, for example, letters from California Public Employees' Retirement System; CFA Centre for Financial Market Integrity, dated April 13, 2006; Connecticut Retirement Plans and Trust Funds, dated April 10, 2006; Leo J. Burns; Governance for Owners USA, Inc.; Laborers International Union of North America; Nancy Lucke Ludgus; jointly, California Public Employees' Retirement System, California State Teachers' Retirement System, Cooperative Insurance Society—UK, F&C Asset Management—UK, Illinois State Board of Investment, London Pensions Fund Authority—UK, New York State Common Retirement Fund, New York City Pension Funds, Ontario Teachers' Pension Plan, PGGM Investments—Netherlands, Public Sector and Commonwealth Super (PSS/CSS)—Australia, RAILPEN Investments—UK, State Board of Administration (SBA) of Florida, Stichting Pensioenfondsen ABP—Netherlands, UniSuper Limited—Australia, and Universities Superannuation Scheme—UK; State Board of Administration (SBA) of Florida; Teamsters Local 671 Health Services and Insurance Plan; Southwestern Pennsylvania and Western Maryland Area Teamsters and Employers Pension Fund; United Church Foundation, Inc.; Washington State Investment Board; and Western PA Teamsters & Employers Welfare Fund.

<sup>1</sup> 17 CFR 229.402 and 17 CFR 228.402.

<sup>2</sup> 17 CFR 229.10 *et seq.*

<sup>3</sup> 17 CFR 228.10 *et seq.*

<sup>4</sup> *Executive Compensation and Related Person Disclosure*, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] (the "2006 Executive Compensation Release"). These revisions became effective on November 7, 2006.

<sup>5</sup> The discussion that follows focuses on amendments to Item 402 of Regulation S-K, with references to differences from Item 402 of Regulation S-B where appropriate.

<sup>6</sup> Item 402(c) of Regulation S-K, which presents information for each of the company's last three completed fiscal years, and Item 402(b) of Regulation S-B, which presents information for each of a small business issuer's last two completed fiscal years.

<sup>7</sup> Item 402(d) of Regulation S-K.

<sup>8</sup> Item 402(c)(2)(x) of Regulation S-K and Item 402(b)(2)(x) of Regulation S-B.

<sup>9</sup> Item 402(k) of Regulation S-K and Item 402(f) of Regulation S-B. Each of these tables presents information for the last completed fiscal year.

<sup>10</sup> Items 402(c)(2)(v) and (vi) of Regulation S-K and Items 402(b)(2)(v) and (vi) of Regulation S-B require these columns in the Summary Compensation Table. Items 402(k)(2)(iii) and (iv) of Regulation S-K and Items 402(f)(2)(iii) and (iv) of Regulation S-B require these columns in the Director Compensation Table.

amount of an award's total fair value that is recognized in the company's financial statements for the fiscal year.<sup>14</sup> Some of these commenters expressed concerns that disclosing the full grant date fair value would overstate compensation earned related to service rendered for the year, and might confuse the discussion and analysis of compensation policies and practices.<sup>15</sup> Others stated that requiring immediate reporting of the full grant date fair value would not necessarily reflect the cost to the company or the benefit to the named executive officer or director, and that the actual amounts earned later could be substantially different.<sup>16</sup> For example, a performance-based stock award might never be earned, yet the entire grant date fair value of the award is required to be reported in the Summary Compensation Table in the fiscal year of grant.<sup>17</sup> Some commenters expressed concern regarding inconsistency with the presentation of non-equity incentive plan compensation,<sup>18</sup> which is reported when earned.<sup>19</sup>

Commenters also suggested that providing compensation disclosure that is consistent with the company's financial statements would make it easier for analysts and investors to analyze compensation for top executives.<sup>20</sup> One commenter noted particularly that the Financial Accounting Standards Board engaged in a thorough and extensive process before concluding that financial statements should reflect the compensation cost of the award proportionately over the vesting period.<sup>21</sup> Another commenter

stated that the accounting rules shape decision-making on executive compensation.<sup>22</sup> Regarding identification of the most highly compensated executive officers, one commenter noted that reporting full grant date fair value would cause wide year-to-year swings in reported compensation when in fact the executive is earning a consistent level of compensation, and cause inconsistencies in the identification of named executive officers from year-to-year.<sup>23</sup>

Our comprehensive revisions also adopted the Grants of Plan-Based Awards Table to supplement and complement Summary Compensation Table disclosure of stock and option awards by disclosing, among other things, the number of shares of stock or units comprising or underlying the award. This supplemental table shows the terms of grants, including estimated future payouts for both equity incentive plans and non-equity incentive plans,<sup>24</sup> with separate disclosure for each grant.

## II. Discussion

Under FAS 123R, while the compensation cost is initially measured based on the grant date fair value of an award, it is generally recognized for financial reporting purposes over the period in which the employee is required to provide service in exchange for the award (generally the vesting period). When and where to disclose this compensation cost as executive compensation disclosure requires a careful balancing. In the 2006 Executive Compensation Release, we chose to require disclosure of the full grant date fair value as compensation when the grant is made. As we explained, on balance we chose that approach for the purpose of executive compensation disclosure for a variety of reasons, including that it informs investors of current actions regarding plan awards, and emphasizes the importance of the compensation committee's compensation decisions for the most recent fiscal year.

We recognize, however, that no one approach to disclosure of stock and option awards addresses all of the issues regarding disclosure of these forms of compensation. Upon further

consideration, we have concluded that a combination of disclosure of the compensation cost associated with equity awards as that cost is recognized in the financial statements in the Summary Compensation Table, combined with disclosure of the grant date fair value of those awards on a grant-by-grant basis in the Grants of Plan-Based Awards Table, would provide a fuller and more useful picture of executive compensation than our recently adopted rules. Thus, we now adopt, as interim final rules, amendments that implement an approach to Summary Compensation Table disclosure of equity awards that provides disclosure of compensation cost of those awards over the requisite service period, as described in FAS 123R. Adopting the amendments as interim final rules—before issuers are required to comply with the recently adopted amendments—will avoid presentation of executive compensation disclosure in the first year that would be different in later years. Measuring compensation in this manner should provide investors with a clearer view of the annual compensation earned by executives and the annual compensation costs to a company, consistent with the timing of financial statement reporting. Measuring compensation in this manner also should eliminate the potential for distortion in identifying named executive officers based on a measure that reflects the full grant date fair value of awards, such as when a single large grant that will be earned by services to be performed over multiple years changes the composition of the named executive officers in the Summary Compensation Table.

In addition, we are revising the Grants of Plan-Based Awards Table to add a column showing the full grant date fair value of each award granted, computed in accordance with FAS 123R. This will provide investors a more complete perspective of the compensation decisions made with respect to the last completed fiscal year, and facilitate Compensation Discussion and Analysis disclosure of the company's policies and decisions regarding compensation awarded to, earned by, or paid to the named executive officers.<sup>25</sup> As a result of the amendments, investors will have more disclosure and ultimately a more complete picture of a company's

<sup>14</sup> See, for example, letters from the SEC Regulations Committee of the American Institute of Certified Public Accountants ("AICPA"); Baker, Donelson, Bearman, Caldwell & Berkowitz, P.C.; Chamber of Commerce of the United States of America ("Chamber of Commerce"); Computer Sciences Corporation; Deloitte & Touche LLP ("Deloitte"); Ernst & Young LLP ("E&Y"); Fenwick & West LLP ("Fenwick"); Foley & Lardner LLP ("Foley"); HR Policy Association; American Bar Association, Joint Committee on Employee Benefits; and KPMG LLP ("KPMG").

<sup>15</sup> See letters from Chamber of Commerce and E&Y.

<sup>16</sup> See letters from Foley (noting that awards would be forfeited if the executive terminates employment before expiration of the vesting period) and WorldatWork.

<sup>17</sup> See letter from Compass Bancshares, Inc.

<sup>18</sup> See, for example, letters from The Corporate & Securities Law Committee and the Employment & Labor Law Committee of the Association of Corporate Counsel; Amalgamated Bank Long-Vest Funds; BDO Seidman, LLP ("BDO Seidman"); Council of Institutional Investors, dated March 29, 2006; IUE-CWA Pension Fund and 401(k) Plan; and Mercer Human Resources Consulting.

<sup>19</sup> Item 402(c)(2)(vii) of Regulation S-K and Item 402(b)(2)(vii) of Regulation S-B.

<sup>20</sup> See letters from AICPA; Chamber of Commerce; Deloitte; EY; and KPMG.

<sup>21</sup> See letter from Fenwick.

<sup>22</sup> See letter from Steven Hall & Partners. If this is the case, we would anticipate that this influence may be discussed in the Compensation Discussion and Analysis. See Item 402(b)(2)(xii) of Regulation S-K.

<sup>23</sup> See letter from Fenwick.

<sup>24</sup> Equity incentive plan and non-equity incentive plan are both defined in Item 402(a)(6)(iii) of Regulation S-K and Item 402(a)(5)(iii) of Regulation S-B.

<sup>25</sup> The Compensation Discussion and Analysis section is required by Item 402(b) of Regulation S-K. Instruction 2 to Item 402(b) provides, among other things, that the Compensation Discussion and Analysis should be of the information contained in the tables and otherwise disclosed pursuant to Item 402 of Regulation S-K.

compensation decisions. We believe that this approach will better fulfill the Commission's objective of informing investors of current actions regarding plan awards and compensation decisions, and that this disclosure ultimately will be easier for companies to prepare and investors to understand.

#### A. Summary Compensation Table

Under the amendments we adopt today as interim final rules, the dollar amount of compensation cost recognized over the requisite service period, as described in FAS 123R, will be the amount reported in the Stock Awards and Option Awards columns in the Summary Compensation Table.<sup>26</sup> Compensation cost will include both the amounts recorded as compensation expense in the income statement for the fiscal year as well as any amounts earned by an executive that have been capitalized on the balance sheet for the fiscal year. This amount will include compensation cost recognized in the financial statements with respect to awards granted in previous fiscal years and the subject fiscal year. The amendments revise the corresponding columns in the Director Compensation Table in the same way.<sup>27</sup>

We also amend the related instruction calling for a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the company's financial statements, footnotes to the financial statements, or discussion in Management's Discussion and Analysis,<sup>28</sup> and providing that the referenced sections are deemed part of the Item 402 disclosure, to also require footnote disclosure of awards that are forfeited.<sup>29</sup> Since the amendments correlate Summary Compensation Table disclosure of stock and option awards to the dollar amount recognized for financial statement purposes with respect to the fiscal year, the other related instruction, limiting the amount reported with respect to a repriced option or SAR to the FAS 123R incremental fair value,<sup>30</sup> is rescinded.

<sup>26</sup> Items 402(c)(2)(v) and (vi) of Regulation S-K and Items 402(b)(2)(v) and (vi) of Regulation S-B.

<sup>27</sup> Items 402(k)(2)(iii) and (iv) of Regulation S-K and Items 402(f)(2)(iii) and (iv) of Regulation S-B.

<sup>28</sup> Item 303 of Regulation S-K [17 CFR 229.303].

<sup>29</sup> Former Instruction 1 to Item 402(c)(2)(v) and (vi) of Regulation S-K and former Instruction 1 to Item 402(b)(2)(v) and (vi) of Regulation S-B. Each of these instructions is redesignated as the Instruction to the respective Item.

<sup>30</sup> Former Instruction 2 to Item 402(c)(2)(v) and (vi) of Regulation S-K and former Instruction 2 to Item 402(b)(2)(v) and (vi) of Regulation S-B. With respect to the Director Compensation Table, we correspondingly amend the Instruction to Item 402(k) of Regulation S-K and the Instruction to Item

As discussed below,<sup>31</sup> this information and the full grant date fair value disclosure formerly disclosed in the Summary Compensation Table is moved to the Grants of Plan-Based Awards Table, where it is required on a grant-by-grant basis.

We also revise the instruction to the Summary Compensation Table Salary and Bonus columns regarding salary or bonus forgone at the election of a named executive officer in favor of receiving a non-cash form of compensation.<sup>32</sup> Reporting such forgone amounts in the Stock Awards or Option Awards columns after salary or bonus is earned is inconsistent with the original terms of the award that would have compensated the named executive officer in cash. Accordingly, the revised instruction requires the forgone amount to be reported in the Salary or Bonus column, with footnote disclosure of the receipt of non-cash compensation that refers to the Grants of Plan-Based Awards Table where the stock, option or non-equity incentive plan award elected is reported.

Under FAS 123R, the classification of an award as an equity or liability award is an important aspect of the accounting because the classification will affect the measurement of compensation cost recognized in each financial statement reporting period. Awards with cash-based settlement, certain repurchase features, or other features that do not result in an employee bearing the risks and rewards normally associated with share ownership for a specified period of time are classified as liability awards under FAS 123R. For an award classified as an equity award under FAS 123R, the compensation cost recognized is fixed for a particular award and, absent modification of the award, is not revised with subsequent changes in market prices or other assumptions used for purposes of the valuation. In contrast, liability awards are initially measured at fair value on the grant date, but for purposes of recognition in the financial statements are then re-

402(f) of Regulation S-B to reflect this rescission. We also make a technical correcting amendment to the Instruction to Item 402(k) of Regulation S-K so that it also applies Instructions 1 and 5 to Item 402(c)(2)(ix). These two instructions regarding the All Other Compensation column address the treatment of non-equity incentive plan awards and earnings and earnings on stock and options, and accrued amounts under termination or change in control plans or arrangements, respectively.

<sup>31</sup> See Section II.B.

<sup>32</sup> Instruction 2 to Item 402(c)(2)(iii) and (iv) of Regulation S-K and Instruction 2 to Item 402(b)(2)(iii) and (iv) of Regulation S-B. Compensation that is within the scope of FAS 123R, and hence reportable in the Stock Awards or Option Awards columns, is specified by Paragraph 4 of FAS 123R.

measured at each financial statement reporting date through the date the awards are settled under FAS 123R. Under the amendments to the Summary Compensation Table and Director Compensation Table, these re-measurements of liability awards will be reflected in executive compensation disclosure, providing a more comprehensive measure of liability awards over time.

FAS 123R requires a company to aggregate individuals receiving awards into relatively homogenous groups, for example, executives and non-executives, with respect to exercise and post-vesting employment termination behaviors for the purpose of determining expected term assumption used for computing the grant date fair value. The rules we adopt today as interim final rules, like the recently adopted amendments, are not intended to change the method used to value employee stock options for purposes of FAS 123R or to affect the judgments as to reasonable groupings for purposes of determining the expected term assumption required by FAS 123R. Where a company uses more than one group, the measurement of grant date fair value for purposes of Item 402 will be derived using the expected term assumption for the group that includes the named executive officers (or the group that includes directors for purposes of the Director Compensation Table).

In determining the amount recognized, FAS 123R requires a company to estimate at the grant date the number of awards that ultimately will be earned. Those estimates are revised each period as awards vest or are forfeited. The interim final rules that we adopt today are not intended to change the method a company uses to estimate forfeitures under FAS 123R. However, under the amendments, the compensation cost disclosed for Item 402 purposes will not include an estimate of forfeitures related to service-based vesting conditions. Compensation cost for awards containing service-based vesting conditions<sup>33</sup> will be disclosed assuming that a named executive officer will perform the requisite service to vest in the award. If the named executive officer fails to perform the requisite service and forfeits the award, the

<sup>33</sup> As defined in Appendix E of FAS 123R, a service condition is "a condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that depends solely on an employee rendering service to the employer for the requisite service period. A condition that results in the acceleration of vesting in the event of an employee's death, disability, or termination without cause is a service condition."

amount of compensation cost previously disclosed in the Summary Compensation Table will be deducted in the period during which the award is forfeited.<sup>34</sup>

Under the interim final rules, compensation cost for awards containing a performance-based vesting condition<sup>35</sup> will be disclosed in the Summary Compensation Table only if it is probable that the performance condition will be achieved. If the achievement of the performance condition is not probable at the grant date but becomes probable in a subsequent period, the proportionate amount of compensation cost based on service previously rendered will be disclosed in the Summary Compensation Table during the period in which achievement of the performance condition becomes probable. Likewise, if the achievement of a performance condition was previously considered probable but in a later period is no longer considered probable, the amount of compensation cost previously disclosed in the Summary Compensation Table will be reversed during the period in which it is determined that achievement of the performance condition is no longer probable.<sup>36</sup>

<sup>34</sup> This approach to forfeitures was suggested in the letter from BDO Seidman.

<sup>35</sup> As defined in Appendix E of FAS 123R, a performance condition is "a condition affecting the vesting, exercisability, exercise price or other pertinent factors used in determining the fair value of an award that relates to both (a) an employee's rendering service for a specified (either explicitly or implicitly) period of time and (b) achieving a specified performance target that is defined solely by reference to the employer's own operations (or activities). Attaining a specified growth rate in return on assets, obtaining regulatory approval to market a specified product, selling shares in an initial public offering or other financing event, and a change in control are examples of performance conditions for purposes of this Statement. A performance target also may be defined by reference to the same performance measure of another entity or group of entities. For example, attaining a growth rate in earnings per share that exceeds the average growth rate in earnings per share of other entities in the same industry is a performance condition for purposes of this Statement. A performance target might pertain either to the performance of the enterprise as a whole or to some part of the enterprise, such as a division or an individual employee."

<sup>36</sup> Disclosing stock and option awards as they are recognized for financial statement reporting purposes may not mirror the timing of disclosure of non-equity incentive plan compensation. Because there is not one clearly required or accepted standard for measuring the value at grant date of non-equity incentive plan awards that reflects the applicable performance contingencies, as there is for equity-based awards under FAS 123R, we have not included such a value in the Summary Compensation Table disclosure. Instead, non-equity incentive plan compensation is disclosed in the Summary Compensation Table in the year when the relevant specified performance criteria are satisfied and the compensation earned, whether or not

In summary, if an award with service or performance-based conditions ultimately vests, the amount cumulatively recognized in the Summary Compensation Table over a period of years should equal 100% of the grant date fair value of the equity award or the total fair value at the date of settlement for a liability award. The amount cumulatively reported in the Summary Compensation Table for awards with service or performance-based conditions that do not vest will be zero. On this basis, the amount cumulatively reported for equity awards with graded vesting will equal 100% of the grant date fair value of the portion of the award that vests. For example, if 20% of an award to the principal executive officer vests in each of the five years following the grant and the principal executive officer leaves the company after the fourth year of service, 80% of the award's grant date fair value will be reported cumulatively in the Summary Compensation Table over those four years of service.<sup>37</sup>

In some cases, correlating disclosure in the Stock Awards and Option Awards columns to the financial statement recognition timing could result in a negative number. For example, a negative number would result if the value of awards forfeited in a fiscal year by a named executive officer exceeds the value of other awards recognized in the Summary Compensation Table for that same named executive officer. Such a negative number will be disclosed in the relevant column and affect the calculation of "total" for purposes of determining who is a named executive officer. In addition, there could be instances when compensation cost is recognized in the financial statements under FAS 123R in the year before the award is granted. This occurs when an employee is rendering services in exchange for an award, but a grant has not occurred because the terms of the award have not yet been finalized. There also could be instances where a grant has been made, but compensation cost is not recognized in the financial statements. This occurs when an award has a performance condition that is not considered at the date of grant to be probable to vest.<sup>38</sup>

payment is actually made to the named executive officer in that year. See Item 402(c)(2)(vii) of Regulation S-K, Item 402(b)(2)(vii) of Regulation S-B and 2006 Executive Compensation Release at Section II.C.1.c.ii.

<sup>37</sup> This example of graded vesting assumes an award with service-based vesting conditions only, where the company has elected the straight-line attribution method pursuant to paragraph 42 of FAS 123R.

<sup>38</sup> Footnote 25 of FAS 123R provides that whether vesting is probable for this purpose is determined

Under FAS 123R, an award granted to a retirement eligible employee who is entitled to retain the award at retirement generally is not considered to have a substantive service requirement. This is because the employee can keep the benefit of the award without performing services, regardless of the stated vesting terms. In this circumstance, the full grant date fair value of the award is recognized in the company's financial statements in the year of grant. Thus, the interim final rules do not effect significant change from the former requirements for computing Stock Awards and Option Awards disclosure for retirement eligible executives.

The amendments do not revise the instruction regarding the determination of the most highly compensated executive officers for purposes of identifying named executive officers other than the principal executive officer and principal financial officer.<sup>39</sup> This determination will continue to be based on total compensation, reduced by the sum of the increase in pension values and nonqualified deferred compensation above-market or preferential earnings reported in column (h) of the Summary Compensation Table, subject to a \$100,000 threshold. However, the amendments to the Stock Awards and Option Awards disclosure may reduce potential fluctuations in total compensation resulting from year-to-year differences in equity awards, as a commenter suggested.<sup>40</sup> Consequently, a company's identification of named executive officers may be more consistent from year-to-year, facilitating investors' ability to track year-to-year changes in compensation for the same persons.

#### B. Grant of Plan-Based Awards Table

Under the interim final rules, the grant date fair value information with respect to equity awards to named executive officers is moved to the Grants of Plan-Based Awards Table and expanded to include grant-by-grant information. As described above, this should provide investors a more complete perspective of the compensation decisions made with respect to the last completed fiscal year and facilitate Compensation Discussion and Analysis disclosure of the

based on the standard set forth in Financial Accounting Standards Board Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* (FAS 5), at paragraph 3, which defines probable as "the future event or events are likely to occur."

<sup>39</sup> Instruction 1 to Item 402(a)(3) of Regulation S-K and Instruction 1 to Item 402(a)(2) of Regulation S-B.

<sup>40</sup> See letter from Fenwick.

company's policies and decisions regarding named executive officers' compensation.<sup>41</sup>

The amendments revise the Grants of Plan-Based Awards Table to add column (I), showing the full grant date fair value of each equity award, computed in accordance with FAS 123R.<sup>42</sup> Presenting this information on a grant-by-grant basis is consistent with the presentation of other information in the Grants of Plan-Based Awards Table. This presentation should continue to provide investors a clear picture of the value of options when granted, including in-the-money awards.<sup>43</sup> The table will continue to disclose the number of shares underlying an award and other details regarding the award.<sup>44</sup> To conform the presentation for directors, we amend the Director Compensation Table in Item 402 of Regulation S-K to require footnote disclosure of the grant date fair value of each equity award computed in accordance with FAS 123R.<sup>45</sup> Under the amendments, grant date fair value information is not required regarding equity awards to named executive officers or directors of companies covered by Item 402 of Regulation S-B, which does not include a Grants of

Plan-Based Awards Table.<sup>46</sup> This differential treatment of small business issuers is consistent with other aspects of Item 402 of Regulation S-B, which in general recognizes that the executive compensation arrangements of small business issuers typically are less complex than those of other public companies and that satisfying disclosure requirements applicable to other public companies may impose unwarranted burdens on small business issuers.<sup>47</sup>

The interim final rules further amend the Grants of Plan-Based Awards Table to include information concerning repriced or materially modified options, stock appreciation rights and similar option-like instruments, disclosing the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R.<sup>48</sup> Consistent with the presentation of other information in the Grants of Plan-Based Awards Table, this disclosure will be made on a grant-by-grant basis. The Director Compensation Table in Item 402 of Regulation S-K also is amended to require footnote disclosure of the same information.<sup>49</sup> Consistent with FAS 123R, this disclosure does not apply to any modification that equalizes the fair value of an award before and after the modification, such as a modification made pursuant to an antidilution provision that requires adjustment in the event of a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs. Similarly, this disclosure does not apply to a repricing that occurs through a pre-existing formula or mechanism in the terms of the plan or award that results in the periodic

adjustment of the option or SAR exercise or base price, as the adjustment feature would have been reflected in the grant date fair value of the award.<sup>50</sup> As described in the 2006 Executive Compensation Release, disclosure also will be provided in the Compensation Discussion and Analysis and the narrative disclosures for the Summary Compensation Table and Grants of Plan-Based Awards Table,<sup>51</sup> as appropriate, regarding awards granted in connection with repricing transactions.<sup>52</sup>

### III. Administrative Law Matters and Request for Comments

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the *Federal Register*.<sup>53</sup> This requirement does not apply, however, if the agency "for good cause finds \* \* \* that notice and public procedure are impracticable, unnecessary, or contrary to the public interest."<sup>54</sup>

The Commission, for good cause, finds that notice and solicitation of comment regarding the amendments to Item 402 of Regulations S-K and S-B is impracticable, unnecessary and contrary to the public interest. First, the subject matter of the amendments already was subject to extensive public comment in connection with the 2006 Executive Compensation Release, and the Commission has considered those comments thoroughly in adopting these interim final rules.

Second, compliance with the Item 402 amendments adopted in the 2006 Executive Compensation Release is required for proxy and information statements filed on or after December 15, 2006 that are required to include Item 402 disclosure for fiscal years ending on or after December 15, 2006, and for Forms 10-K and 10-KSB for fiscal years ending on or after December 15, 2006.<sup>55</sup> This compliance schedule affects all public companies with a calendar year fiscal year that are required to file proxy or information statements, which we estimate to number approximately 12,190, excluding investment companies. Submitting the amendments to notice and further opportunity for public comment would generate considerable

<sup>41</sup> See general discussion in Section II above.

<sup>42</sup> Item 402(d)(2)(viii) of Regulation S-K. Disclosing the value of the equity award in this table resembles the approach taken in the Option/SAR Grants Table previously required by Item 402(c) of Regulation S-K as adopted in the 1992 Release. That table required disclosure of either (a) the present value of the grant at grant date under any option-pricing model, or (b) the potential realizable value of each option or freestanding SAR grant assuming annualized appreciation rates of 5% and 10%, and 0% for awards where the exercise or base price was below the market price of the underlying security at the date of grant. In their comment letters, AICPA, E&Y and KPMG recommended presenting full grant date fair value in a supplemental table. In light of our previous decision to report the full grant date fair value in the Summary Compensation Table, we did not follow this recommendation in the 2006 Executive Compensation Release.

<sup>43</sup> As noted in the 2006 Executive Compensation Release at Section II.C.1.c.i, disclosing grant date fair value will give investors a clearer picture of the value of any in-the-money awards.

<sup>44</sup> Item 402(c)(2)(ix)(G) of Regulation S-K and Item 402(b)(2)(ix)(G) of Regulation S-B require disclosure in the Summary Compensation Table. All Other Compensation column of the dollar value of any dividends or other earnings paid on stock or option awards when those amounts were not factored in the grant date fair value for the stock or option award. Item 402(k)(2)(vii)(I) of Regulation S-K and Item 402(f)(2)(vii)(I) of Regulation S-B require corresponding disclosure in the Director Compensation Table. These items are amended to reflect that the grant date fair value no longer is required to be reported in the Stock Awards or Option Awards columns, and in the case of Regulation S-K, must be reported in the Grants of Plan-Based Awards Table with respect to named executive officers.

<sup>45</sup> Instruction to Item 402(k)(2)(iii) and (iv).

<sup>46</sup> Instead, Item 402(c) of Regulation S-B requires narrative disclosure to the Summary Compensation Table. Item 402(c)(4) includes among the examples of material factors necessary to an understanding of the Summary Compensation Table for which narrative disclosure should be provided the material terms of each grant, including but not limited to the date of exercisability, any conditions to exercisability, any tandem feature, any reload feature, any tax-reimbursement feature, and any provision that could cause the exercise price to be lowered.

<sup>47</sup> See 2006 Executive Compensation Release at Section II.D.1.

<sup>48</sup> Instruction 7 to Item 402(d) of Regulation S-K. Disclosure of repriced awards was proposed for the Grants of All Other Equity Awards Table, on which the Grants of Plan-Based Awards Table is based in part. *Executive Compensation and Related Party Disclosure*, Release No. 33-8655 (Jan. 27, 2006) [71 FR 6542] at Section II.B.2.b. In light of previously adopting Summary Compensation Table disclosure of the FAS 123R incremental fair value of these awards, we did not adopt disclosure of these awards in the Grants of Plan-Based Awards Table in the 2006 Executive Compensation Release. See the 2006 Executive Compensation Release at Section II.C.2.

<sup>49</sup> Instruction to Item 402(k)(2)(iii) and (iv).

<sup>50</sup> Instruction 7 to Item 402(d) and Instruction to Item 402(k)(2)(iii) and (iv), which conform to Instruction 1 to Item 402(e)(1).

<sup>51</sup> Item 402(e)(1)(ii) of Regulation S-K and Item 402(c)(2) of Regulation S-B.

<sup>52</sup> 2006 Executive Compensation Release at Section II.C.3.a.

<sup>53</sup> See 5 U.S.C. 553(b).

<sup>54</sup> *Id.*

<sup>55</sup> 2006 Executive Compensation Release at Section VII.

uncertainty regarding the executive compensation disclosure standards to apply as these companies prepare their proxy statements. Given that the amendments affect not only the calculation of total compensation for each named executive officer, but also the identification of the named executive officers (other than the principal executive officer and principal financial officer) based on highest total compensation, such uncertainty could impose extensive burdens and costs. In effect, submitting the amendments to notice and further opportunity for public comment could compel calendar year-end companies to prepare two different sets of executive compensation disclosures because they would not know which version of Item 402 ultimately would apply on the date the proxy or information statement must be filed.

Adopting the amendments as interim final rules also will substantially benefit investors by minimizing any inconsistency between the measure used for disclosure in the Summary Compensation Table of Stock Awards and Option Awards in the first year of compliance and the measure used in later years. Avoiding such potential inconsistency will facilitate year-to-year comparability of the compensation disclosed for individual named executive officers and directors.

The Administrative Procedure Act also generally requires that an agency publish an adopted rule in the **Federal Register** 30 days before it becomes effective.<sup>56</sup> This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.<sup>57</sup> For the same reasons as it is waiving notice and comment, the Commission finds good cause to make the amendments effective as interim final rules upon publication of this release in the **Federal Register**.<sup>58</sup> The compliance dates for the interim final rules will be the same as the compliance dates for the amendments to Item 402 of Regulations S-K and S-B that were adopted in the 2006 Executive Compensation Release.<sup>59</sup>

Although the Commission is dispensing with prior notice of

proposed rulemaking, the Commission is interested in receiving written comments on the interim final rules within 30 days after publication of this release in the **Federal Register**. The Commission will consider those comments and make changes to the amendments if necessary.

- Do the amendments result in disclosure that is easier or more difficult for investors to understand? Do the amendments facilitate or complicate company compliance? For example, does presenting the compensation costs of stock and option awards over the requisite service period, as described in FAS 123R, for each individual named executive officer increase compliance costs?

- Does correlating the Summary Compensation Table and Director Compensation Table disclosure to the recognition of the compensation cost of stock and option awards over the requisite service period, as described in FAS 123R, with full grant date fair value disclosure for named executive officers and directors of non-small business issuers only, provide investors with a clearer and more useful presentation of compensation for the subject fiscal year than disclosure of aggregate grant date fair value in the Summary and Director Compensation Tables? Are there other approaches that would provide a better presentation of compensation?

- Should footnote or narrative disclosure be required to identify the remeasurement of liability awards? If so, what level of detail should we require?

- Under the interim final rules, the compensation cost disclosed for Summary Compensation Table and Director Compensation Table purposes does not include an estimate of forfeitures related to service-based vesting conditions. Is this deviation from FAS 123R needed to present meaningful executive compensation disclosure? If not, why not? Does this deviation make it easier or harder for companies to prepare the disclosure and for investors to understand it?

- Correlating disclosure in the Stock Awards and Option Awards columns to an approach that provides disclosure of compensation cost of those awards over the requisite service period could result in a negative number. In this circumstance, the negative number will be disclosed and will affect the calculation of "total" for purposes of determining who is a named executive officer. Instead, should the same approach be followed as for disclosure of the aggregate change in actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial plans,

where a negative number is disclosed in a footnote but not reflected in the applicable column and not subtracted for purposes of computing the total?<sup>60</sup>

- Does applying a recognition-based measure for Summary Compensation Table disclosure of equity awards result in any circumstances where, in disclosing a named executive officer's potential payments upon termination or change-in-control,<sup>61</sup> there would be a disclosure gap regarding the remaining value of outstanding awards (as adjusted for any acceleration of vesting) that has not yet been recognized?

- Does spreading out disclosure of equity award compensation over the period that the cost is recognized for financial reporting purposes result in less variability in the amount of total compensation reported from year-to-year?

- If the amendments result in fewer year-to-year fluctuations in the list of named executive officers, will such increased consistency result in more meaningful disclosure to investors?

- The interim final rules revise Summary Compensation Table disclosure of salary or bonus forgone at the election of a named executive officer under which stock, equity-based or other forms of non-cash compensation have instead been received by the named executive officer to require this compensation to be disclosed in the salary or bonus column, as applicable. Should this compensation be disclosed this way? Are there any other items of disclosure that should be revised in light of adopting a recognition-based approach to Summary Compensation Table and Director Compensation Table disclosure of equity-based compensation?

- Will Grants of Plan-Based Awards Table disclosure of the grant date fair value on a grant-by-grant basis improve investors' understanding of the value of awards, including in-the-money grants?

- For companies subject to Item 402 of Regulation S-K, is footnote disclosure in the Director Compensation Table of the grant date fair value of each equity award necessary to investors' understanding of director compensation?

- Under the interim final rules, disclosure of the full grant date fair value of equity awards and disclosure of the incremental fair value for repriced or materially modified awards no longer will be required for named executive officers and directors of small business

<sup>60</sup> Instruction 3 to Item 402(c)(2)(viii) of Regulation S-K.

<sup>61</sup> This disclosure is required by Item 402(j) of Regulation S-K and Item 402(e) of Regulation S-B.

<sup>56</sup> See 5 U.S.C. 553(d).

<sup>57</sup> *Id.*

<sup>58</sup> This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rules to become immediately effective notwithstanding the requirements of 5 U.S.C. 801 (if a Federal agency finds that notice and public comment are "impractical, unnecessary, or contrary to the public interest," a rule "shall take effect at such time as the Federal agency promulgating the rule determines.")

<sup>59</sup> See 2006 Executive Compensation Release at Section VII.

issuers. Are these results appropriate? Should this disclosure also be required, on either an aggregate or grant-by-grant basis by Regulation S-B companies, either as a footnote or in the narrative disclosure to the Summary Compensation Table?<sup>62</sup> As a footnote or in narrative disclosure to the Director Compensation Table?<sup>63</sup>

- In circumstances where compensation cost with respect to an award is first recognized in the financial statements in the year before the award is granted, should disclosure in the Grants of Plan-Based Awards Table also be required in the year before the award is granted to eliminate potential inconsistency between these tables? What modifications would be required to reflect that the terms of the award have not yet been finalized?

- Should footnote or narrative disclosure be required to identify in the Grants of Plan-Based Awards Table and the Regulation S-B narrative disclosure to the Summary Compensation Table equity awards with performance conditions that are not considered probable of achievement and therefore are not reflected in the Summary Compensation Table disclosure? If so, what level of detail should we require?

#### IV. Transition Guidance

Because FAS 123R became effective for companies in 2006, it did not apply to stock and option awards that were granted in earlier years. Consequently, we are providing transition guidance for application of the Summary Compensation Table and Director Compensation Table amendments to disclosure of awards that were granted before 2006, including both equity awards that are not yet vested and liability awards that are not yet settled.<sup>64</sup> In this regard, we are requiring companies to utilize the FAS 123R modified prospective transition method<sup>65</sup> for Item 402 disclosure purposes, without regard to whether they have adopted that method for financial statement reporting purposes.<sup>66</sup> Under the modified

prospective transition method, a proportionate share of the grant date fair value determined under Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, of equity awards that are outstanding at the date FAS 123R was adopted will be recognized in the financial statements over those awards' remaining vesting periods, if any. Liability awards that are outstanding at the date FAS 123R was adopted will be recognized in the financial statements until those awards are settled, based on the fair values of those awards at each financial statement reporting period under FAS 123R as well as the portion of the awards that have vested. The same approach will apply for presentation of the corresponding information in the Summary Compensation Table and Director Compensation Table for fiscal 2006 and later fiscal years.

#### V. Paperwork Reduction Act

##### A. Background

The interim final rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.<sup>67</sup> We are submitting these to the Office of Management and Budget for review and approval in accordance with the Paperwork Reduction Act.<sup>68</sup> The titles for the collection of information are:<sup>69</sup>

- (1) "Regulation S-B" (OMB Control No. 3235-0417);
- (2) "Regulation S-K" (OMB Control No. 3235-0071);
- (3) "Form SB-2"<sup>70</sup> (OMB Control No. 3235-0418);
- (4) "Form S-1"<sup>71</sup> (OMB Control No. 3235-0065);
- (5) "Form S-4"<sup>72</sup> (OMB Control Number 3235-0324);
- (6) "Form S-11"<sup>73</sup> (OMB Control Number 3235-0067);
- (7) "Regulation 14A"<sup>74</sup> and Schedule 14A"<sup>75</sup> (OMB Control Number 3235-0059);

compensation disclosure may not match financial statement disclosure during the transition period.

<sup>67</sup> 44 U.S.C. 3501 *et seq.*

<sup>68</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>69</sup> The paperwork burden from Regulation S-K is imposed through the forms that are subject to the requirements in those Regulations and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burdens imposed by Regulation S-K to be a total of one hour.

<sup>70</sup> 17 CFR 239.10.

<sup>71</sup> 17 CFR 239.11.

<sup>72</sup> 17 CFR 239.25.

<sup>73</sup> 17 CFR 239.18.

<sup>74</sup> 17 CFR 240.14a-1 *et seq.*

<sup>75</sup> 17 CFR 240.14a-101.

(8) "Regulation 14C"<sup>76</sup> and Schedule 14C"<sup>77</sup> (OMB Control Number 3235-0057);

(9) "Form 10"<sup>78</sup> (OMB Control No. 3235-0064);

(10) "Form 10-SB"<sup>79</sup> (OMB Control No. 3235-0419)

(11) "Form 10-K"<sup>80</sup> (OMB Control No. 3235-0063);

(12) "Form 10-KSB"<sup>81</sup> (OMB Control No. 3235-0420); and

(13) "Form N-2"<sup>82</sup> (OMB Control No. 3235-0026).

We adopted all of the existing regulations and forms pursuant to the Securities Act of 1933 ("Securities Act")<sup>83</sup> and the Securities Exchange Act of 1934 ("Exchange Act"),<sup>84</sup> except for Form N-2, which we adopted pursuant to the Securities Act and the Investment Company Act of 1940 ("Investment Company Act").<sup>85</sup> These regulations and forms set forth the disclosure requirements for annual<sup>86</sup> and current reports, registration statements, proxy statements and information statements that are prepared by issuers to provide investors with the information they need to make informed investment decisions in registered offerings and in secondary market transactions, as well as informed voting decisions in the case of proxy statements.

The amendments adopted as interim final rules are intended to provide investors a fuller and more useful picture of executive compensation. In particular, they are intended to provide a more complete perspective of the compensation decisions made with respect to the last completed fiscal year, facilitate Compensation Discussion and Analysis disclosure of the company's policies and decisions regarding named executive officers' compensation, and provide investors with a clearer view of the annual compensation earned by executives and directors and the annual compensation costs to a company consistent with the timing of financial statement reporting.

The hours and costs associated with preparing disclosure, filing forms, and retaining records constitute reporting and cost burdens imposed by the collection of information. An agency may not conduct or sponsor, and a

<sup>76</sup> 17 CFR 240.14c-1 *et seq.*

<sup>77</sup> 17 CFR 240.14c-101.

<sup>78</sup> 17 CFR 249.210.

<sup>79</sup> 17 CFR 249.210b.

<sup>80</sup> 17 CFR 249.310.

<sup>81</sup> 17 CFR 249.310b.

<sup>82</sup> 17 CFR 239.14 and 274.11a-1.

<sup>83</sup> 15 U.S.C. 77a *et seq.*

<sup>84</sup> 15 U.S.C. 78a *et seq.*

<sup>85</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>86</sup> The pertinent annual reports are those filed on Form 10-K and Form 10-KSB.

<sup>62</sup> Item 402(c) of Regulation S-B.

<sup>63</sup> Item 402(f)(3) of Regulation S-B.

<sup>64</sup> Under the amendments, the adjustments to update the cumulative compensation costs recognized for certain awards that a company might have in the year that FAS 123R initially is adopted will not be included in the Summary Compensation Table disclosure for that year.

<sup>65</sup> Under the modified prospective transition method in FAS 123R, the accounting for new awards and awards that are modified, repurchased or cancelled after the standard's effective date must apply the provisions of FAS 123R.

<sup>66</sup> Consequently, for companies that have not adopted the modified prospective transition method for financial statement reporting, the tabular

person is not required to respond to, a collection of information unless it displays a currently valid control number.

The information collection requirements related to annual and current reports, registration statements, proxy statements and information statements are mandatory. However, the information collection requirements relating exclusively to proxy and information statements will apply only to issuers subject to the proxy rules. There is no mandatory retention period for the information disclosed, and the information disclosed will be made publicly available on the EDGAR filing system.

#### B. Summary of Information Collections

The amendments will affect existing disclosure burdens for affected filings as follows:

- The dollar value reported in the Stock Awards and Option Awards columns of the Summary Compensation Table and Director Compensation Table is revised to disclose the compensation cost of those awards over the requisite service period, as described in FAS 123R, but will not reflect the estimate for forfeitures related to service-based vesting used for financial statement reporting purposes;
- The Stock Awards and Option Awards columns of the Summary Compensation Table and Director Compensation Table are revised to require footnote disclosure of forfeitures during the last completed fiscal year;
- The Grants of Plan-Based Awards Table is revised to require disclosure of the grant date fair value of each individual equity award, computed in accordance with FAS 123R, and the Item 402 of Regulation S-K Director Compensation Table is revised to require footnote disclosure of the same information; and
- The Grants of Plan-Based Awards Table is revised to require disclosure of any option or SAR that was repriced or otherwise materially modified during the last completed fiscal year, including the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R, and the Item 402 of Regulation S-K Director Compensation Table is revised to require footnote disclosure of the same incremental fair value information.

#### C. Paperwork Reduction Act Burden Estimates

For purposes of the Paperwork Reduction Act, we estimate no annual incremental increase in the paperwork burden for companies to comply with our amended collection of information

requirements. We base this estimate on the fact that the revised approach is substantially the same as the approach companies already apply when complying with financial reporting requirements, most of the information that will be required to be disclosed will be collected to comply with financial reporting requirements, and any necessary modifications will not impose additional burdens compared to the burdens associated with applying the currently required disclosure. We also base this estimate on the likelihood that the revised approach will make companies' identification of named executive officers more consistent from year-to-year, thereby possibly reducing the burden of tracking the compensation of all executive officers in order to determine which executive officers are the most highly compensated.

#### D. Request for Comment

We invite comment on this estimate and its assumptions. We request comment in order to: (a) Evaluate whether the collections of information are necessary for the proper performance of our functions, including whether the information will have practical utility; (b) evaluate the accuracy of our estimate of the burden of the collections of information; (c) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (d) evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology.<sup>87</sup>

### VI. Cost-Benefit Analysis

#### A. Background

We are adopting, as interim final rules, amendments to our rules governing disclosure of executive compensation. The amendments adopted as interim final rules are intended to provide investors a fuller and more useful picture of executive compensation. In particular, they are intended to provide a more complete perspective of the compensation decisions made with respect to the last completed fiscal year, facilitate Compensation Discussion and Analysis disclosure of the company's policies and decisions regarding named executive officers' compensation, and provide investors with a clearer view of the annual compensation earned by executives and directors and the annual compensation costs to a company

consistent with the timing of financial statement reporting.

#### B. Summary of Amendments

Under the amendments adopted as interim final rules, a measure based on the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R will become the measure for reporting in the Stock Awards and Option Awards columns in the Summary Compensation Table and the Director Compensation Table. However, this measure does not include an estimate of forfeitures related to service-based vesting conditions, and the amendments require footnote disclosure of awards forfeited during the last completed fiscal year. The new measure, which is included in total compensation disclosed in the Summary Compensation Table, could affect the determination of most highly compensated executive officers for purposes of identifying named executive officers other than the principal executive officer and principal financial officer.

Under the interim final rules, the Grants of Plan-Based Awards Table is amended to add a column showing the grant date fair value of each equity award computed in accordance with FAS 123R, and information for repriced options, stock appreciation rights and similar option-like instruments, including the incremental fair value computed as of the repricing or modification date in accordance with FAS 123R. The interim final rules also amend the Director Compensation Table in Item 402 of Regulation S-K to provide footnote disclosure of the same grant date fair value and incremental fair value information.

#### C. Benefits

Basing Stock and Options Award disclosure in the Summary Compensation Table and Director Compensation Table on the amount recognized for financial statement purposes, as required by the interim final rules, will provide investors with a fuller and more useful picture of executive compensation. Measuring compensation in a manner more consistent with FAS 123R recognition will provide investors with a clearer view of the annual compensation costs to a company. The amended presentation in some circumstances will reduce the possibility of overstating compensation related to service rendered for the year that could result from disclosing the full grant date fair value, particularly with respect to liability awards, which are subject to

<sup>87</sup> Comments are requested pursuant to 44 U.S.C. 3506(c)(2)(B).

remeasurement, and will better reflect the possibility that some awards may be forfeited. Potentially reducing the variability in the identity of named executive officers from year-to-year may result in compensation disclosure that is more meaningful to investors due to the ability to track year-to-year changes in the same executive's compensation.

For companies subject to Item 402 of Regulation S-K, grant date fair value information is moved to the Grants of Plan-Based Awards Table, where it is presented on a more comprehensible grant-by-grant basis. This should provide investors a more complete perspective of the compensation decisions made with respect to the last completed fiscal year and facilitate Compensation Discussion and Analysis disclosure of the company's policies and decisions regarding named executive officers' compensation. Amending the Director Compensation Table in Item 402 of Regulation S-K to provide footnote disclosure of the same grant date fair value and incremental fair value information also will present this information on a more comprehensible grant-by-grant basis. Conforming Summary Compensation Table disclosure of equity-based awards to the timing mandated for the company's financial statements, together with the fair value disclosure in the Grants of Plan-Based Awards Table, will provide more disclosure, potentially making it easier for investors and analysts to analyze compensation for top executives.

Although difficult to quantify, disclosure under the amendments will benefit investors in terms of the transparency, completeness and accessibility of executive compensation disclosure. Making Summary Compensation Table and Director Compensation Table disclosure of stock and option awards more comparable to the approach used for financial accounting recognition purposes will make executive compensation disclosure more transparent by providing investors a clearer picture of annual compensation costs. Moving grant date fair value information to the Grants of Plan-Based Awards Table, where it is presented on a more comprehensive grant-by-grant basis, and requiring the same disclosure in a footnote to the Director Compensation Table, makes this disclosure more complete and accessible for investors in companies that report under Item 402 of Regulation S-K. To the extent that the amendments facilitate Compensation Discussion and Analysis disclosure of the company's policies and decisions regarding named executive officers'

compensation, investors will obtain a more complete perspective of the compensation decisions made with respect to the last completed fiscal year.

#### D. Costs

In our view, the amendments to the executive compensation disclosure rules adopted as interim final rules do not significantly increase the costs of complying with the Commission's rules. In order to implement the amendments, companies will need to incur costs to revise their disclosure controls. However, we believe that these costs will be incurred principally on a transitional basis as companies and their advisors determine how best to compile and report information in response to the amended disclosure requirements. We base this view on the fact that the amended approach for Summary Compensation Table and Director Compensation Table disclosure is substantially the same as the approach companies already apply when complying with financial reporting requirements, most of the information that will be required to be disclosed will have been collected to comply with financial reporting requirements, and any necessary modifications will impose minimal additional costs compared to the costs associated with applying the formerly required disclosure. We also base this view on the likelihood that the amended approach will make companies' identification of named executive officers more consistent from year-to-year, thereby possibly reducing the costs of tracking the compensation of all executive officers in order to determine which executive officers are the most highly compensated.

The amendments also may generate costs if they affect the compensation practices of companies or executives' preferences with respect to executive compensation. Under the amendments, the Item 402 of Regulation S-B Summary Compensation Table and Director Compensation Table no longer will provide the full grant date fair value of equity awards to named executive officers. Similarly, neither of these tables will provide disclosure of the incremental fair value of awards that are repriced or materially modified. To the extent that the loss of this information will reduce the value of executive compensation disclosure to investors, the amendments could impose costs on investors.

#### E. Request for Comment

• We solicit quantitative data to assist our assessment of the benefits and costs of the revised disclosure requirements.

• What, if any, additional work and costs are involved in collecting the information necessary to comply with the amendments? What are the types of costs, and in what amounts? In what way can the amendments be modified to mitigate the costs?

• Does identification of named executive officers based on the portion of equity compensation earned during the fiscal year result in more meaningful identification of named executive officers than under the former method based on the aggregate grant date fair value of awards?

• Will the interim final rules have an effect on companies' choice of compensation packages, or executives' preferences with respect to equity awards?

• Assuming the interim final rules are retained, what are the costs in the first year of compliance versus subsequent years?

• We solicit comments on the degree to which companies already collect the information that the amendments will require to be disclosed.

### VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Exchange Act Section 23(a)(2)<sup>88</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Furthermore, Securities Act Section 2(b),<sup>89</sup> Exchange Act Section 3(f)<sup>90</sup> and Investment Company Act Section 2(c)<sup>91</sup> require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

We have also discussed other impacts of the amendments adopted as interim final rules in our Cost-Benefit, Paperwork Reduction Act and Final Regulatory Flexibility Act Analyses. The amendments to Regulations S-K and S-B are intended to make executive compensation disclosure more consistent with financial statement disclosure, which should promote

<sup>88</sup> 15 U.S.C. 78w(a)(2).

<sup>89</sup> 15 U.S.C. 77b(b).

<sup>90</sup> 15 U.S.C. 78c(f).

<sup>91</sup> 15 U.S.C. 80a-2(c).

efficiency. The amendments should enhance investors' understanding of how corporate resources are used, and enable shareholders to better evaluate the actions of the board of directors and executive officers in fulfilling their responsibilities. In particular, measuring executive and director compensation in a manner more consistent with financial accounting recognition, along with disclosure of the grant date fair value of equity awards on a grant-by-grant basis, should provide investors with a fuller and more useful picture of executive compensation. This would include a clearer view of a company's compensation decisions and the annual compensation costs to a company.

The amendments may have the effect of reducing the likelihood of inconsistencies in the identity of named executive officers from year-to-year. To this extent, the number of executives for whom competitors could potentially gain insights with respect to a company's executive compensation practices through the required disclosure over a period of years may be reduced. However, we do not expect the incremental effect of the amendments overall to affect competition materially.

In adopting the amendments, we have considered their effect on capital formation and believe that the amendments will have little effect on capital formation.

We request comment on whether the amendments will promote efficiency, competition, and capital formation or have an impact or burden on competition. Commenters are requested to provide empirical data and other factual support for their views, if possible.

### VIII. Final Regulatory Flexibility Act Analysis

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to revisions to the rules and forms under the Securities Act and Exchange Act, adopted as interim final rules, that will provide investors with a presentation of compensation for the fiscal year that is more comparable to the approach used for financial accounting purposes.

#### A. Need for the Amendments

Since the enactment of the Securities Act and the Exchange Act, the Commission has on a number of occasions explored the best methods for communicating clear, concise and meaningful material information about executive and director compensation. Recently, the Commission adopted comprehensive amendments to improve the clarity and completeness of

executive compensation disclosure.<sup>92</sup> The interim final rules principally modify two aspects of those comprehensive amendments: modifying the timing of reporting option and stock awards in the Summary Compensation Table and Director Compensation Table so that it is more comparable to financial accounting recognition; and, in Item 402 of Regulation S-K, requiring Grants of Plan-Based Awards Table reporting of the full grant date fair value of equity awards and information regarding option, SAR and similar option-like awards that are repriced or materially modified during the fiscal year, and Director Compensation Table footnote disclosure of the same information. The overall goal of the amendments is to increase the transparency and completeness of executive compensation disclosure by providing investors a fuller and more useful picture of executive compensation. In particular, they are intended to provide a more complete perspective of the compensation decisions made with respect to the last completed fiscal year, facilitate Compensation Discussion and Analysis disclosure of the company's policies and decisions regarding named executive officers' compensation, and provide investors with a clearer view of the annual compensation earned by executives and directors and the annual compensation costs to a company consistent with the timing of financial statement reporting.

#### B. Significant Issues Raised by Public Comment

As summarized in Section I above, several commenters expressed the view that Summary Compensation Table disclosure of equity awards should be presented on a basis that is generally consistent with financial statement reporting. We have taken these comments into account in adopting the amendments that would apply to small entities.

#### C. Small Entities Subject to the Amendments

For purposes of the Regulatory Flexibility Act, Securities Act Rule 157<sup>93</sup> and Exchange Act Rule 0-10(a)<sup>94</sup> define an issuer to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of \$5 million or less on the last day of its most recent fiscal year. These are the types of entities that we refer to as small entities in this section.

<sup>92</sup> See the 2006 Executive Compensation Release.

<sup>93</sup> 17 CFR 230.157.

<sup>94</sup> 17 CFR 240.0-10(a).

We believe that the amendments will affect small entities that are operating companies. We estimate that there are approximately 2,500 issuers, other than investment companies, that may be considered small entities. Under Rule 0-10 under the Investment Company Act,<sup>95</sup> an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. We believe that the amendments will affect small entities that are investment companies. Specifically, we believe that the amendments will affect small entities that are business development companies.<sup>96</sup> We estimate that there are 53 business development companies that qualify as small entities.

#### D. Reporting, Recordkeeping, and Other Compliance Requirements

We note that small business issuers,<sup>97</sup> which is a broader category of issuers than small entities, in certain circumstances may provide the executive compensation disclosure specified in Item 402 of Regulation S-B, rather than the corresponding disclosure specified in Item 402 of Regulation S-K.

The amendments adopted as interim final rules will affect small business issuers as follows:

- The dollar value reported in the Stock Awards and Option Awards columns of the Summary Compensation Table and Director Compensation Table is revised to disclose the compensation cost of those awards over the requisite service period, as described in FAS 123R, but will not reflect the estimate for forfeitures related to service-based vesting used for financial statement reporting purposes; and
- The Stock Awards and Option Awards columns of the Summary Compensation Table and Director Compensation Table are revised to require footnote disclosure of forfeitures during the last completed fiscal year.

Because Item 402 of Regulation S-B does not include the Grants of Plan-Based Awards Table, the amendments to Item 402 of Regulation S-B do not include the following disclosures that

<sup>95</sup> 17 CFR 270.0-10.

<sup>96</sup> Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act. 15 U.S.C. 80a-2(a)(48).

<sup>97</sup> Item 10 of Regulation S-B (17 CFR 228.10) defines a small business issuer as a registrant that has revenues of less than \$25 million, is a U.S. or Canadian issuer, is not an investment company, and has a public float of less than \$25 million. Also, if it is a majority owned subsidiary, the parent corporation also must be a small business issuer.

are required for named executive officers and directors by the amendments to Item 402 of Regulation S-K:

- Disclosure of the grant date fair value of each individual equity award, computed in accordance with FAS 123R; and
- Disclosure of the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R, of any option or SAR that was repriced or otherwise materially modified during the last completed fiscal year.

As a result, the amendments to Item 402 of Regulation S-B do not result in the same level of incremental increase in costs or burdens to small businesses as do the amendments to Item 402 of Regulation S-K.

*E. Agency Action To Minimize Effect on Small Entities*

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, we considered the following alternatives:

1. Establishing different compliance or reporting requirements which take into account the resources available to smaller entities;
2. The clarification, consolidation or simplification of disclosure for small entities;
3. Use of performance standards rather than design standards; and
4. Exempting smaller entities from coverage of the disclosure requirements, or any part thereof.

We have considered different changes to our rules and forms to achieve our regulatory objectives, and where possible, have taken steps to minimize the effect of the rules on smaller entities. The amendments are unlikely to have a significant impact on smaller entities because their principal effect is to make Summary Compensation Table and Director Compensation Table disclosure of stock and option awards more comparable to the financial statement presentation of those compensation items. The amendments do not affect the abbreviated format of the Regulation S-B Summary Compensation Table, which requires disclosure with respect to the principal executive officer and two most highly compensated executive officers for the small business issuer's last two completed fiscal years. Because Item 402 of Regulation S-B does not include a Grants of Plan-Based Awards Table,

the amendments to that table do not apply.

*F. General Request for Comments*

We solicit written comments regarding this analysis. We request comment on whether the amendments adopted as interim final rules could have an effect that we have not considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

**IX. Statutory Authority and Text of the Amendments**

We are adopting rule amendments pursuant to Sections 3(b), 6, 7, 10, and 19(a) of the Securities Act, as amended, Sections 12, 13, 14, 15(d) and 23(a) of the Exchange Act, as amended, Section 38 of the Investment Company Act, and Section 3(a) of the Sarbanes-Oxley Act of 2002.

**List of Subjects**

*17 CFR Part 228*

Reporting and recordkeeping requirements, Securities, Small businesses.

*17 CFR Part 229*

Reporting and recordkeeping requirements, Securities.

■ For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

**PART 228—INTEGRATED DISCLOSURE SYSTEM FOR SMALL BUSINESS ISSUERS**

■ 1. The authority citation for part 228 continues to read in part as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 77nnn, 77sss, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-29, 80a-30, 80a-37, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350.

■ 2. Section 228.402 is amended by revising Instruction 2 to Item 402(b)(2)(iii) and (iv), paragraphs (b)(2)(v), (b)(2)(vi) and the Instructions to Item 402(b)(2)(v) and (b)(2)(vi), paragraph (b)(2)(ix)(G), paragraphs (f)(2)(iii), (f)(2)(iv) and (f)(2)(vii)(I), and Instruction to Item 402(f) to read as follows:

**§ 228.402 (Item 402) Executive compensation.**

- (b) \* \* \*
- (2) \* \* \*

*Instructions to Item 402(b)(2)(iii) and (iv).*

\* \* \* \* \*

2. Small business issuers shall include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based or other forms of non-cash compensation instead have been received by the named executive officer. However, the receipt of any such form of non-cash compensation instead of salary or bonus must be disclosed in a footnote added to the salary or bonus column and, where applicable, referring to the narrative disclosure to the Summary Compensation Table (required by paragraph (c) of this Item) where the material terms of the stock, option or non-equity incentive plan award elected by the named executive officer are reported.

(v) For awards of stock, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (e));

(vi) For awards of options, with or without tandem SARs, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (f));

*Instruction to Item 402(b)(2)(v) and (vi).*  
For awards reported in columns (e) and (f), disregard the estimate of forfeitures related to service-based vesting conditions. Include a footnote describing all forfeitures during the year, and disclosing all assumptions made in the valuation. Disclose assumptions made in the valuation by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

\* \* \* \* \*

(ix) \* \* \*  
(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value for the stock or option award; and

\* \* \* \* \*

- (f) \* \* \*
- (2) \* \* \*

(iii) For awards of stock, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (c));

(iv) For awards of stock options, with or without tandem SARs, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (d));

\* \* \* \* \*

(vii) \* \* \*  
(I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts

were not factored into the grant date fair value for the stock or option award; and

\* \* \* \* \*

*Instruction to Item 402(f).*

In addition to the Instruction to paragraph (f)(2)(vii) of this Item, the following apply equally to paragraph (f) of this Item: Instructions 2 and 4 to paragraph (b) of this Item; the Instructions to paragraphs (b)(2)(iii) and (iv) of this Item; the Instruction to paragraphs (b)(2)(v) and (vi) of this Item; the Instructions to paragraph (b)(2)(vii) of this Item; the Instruction to paragraph (b)(2)(viii) of this Item; the Instructions to paragraph (b)(2)(ix) of this Item; and paragraph (c)(7) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (f) of this Item that correspond to analogous disclosures provided for in paragraph (b) of this Item to which they refer.

**PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K**

■ 3. The general authority citation for part 229 is revised to read in part as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jii, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37,

80a-38, 80av39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

■ 4. Section 229.402 is amended by revising Instruction 2 to Item 402(c)(2)(iii) and (iv), paragraphs (c)(2)(v) and (c)(2)(vi), the Instructions to Item 402(c)(2)(v) and (c)(2)(vi), and paragraph (c)(2)(ix)(G), revising the Grants of Plan-Based Awards Table in paragraph (d)(1), removing “and” at the end of paragraph (d)(2)(vi), removing the period at the end of paragraph (d)(2)(vii) and adding “and” in its place, adding paragraph (d)(2)(viii) and Instruction 7 to Item 402(d), revising paragraphs (k)(2)(iii), (k)(2)(iv), the Instruction to Item 402(k)(2)(iii) and (iv), and revising paragraph (k)(2)(vii)(1) and Instruction to Item 402(k), to read as follows:

**§ 229.402 (Item 402) Executive compensation.**

\* \* \* \* \*

(c) \* \* \*  
(2) \* \* \*

*Instructions to Item 402(c)(2)(iii) and (iv).*

\* \* \* \* \*

2. Registrants shall include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based or other forms of non-cash compensation instead have been received by the named executive officer. However, the receipt of any such form of non-cash compensation instead of salary or bonus must be disclosed in a footnote added to the salary or bonus column and, where applicable, referring to the Grants of Plan-Based Awards Table (required by paragraph (d) of this Item) where the stock,

option or non-equity incentive plan award elected by the named executive officer is reported.

(v) For awards of stock, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (e));

(vi) For awards of options, with or without tandem SARs, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (f));

*Instruction to Item 402(c)(2)(v) and (vi).* For awards reported in columns (e) and (f), disregard the estimate of forfeitures related to service-based vesting conditions. Include a footnote describing all forfeitures during the year, and disclosing all assumptions made in the valuation. Disclose assumptions made in the valuation by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

\* \* \* \* \*

(ix) \* \* \*

(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (f) of the Grants of Plan-Based Awards Table required by paragraph (d)(2)(viii) of this Item; and

\* \* \* \* \*

(d) \* \* \*

**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)	Grant date fair value of stock and option awards
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)				
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
PEO											
PFO											
A											
B											
C											

(2) \* \* \*

(viii) The grant date fair value of each equity award computed in accordance with FAS 123R (column (l)). If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise or base price of

options, SARs or similar option-like instruments previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means (“repriced”), or otherwise has materially modified such awards, the incremental

fair value, computed as of the repricing or modification date in accordance with FAS 123R, with respect to that repriced or modified award, shall be reported.

*Instructions to Item 402(d).*

\* \* \* \* \*

7. Options, SARs and similar option-like instruments granted in connection with a repricing transaction or other material modification shall be reported in this Table. However, the disclosure required by this Table does not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.

\* \* \* \* \*

(k) \* \* \*  
(2) \* \* \*

(iii) For awards of stock, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (c));

(iv) For awards of stock options, with or without tandem SARs, the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R (column (d));

*Instruction to Item 402(k)(2)(iii) and (iv).*  
For each director, disclose by footnote to the appropriate column: the grant date fair value of each equity award computed in accordance with FAS 123R; for each option, SAR or similar option like instrument for which the registrant has adjusted or amended the exercise or base price during the last completed fiscal year, whether through amendment, cancellation or replacement grants, or any other means ("repriced"), or otherwise has materially modified such awards, the incremental fair value, computed as of the repricing or modification date in accordance with FAS 123R; and the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end. However, the disclosure required by this Instruction does not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.

\* \* \* \* \*

(vii) \* \* \*

(I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value for the stock or option award; and

\* \* \* \* \*

*Instruction to Item 402(k).*

In addition to the Instruction to paragraphs 402(k)(2)(iii) and (iv) and the Instructions to paragraph (k)(2)(vii) of this Item, the following apply equally to paragraph (k) of this Item: Instructions 2 and 4 to paragraph (c) of this Item; Instructions to paragraphs (c)(2)(iii) and (iv) of this Item; the Instruction to paragraphs (c)(2)(v) and (vi) of this Item; Instructions to paragraph (c)(2)(vii) of this

Item; Instructions to paragraph (c)(2)(viii) of this Item; and Instructions 1 and 5 to paragraph (c)(2)(ix) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (k) of this Item that correspond to analogous disclosures provided for in paragraph (c) of this Item to which they refer.

Dated: December 22, 2006.

By the Commission.

**J. Lynn Taylor,**

*Assistant Secretary.*

[FR Doc. 06-9932 Filed 12-26-06; 2:29 pm]

BILLING CODE 8011-01-P

**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[TD 9308]

RIN 1545-BF75

**Reporting Rules for Widely Held Fixed Investment Trusts**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations and removal of the temporary regulations.

**SUMMARY:** This document contains final regulations amending § 1.671-5 which provides reporting rules for widely held fixed investment trusts (WHFITs). These final regulations clarify and simplify reporting for trustees and middlemen of non-mortgage widely held fixed investment trusts (NMWHFITs). These final regulations also provide temporary safe harbor reporting rules for widely held mortgage trusts (WHMTs) that are outside the WHMT safe harbor. The preamble to these regulations also provides that trustees of WHFITs are to indicate on the Form 1041, "U.S. Income Tax Return for Estates and Trusts," filed for a WHFIT's 2006 calendar year that the return is a final return.

**DATES:** *Effective Date:* These regulations are effective December 29, 2006.

*Applicability Date:* For date of applicability see § 1.671-5(n).

**FOR FURTHER INFORMATION CONTACT:** Faith Colson, (202) 622-3060 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collection of information contained in these final regulations has been previously reviewed and approved by the Office of Management and

Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1540. The collection of information in these final regulations is in § 1.671-5. This information is required to be reported to beneficial owners of trust interests to enable them to correctly report their share of the items of income, deduction, and credit of the WHFIT in which they have invested. This information is also required to be reported to the IRS to enable the IRS to verify that trustees and middlemen are accurately reporting information to beneficial owners of trust interests and that beneficial owners are properly reporting their ownership of a trust interest.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

The estimated annual burden per recordkeeper varies from 1 to 4 hours, depending on individual circumstances, with an estimated average of 2 hours. Comments concerning the accuracy of this burden estimate should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W-CAR:MP:T:T:SP, Washington DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background**

This document contains amendments to 26 CFR part 1. On January 24, 2006, the Internal Revenue Service (IRS) and the Treasury Department published the WHFIT reporting rules in the **Federal Register** (TD 9241) (71 FR 4002) under § 1.671-5 (WHFIT reporting rules). On August 3, 2006, in response to comments received subsequent to the publication of the WHFIT reporting rules, the IRS and the Treasury Department published final and temporary regulations (TD 9279) (71 FR 43968) (temporary regulations) as well as proposed regulations that, in part, cross-referenced the temporary regulations (71 FR 43998) (proposed regulations) (REG-125071-06) in the **Federal Register**. No public hearing was requested or held with respect to the temporary or proposed regulations.

**APPENDIX B-III**

***SEC Compliance & Disclosure Interpretations Regarding  
Regulation S-K (July 8, 2011)***



## U.S. Securities and Exchange Commission

### Regulation S-K

**Last Update: July 8, 2011**

These Compliance & Disclosure Interpretations ("C&DIs") comprise the Division's interpretations of Regulation S-K. They replace the interpretations of Regulation S-K and Regulation S-B published in:

- the July 1997 Manual of Publicly Available Telephone Interpretations;
- the March 1999 Interim Supplement to the Manual of Publicly Available Telephone Interpretations;
- the November 2000 Current Issues and Rulemaking Projects Outline;
- the 2007 C&DIs on Items 201, 402, 403, 404 and 407; and
- the March 2008 C&DIs on smaller reporting companies.

The bracketed date following each C&DI is the latest date of publication or revision. A number of new C&DIs have been added. For C&DIs relating to Items 201, 402, 403, 404 and 407, as well as to smaller reporting companies, unless the C&DI has been revised or is a new C&DI, the bracketed date is the date on which the C&DI was last published in the sources noted above. All other C&DIs have been reviewed and, if necessary, updated, and are now republished as of July 3, 2008.

### QUESTIONS AND ANSWERS OF GENERAL APPLICABILITY

#### Section 101. Regulation S-K – General Guidance

None

#### Section 102. Item 10 – General

Question 102.01

**Question:** Could a company with a fiscal year ended December 31, 2007 be both a "smaller reporting company," as defined in Item 10(f), and an "accelerated filer," as defined in Rule 12b-2 under the Exchange Act, for filings due in 2008, if it was an accelerated filer with respect to filings due in 2007 and had a public float of \$60 million on the last business day of its second fiscal quarter of 2007?

**Answer:** Yes. A company must look to the definitions of "smaller reporting company" and "accelerated filer" to determine if it qualifies as a smaller reporting company and non-accelerated filer for each year. This company will qualify as a smaller reporting company for filings due in 2008 because fiscal year 2007 is the initial determination year for the company to qualify

for smaller reporting company status, and it had less than \$75 million in public float on the last business day of its second fiscal quarter. However, since the company was an accelerated filer with respect to filings due in 2007, it is required to have less than \$50 million in public float on the last business day of its second fiscal quarter in 2007 to exit accelerated filer status in 2008, as provided in paragraph (3)(ii) of the definition of "accelerated filer" in Rule 12b-2. This company had a public float of \$60 million on the last business day of its second fiscal quarter of 2007, and therefore is unable to transition to non-accelerated filer status. As this example illustrates, due to the application of the transition rules for accelerated filers, a company can be both an accelerated filer and a smaller reporting company at the same time. Such a company may use the scaled disclosure rules for smaller reporting companies in its annual report on Form 10-K, but the report is due 75 days after the end of its fiscal year and must include the Sarbanes-Oxley Section 404 auditor attestation report described in Item 308(b) of Regulation S-K. [July 3, 2008]

#### Question 102.02

**Question:** Will a company that does not qualify as a smaller reporting company for filings due in a particular year be able to qualify as a smaller reporting company if its public float falls below \$75 million at the end of its second fiscal quarter in a future fiscal year?

**Answer:** Any reporting company that can calculate its public float and did not qualify as a smaller reporting company previously will not qualify as a smaller reporting company in the future unless its public float falls below \$50 million on the last business day of its second fiscal quarter. This is provided for in Item 10(f)(2)(iii) of Regulation S-K and follows the rule for exiting accelerated filer status in Rule 12b-2 under the Exchange Act. Companies that cannot calculate their public float would need to fall below \$40 million in annual revenues to qualify as smaller reporting companies in the future. [July 3, 2008]

#### Question 102.03

**Question:** Under the definition of "smaller reporting company" in Item 10 (f) of Regulation S-K, does the corporate parent of a majority-owned subsidiary have to satisfy the public float or revenue requirements of the definition in order for the majority-owned subsidiary to qualify as a smaller reporting company?

**Answer:** Yes, the definition of "smaller reporting company" excludes a majority-owned subsidiary if its corporate parent does not also meet the requirements of a smaller reporting company. [July 3, 2008]

#### Question 102.04

**Question:** Under the definition of "smaller reporting company" in Item 10 (f) of Regulation S-K, must the corporate parent of a majority-owned subsidiary be required to file reports under Section 13(a) or Section 15(d) of the Exchange Act in order for the majority-owned subsidiary to qualify as a smaller reporting company?

**Answer:** No. [July 3, 2008]

## Question 102.05

**Question:** A registrant discloses a financial measure or information that is not in accordance with GAAP or calculated exclusively from amounts presented in accordance with GAAP. In some circumstances, this financial information may have been prepared in accordance with guidance published by a government, governmental authority or self-regulatory organization that is applicable to the registrant, although the information is not required disclosure by the government, governmental authority or self-regulatory organization. Is this information considered to be a "non-GAAP financial measure" for purposes of Regulation G and Item 10 of Regulation S-K?

**Answer:** Yes. Unless this information is *required* to be disclosed by a system of regulation that is applicable to the registrant, it is considered to be a "non-GAAP financial measure" under Regulation G and Item 10 of Regulation S-K. Registrants that disclose such information must provide the disclosures required by Regulation G or Item 10 of Regulation S-K, if applicable, including the quantitative reconciliation from the non-GAAP financial measure to the most comparable measure calculated in accordance with GAAP. This reconciliation should be in sufficient detail to allow a reader to understand the nature of the reconciling items. [Apr. 24, 2009]

**Section 103. Item 101 — Description of Business**

## Question 103.01

**Question:** Does Item 101 require a discussion of the entry into a new segment after the close of the fiscal year for which the Form 10-K is being prepared?

**Answer:** No. [July 3, 2008]

**Section 104. Item 102 — Description of Property**

None

**Section 105. Item 103 — Legal Proceedings**

## Question 105.01

**Question:** Are costs anticipated to be incurred under the Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. § 9601) (otherwise known as the "Superfund" law), pursuant to a remedial agreement entered into in the normal course of negotiation with the EPA, generally considered "sanctions" within Instruction 5(C) to Item 103?

**Answer:** No. The Division's former view that all environmental legal proceedings involving \$100,000 or more instituted by a governmental authority are subject to the disclosure provisions of Instruction 5(C) to Item 103 of Regulation S-K, regardless of whether the money involved is characterized as damages (as in the Superfund cases) or fines, has been superseded by Footnote 30 of Release No. 33-6835 (May 18, 1989) and the letter to Thomas A. Cole (Jan. 17, 1989). Footnote 30 and the Cole letter clarify that, while there are many ways a Superfund "potential monetary

sanction" may be triggered, including the stipulated penalty clause in a remedial agreement, the costs anticipated to be incurred under Superfund, pursuant to a remedial agreement entered into in the normal course of negotiation with the EPA, generally are not "sanctions" within Instruction 5 (C) to Item 103. [July 3, 2008]

#### Question 105.02

**Question:** Does the reference in Instruction 5 to Item 103 to an administrative or judicial proceeding arising under "local provisions" require disclosure of environmental actions brought by a foreign government?

**Answer:** Yes. The reference in Instruction 5 to an administrative or judicial proceeding arising under "local provisions" is sufficiently broad to require disclosure of environmental actions brought by a foreign government. [July 3, 2008]

#### Question 105.03

**Question:** Should a proceeding against an officer of the registrant, which could require the registrant to indemnify the officer for damages, be considered a proceeding in which the officer has a material interest adverse to the registrant that should be disclosed pursuant to Instruction 4 to Item 103?

**Answer:** The mere possibility that a registrant may be required to indemnify an officer for a material claim would not trigger disclosure pursuant to Instruction 4 to Item 103. Under state corporation law, indemnification is potentially available to any officer in any suit or proceeding in which the officer is named by reason of the fact that the person is an officer of the registrant. Whether or not an officer's material interest is "adverse" to the registrant depends on the facts and circumstances of each proceeding. [July 3, 2008]

### **Section 106. Item 201 — Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters**

#### Question 106.01

**Question:** Is the Item 201(d) disclosure required in Part II of Form 10-K, given that Item 5 of Form 10-K indicates that the registrant is required to furnish the information required under Item 201, or should the Item 201(d) disclosure be included (or incorporated by reference) in Part III of Form 10-K given that Item 12 indicates that the registrant is required to furnish the information required under Item 201(d)?

**Answer:** The Item 201(d) disclosure should be included in Part III, Item 12 of Form 10-K. An issuer may rely on General Instruction G.3 to Form 10-K to incorporate by reference the Item 201(d) disclosure from its proxy statement or information statement, even if the issuer did not submit a compensation plan for security holder action at its annual meeting of security holders. See [American Bar Association](#) (Jan. 30, 2004). [Mar. 13, 2007]

#### Question 106.02

**Question:** Is restricted stock that has been granted subject to forfeiture pursuant to an equity compensation plan reportable in the Item 201(d) Equity Compensation Plan Information table?

**Answer:** No. Once issued, the shares of restricted stock that have been granted subject to forfeiture are neither "to be issued upon exercise of outstanding options, warrants and rights" (column (a)) nor "available for future issuance" (column (c)). If the shares of restricted stock so granted are later forfeited, however, they would be reportable in column (c) until granted again. [Mar. 13, 2007]

#### Question 106.03

**Question:** Should shares that may be issued under performance share awards if specified targets are met and shares that are credited as phantom shares under a deferred compensation plan be reported in column (a) of the Equity Compensation Plan Information table as securities to be issued upon exercise of outstanding options, warrants and rights?

**Answer:** Yes. Shares that may be issued under performance share awards if specified targets are met (i.e., an award denominated in shares has been made, but no shares will be issued until the performance targets are met), and shares credited as phantom shares under a deferred compensation plan that will be issued as actual shares upon termination of employment, must be reported in column (a). A footnote to the table should describe the nature of the awards and explain that the weighted-average exercise price in column (b) does not take these awards into account. If the number of shares subject to these awards overstates expected dilution (such as where the award reflects the maximum number of shares to be awarded under best-case targets that are unlikely to be achieved), the footnote can address that situation. [Mar. 13, 2007]

#### Question 106.04

**Question:** A company maintains an employee stock purchase plan covered by Section 423 of the Internal Revenue Code, under which there are outstanding rights to purchase company common stock at a floating exercise price (85% of the lower of (i) market price at the start of the purchase period or (ii) market price at the future close of the purchase period). How should the company report the shares subject to these outstanding rights in the Equity Compensation Plan Information table?

**Answer:** Shares subject to these outstanding rights should be reported in column (c) of the Equity Compensation Plan Information table, together with other shares remaining issuable under the plan. A footnote should disclose the total number of shares remaining available, as well as the number of shares subject to purchase during any current purchase period. Shares subject to the outstanding rights should *not* be reported in column (a) as subject to outstanding options. [Mar. 13, 2007]

#### Question 106.05

**Question:** Column (a) of the Equity Compensation Plan Information table requires disclosure of the number of securities to be issued upon exercise of outstanding options, warrants and rights, and column (b) requires

disclosure of the weighted-average exercise price of these outstanding instruments. If some of a company's outstanding rights can be exercised for no consideration, and therefore their inclusion substantially reduces the weighted-average exercise price, how does the company disclose this information in the table?

**Answer:** In this circumstance, the company should include footnote disclosure of this fact and the footnote should include the weighted-average exercise price of the outstanding instruments excluding those that can be exercised for no consideration. [Mar. 13, 2007]

#### Question 106.06

**Question:** May a registrant plot monthly or quarterly returns in the performance graph required by Item 201(e)?

**Answer:** A registrant may plot monthly or quarterly returns provided that each return is plotted at the same interval, and the annual changes in cumulative total return are reflected clearly. [Mar. 13, 2007]

#### Question 106.07

**Question:** How should a registrant that presents in the performance graph a self-constructed peer or market capitalization index weight the returns of the component entities of that index?

**Answer:** A registrant that presents a self-constructed peer or market capitalization index should weight the returns of the component entities of that index according to their market capitalization as of the beginning of each period for which a return is indicated. [Mar. 13, 2007]

#### Question 106.08

**Question:** May a registrant-constructed peer or market capitalization index exclude the registrant?

**Answer:** Yes. [Mar. 13, 2007]

#### Question 106.09

**Question:** May issuers choose between using the price shown in the registration statement for an initial public offering, the opening price on the first trading day, or the closing market price on the first trading day when preparing the performance graph?

**Answer:** No. The issuer should use the closing market price at the end of the first trading day. [Mar. 13, 2007]

#### Question 106.10

**Question:** Is the performance graph required to be included in Form 10-K, given that Item 5 of Form 10-K indicates that the registrant is required to furnish the information required under Item 201?

**Answer:** No. Instruction 7 to Item 201(e) specifies that the performance graph need not be provided in any filings other than an annual report to security holders required by Exchange Act Rule 14a-3 or Exchange Act Rule 14c-3 that precedes or accompanies a registrant's proxy statement or information statement relating to an annual meeting of security holders at which directors are to be elected (or a special meeting or written consents in lieu of such meeting). [Mar. 13, 2007]

#### Question 106.11

**Question:** If a company includes the performance graph in its Form 10-K, can the company omit the performance graph from its annual report to shareholders required under Exchange Act Rule 14a-3 or Rule 14c-3?

**Answer:** The performance graph is required to be in the annual report to shareholders pursuant to Exchange Act Rule 14a-3 or Rule 14c-3, so unless the company is using a "Form 10-K wrap" approach to satisfy the requirements of Rule 14a-3 or Rule 14c-3, the inclusion of the performance graph in the Form 10-K would not satisfy these requirements. [Mar. 13, 2007]

#### Question 106.12

**Question:** May a registrant include the performance graph in the proxy statement?

**Answer:** Yes, provided that the performance graph is also included in the annual report that accompanies or precedes the proxy statement and therefore complies with Exchange Act Rules 14a-3 or 14c-3. [Mar. 13, 2007]

### Section 107. Item 202 — Description of Registrant's Securities

#### Question 107.01

**Question:** Items 202(a)(1)(x) and (xi) require disclosure of certain restrictions on ownership of the registrant's securities. Are the purchase and sale restrictions imposed by Section 16 of the Exchange Act the types of restrictions required to be disclosed under these items?

**Answer:** No. [July 3, 2008]

### Section 108. Item 301 — Selected Financial Data

#### Question 108.01

**Question:** Item 301 of Regulation S-K requires a foreign private issuer to disclose the exchange rate into U.S. currency of the foreign currency in which the financial statements are denominated. For purposes of this requirement, Item 301 provides that the rate of exchange means the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York. The Federal Reserve Bank of New York has recently ceased publishing these exchange rates on its web site. What source of exchange rate information

must be used for purposes of Item 301?

**Answer:** Although the Federal Reserve Bank of New York is no longer publishing the foreign exchange rates on its web site, it is still certifying them for customs purposes. The Board of Governors of the Federal Reserve Bank publishes these exchange rates on a weekly basis on its web site at <http://www.federalreserve.gov/releases/h10/Update>. You should use this source of exchange rate information for purposes of Item 301 of Regulation S-K. [Apr. 24, 2009]

### **Section 109. Item 302 – Supplementary Financial Information**

None

### **Section 110. Item 303 – Management's Discussion and Analysis of Financial Condition and Results of Operations**

Question 110.01

**Question:** Is a smaller reporting company that has not had revenues from operations in the fiscal periods for which financial statements are furnished in the disclosure document permitted to provide the "plan of operation" information previously required of similarly situated small business issuers by Item 303(a) of former Regulation S-B, in lieu of the "Management's Discussion and Analysis of Financial Condition and Results of Operations" required of all companies by Item 303 of Regulation S-K, as modified by paragraph (d) for smaller reporting companies?

**Answer:** No. The smaller reporting company must satisfy the requirements of Item 303 of Regulation S-K. It should be noted, however, that MD&A disclosure of a company without recent revenues frequently reads very similarly to the disclosure previously required of small business issuers under Item 303(a) of former Regulation S-B. [July 3, 2008]

### **Section 111. Item 304 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Question 111.01

**Question:** If a registrant's principal accountant resigns, declines to stand for re-election or is dismissed, Items 304(a)(1)(iv) and (v) require the registrant to disclose any disagreements and reportable events during the registrant's two most recent fiscal years and any "subsequent interim period" preceding the resignation, declination or dismissal. For purposes of this requirement, what period of time does "subsequent interim period" cover?

**Answer:** The "subsequent interim period" is the period from the end of the registrant's most recent fiscal year through the date of the former principal accountant's resignation, declination to stand for re-election or dismissal. This period is not limited to the end of the most recent fiscal quarterly period. Similarly, the "subsequent interim period" referred to in Item 304(a)(2), which requires disclosure of the engagement of a new principal accountant, is the period from the end of the registrant's most recent fiscal year through the date on which the new principal accountant is engaged.

[Jan. 14, 2011]

#### Question 111.02

**Question:** Item 304(a)(1)(iv) requires affirmative disclosure if there are no disagreements. If a registrant has no reportable events, is the registrant required to disclose that fact?

**Answer:** No. [Jan. 14, 2011]

#### Question 111.03

**Question:** During the two most recent fiscal years and subsequent interim period, the principal accountant advised the registrant that internal controls necessary to develop reliable financial statements did not exist, and the remediation of the internal control deficiency or deficiencies occurred before the end of the subsequent interim period. Is the registrant still required to disclose, pursuant to Item 304(a)(1)(v)(A), that the former principal accountant advised the registrant that the internal controls necessary for the registrant to develop reliable financial statements do not exist?

**Answer:** Yes. The fact that the remediation occurred before the end of the subsequent interim period does not relieve the registrant of its disclosure obligation pursuant to Item 304(a)(1)(v)(A). [Jan. 14, 2011]

#### Question 111.04

**Question:** Under Item 304(a)(1)(v)(A), is a registrant required to disclose whether, during the two most recent fiscal years and any subsequent interim period, the former principal accountant advised that there was a "material weakness" or "significant deficiency" in internal control over financial reporting, as those terms are defined in Rule 1-02(a)(4) of Regulation S-X?

**Answer:** A "material weakness" is defined as "a deficiency, or combination of deficiencies, in internal control over financial reporting...such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis." Advising the registrant that there is a material weakness in internal control over financial reporting is, for purposes of Item 304(a)(1)(v)(A), equivalent to advising the registrant that the "internal controls necessary for the registrant to develop reliable financial statements do not exist." Consequently, if the former principal accountant advised the registrant that there was a material weakness, then the registrant has a reportable event under Item 304(a)(1)(v)(A).

By contrast, if the former principal accountant advised the registrant that one or more significant deficiencies in internal control over financial reporting existed, but did not also advise that there was a material weakness, then that would not be a reportable event under Item 304(a)(1)(v)(A). However, the factors that led to a significant deficiency could result in the conclusion that there are other reportable events that require disclosure. For example, the former principal accountant may have determined that, because of the significant deficiency, there was a need to significantly expand the scope of the audit, which could, in appropriate

circumstances, create a reportable event under Item 304(a)(1)(v)(C). [Jan. 14, 2011]

#### Question 111.05

**Question:** A registrant's principal accountant issued an audit report on the registrant's financial statements in the last two fiscal years containing an explanatory paragraph regarding a registrant's ability to continue as a going concern. Is this required to be disclosed under Item 304(a)(1)(ii)?

**Answer:** Yes. The explanatory paragraph represents a modification of the principal accountant's audit report for an uncertainty, thereby requiring disclosure under Item 304(a)(1)(ii). [Jan. 14, 2011]

#### Question 111.06

**Question:** A registrant's principal accountant issued a report on the registrant's internal control over financial reporting in the last two fiscal years containing an explanatory paragraph, adverse opinion or a disclaimer of opinion. Is this required to be disclosed under Item 304(a)(1)(ii)?

**Answer:** No. Item 304(a)(1)(ii) refers only to the principal accountant's "report on the financial statements." Registrants can voluntarily disclose information about reports on internal control over financial reporting; however, if such reports contain an adverse opinion with respect to the effectiveness of internal control over financial reporting, then that would be reportable pursuant to Item 304(a)(1)(v)(A). See [Question 111.04](#). [Jan. 14, 2011]

#### Question 111.07

**Question:** If a principal accountant resigns, declines to stand for re-election or is dismissed because its registration with the PCAOB has been revoked, should the registrant disclose this fact when filing an Item 4.01 Form 8-K to report a change in certifying accountant?

**Answer:** Yes. Disclosure of the revocation of the accountant's PCAOB registration is necessary to understanding the required disclosure with respect to whether the former accountant resigned, declined to stand for re-election or was dismissed. [Jan. 14, 2011]

### **Section 112. Item 305 – Quantitative and Qualitative Disclosures about Market Risk**

#### Question 112.01

**Question:** Is a registrant required to include Item 305 market risk disclosure in its Form 10-Q?

**Answer:** A registrant does not have to include Item 305 disclosure in its Form 10-Q unless there is a material change to the Item 305 information disclosed in its most recently filed Form 10-K. [July 3, 2008]

### **Section 113. Item 306 [Reserved]**

None

#### **Section 114. Item 307 — Disclosure Controls and Procedures**

None

#### **Section 115. Items 308 and 308T — Internal Control over Financial Reporting**

Question 115.01

**Question:** Is a Form 11-K required to include internal control reports?

**Answer:** No. Item 308 does not apply to Form 11-K. [July 3, 2008]

Question 115.02

**Question:** In annual reports for fiscal years ending on or after December 15, 2007 but before December 15, 2009, non-accelerated filers are required to provide management's report on internal control over financial reporting pursuant to Item 308T of Regulation S-K. The report is deemed not to be "filed" for purposes of Section 18 of the Exchange Act, unless the company specifically states that the report is to be considered "filed" under the Exchange Act or incorporates it by reference into a filing under the Securities Act or the Exchange Act. Does a non-accelerated filer's failure to provide management's report in its Form 10-K under Item 308T(a) affect its form eligibility or the ability to use Rule 144?

**Answer:** It is the Division's view that the failure to provide this management report renders the annual report materially deficient. As a result, if management did not complete the evaluation and provide the report as required by Item 308T(a), the company would not be timely or current in its Exchange Act reporting. This would result in the company not being eligible to file new Form S-3 or Form S-8 registration statements and the loss of the availability of Rule 144. Because the filing of the Form 10-K constitutes the Section 10(a)(3) update for any effective Forms S-3 or S-8, the company also would be required to suspend any sales under already effective registration statements.

However, if the company subsequently amends its Form 10-K to provide management's report on whether or not internal control is effective, the company can file new Forms S-8 and resume making sales under already effective Forms S-8, and shareholders can avail themselves of Rule 144 (assuming all other conditions to use of the form or rule are satisfied). This would be the case regardless of whether management reached an effective or ineffective conclusion about its internal control. Although amending the Form 10-K to provide management's report may result in the company becoming current, it would remain untimely and would not be eligible to file new Forms S-3. [July 3, 2008]

#### **Section 116. Item 401 — Directors, Executive Officers, Promoters and Control Persons**

Question 116.01

**Question:** Should the Item 401(b) information presented in the Form 10-K be furnished for current officers, rather than for those officers who held such positions during the last fiscal year?

**Answer:** Yes. [July 3, 2008]

#### Question 116.02

**Question:** Does Item 401(e) information with respect to executive officers need to be included in proxy statements if it is included separately in the Form 10-K?

**Answer:** No. Although Instruction 3 to Item 401(b) does not refer to Item 401(e), which requires disclosure about business experience, Item 401(e) information need not be included in the proxy statement if it is presented in the Form 10-K. [July 3, 2008]

#### Question 116.03

**Question:** Is Item 401(f) applicable to persons in the "significant employee" category of Item 401(c)?

**Answer:** Item 401(f) is not applicable to persons in the "significant employee" category of Item 401(c), unless such persons are de facto executive officers. [July 3, 2008]

#### Question 116.04

**Question:** Is Item 401(f)(1) disclosure required for legal proceedings in foreign countries?

**Answer:** Yes. Item 401(f)(1) requires disclosure regarding petitions filed under the "[f]ederal bankruptcy laws or any state insolvency law." This item should be interpreted to require disclosure regarding comparable events in foreign countries (except in the unusual situation where it is not material). For example, disclosure should be provided when a director of a U.S. public company is also the CEO of a non-U.S. company and a receiver is appointed for the non-U.S. company. [July 3, 2008]

#### Question 116.05

**Question:** For each director and nominee, Item 401(e)(1) requires disclosure of such person's "specific experience, qualifications, attributes or skills" that led the board to conclude that such person should serve as a director at the time that a filing containing the disclosure is made. May a company provide these disclosures on a group basis if the directors or nominees share similar characteristics, such as all of them are audit committee financial experts or all of them are current or former CEOs of major companies?

**Answer:** No. The disclosure of each director or nominee's experience, qualifications, attributes or skills must be provided on an individual basis. For each person, a company must disclose why the person's *particular* and *specific* experience, qualifications, attributes or skills led the board to

conclude that such person should serve as a director of the company, in light of the company's business and structure, at the time that a filing containing the disclosure is made. For example, it would not be sufficient to disclose simply that a person should serve as a director because he or she is an audit committee financial expert. Instead, a company should describe the particular and specific experience, qualifications, attributes or skills that led the board to conclude that this particular person should serve as a director at the time that a filing containing the disclosure is made. [Jan. 20, 2010]

#### Question 116.06

**Question:** Under Item 401(e)(1), how should a company with a classified board disclose why a director's particular and specific experience, qualifications, attributes or skills led the board to conclude that the person should serve as a director at the time that a filing containing the disclosure is made, if the director is not up for re-election at the upcoming shareholders' meeting?

**Answer:** Because the composition of the entire board is important information for shareholder voting decisions, the purpose of this disclosure requirement is to elicit current information about all directors on the board, including on classified boards. For each director who is not up for re-election, the evaluation of the director's particular and specific experience, qualifications, attributes or skills and the conclusion as to why the director should continue serving on the board, should be as of the time that a filing containing the disclosure is made. For some boards of directors, particularly those that do not conduct annual self-evaluations, this may require implementing additional disclosure controls and procedures to ensure that such information about directors who are not up for re-election at the upcoming shareholders' meeting is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. [Jan. 20, 2010]

#### Question 116.07

**Question:** Instruction 3 to Item 401(a) provides that if the information called for by paragraph (a) is being presented in a proxy or information statement, no information need be given respecting any director whose term of office as a director will not continue after the meeting to which the statement relates. Is Item 401(e) disclosure required with respect to any director to whom this Instruction applies?

**Answer:** No. Item 401(e) disclosure is not required for any director for whom the company is not required to provide Item 401(a) disclosure. [Feb. 16, 2010]

#### Question 116.08

Withdrawn July 8, 2011

#### Question 116.09

**Question:** Is a company required to include Item 401(e) information about a director's business experience if the director is appointed by holders of a

class of preferred stock?

**Answer:** Yes. In this situation, the company may either provide the same information about this director as it would directors nominated by the board or disclose that the preferred shareholder has advised the company that the shareholder has appointed this director because of [the Item 401(e) information provided to the company by the shareholder that the company would then include in its filing]. [Mar. 4, 2011]

#### Question 116.10

**Question:** Pursuant to Instruction 3 of Item 401(a), an issuer omits from its proxy statement Item 401(a) and Item 401(e) information with respect to directors whose terms will not continue after the annual shareholders' meeting. Is this information nevertheless required to be included in a Form 10-K that incorporates its Part III information by reference from the proxy statement?

**Answer:** No. If an issuer provides its Form 10-K, Part III information by incorporation by reference from the proxy statement and the issuer files its definitive proxy statement within 120 days of its fiscal year-end, then the issuer may rely on Instruction 3 to Item 401(a) to omit, from both the proxy statement and the Form 10-K, Item 401(a) and Item 401(e) information with respect to directors whose terms will not continue after the annual shareholders' meeting. If an issuer includes Item 401(a) and Item 401(e) information directly in Part III of Form 10-K, the issuer must provide such information about all current directors, including those directors whose terms will not continue after the annual shareholders' meeting. [July 8, 2011]

### Section 117. Item 402(a) – Executive Compensation; General

#### Question 117.01

**Question:** When a company that is in the process of restating its financial statements has not filed its Form 10-K for the fiscal year ended December 31, 2005, must the company comply with the 2006 Executive Compensation Rules when it ultimately files the Form 10-K for the fiscal year ended December 31, 2005?

**Answer:** The company is not required to comply with the 2006 Executive Compensation rules in the Form 10-K for the fiscal year ended December 31, 2005. [Jan. 24, 2007]

#### Question 117.02

**Question:** If a company files a preliminary proxy statement under Exchange Act Rule 14a-6 which omits the executive and director compensation disclosure required by Item 402 of Regulation S-K, would the staff request a revised preliminary proxy statement and deem that the 10-calendar day waiting period specified in Rule 14a-6 does not begin to run until the required information is filed?

**Answer:** Yes. However, given that the executive and director compensation rules were substantially revised in 2006, in a situation where

a company that is complying with the 2006 rules for the first time files a preliminary proxy statement excluding the required executive and director compensation disclosure, the staff will not request a revised preliminary proxy statement nor deem the 10-calendar day waiting period specified in Rule 14a-6 to be tolled, so long as: (1) the omitted executive and director compensation disclosure is included in the definitive proxy statement; (2) the omitted disclosure does not relate to the matter or matters that caused the company to have to file preliminary proxy materials; and (3) the omitted disclosure is not otherwise made available to the public prior to the filing of the definitive proxy statement. [Feb. 12, 2007]

#### Question 117.03

**Question:** During 2009, a company recovers (or "claws-back") a portion of an executive officer's 2008 bonus. How does this affect the company's 2009 Item 402 disclosure for that executive officer?

**Answer:** The portion of the 2008 bonus recovered in 2009 should not be deducted from 2009 bonus or total compensation for purposes of determining, pursuant to Items 402(a)(3)(iii) and (iv), whether the executive is a named executive officer for 2009. If the executive is a named executive officer for 2009, the Summary Compensation Table should report for the 2008 year, in the Bonus column (column (d)) and Total column (column (j)), amounts that are adjusted to reflect the "claw-back," with footnote disclosure of the amount recovered. As the instruction to Item 402 (b) provides, if "necessary to an understanding of the registrant's compensation policies and decisions regarding the named executive officers," the Compensation Discussion and Analysis should discuss the reasons for the "claw-back" and how the amount recovered was determined. [Aug. 14, 2009]

#### Question 117.04

**Question:** During 2009, a company grants an equity award to an executive officer. The same award is forfeited during 2009 because the executive officer leaves the company. Should the grant date fair value of this award be included for purposes of determining 2009 total compensation and identifying 2009 named executive officers?

**Answer:** Yes. [Jan. 20, 2010]

#### Question 117.05

**Question:** A registrant with a calendar fiscal year end has filed a Securities Act registration statement (or post-effective amendment) for which it seeks effectiveness after December 31, 2009 but before its 2009 Form 10-K is due. Must it include Item 402 disclosure for 2009 in the registration statement before it can be declared effective?

**Answer:** If the registration statement is on Form S-1, then it must include Item 402 disclosure for 2009 before it can be declared effective. This is because 2009 is the last completed fiscal year. Part I, Item 11(l) of Form S-1 specifically requires Item 402 information in the registration statement, which includes Summary Compensation Table disclosure for each of the registrant's last three completed fiscal years and other disclosures for the

last completed fiscal year. General Instruction VII of Form S-1, which permits a registrant meeting certain requirements to incorporate by reference the Item 11 information, does not change this result because the registrant has not yet filed its Form 10-K for the most recently completed fiscal year.

On the other hand, Form S-3's information requirements are satisfied by incorporating by reference filed and subsequently filed Exchange Act documents; for example, there is no specific line item requirement in Form S-3 for Item 402 information. Accordingly, a non-automatic shelf registration statement on Form S-3 can be declared effective before the Form 10-K is due. [Securities Act Forms C&DI 123.01](#) addresses the situation in which a company requests effectiveness for a non-automatic shelf registration statement on Form S-3 during the period between the filing of the Form 10-K and the definitive proxy statement. [Feb. 16, 2010]

#### Question 117.06

**Question:** An individual who was the company's principal financial officer for part of the last completed fiscal year was serving the company as an executive officer in a different capacity at the end of that year, and was among the company's three most highly compensated executive officers. Does the company include this individual as a named executive officer pursuant to Item 402(a)(3)(iii), as one of its three most highly compensated executive officers other than the principal executive officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year?

**Answer:** No. The company includes this individual as a named executive officer pursuant to Item 402(a)(3)(ii), as an individual who served as principal financial officer during the fiscal year. The company identifies its three most highly compensated executive officers pursuant to Item 402(a)(3)(iii) from among individuals serving as executive officers at the end of the last completed fiscal year who did not serve as its principal executive officer or principal financial officer at any time during that year. [June 4, 2010]

#### Question 117.07

**Question:** Item 402(a)(6)(ii) provides that "registrants may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees." Does this provision also apply to a disability plan that satisfies these nondiscrimination conditions?

**Answer:** Yes. To the extent that the disability plan provides benefits not related to termination of employment, a registrant may rely on Item 402(a)(6)(ii) to omit information regarding the disability plan. To the extent that the disability plan provides benefits related to termination of employment, a registrant may rely on Instruction 5 to Item 402(j) to omit information regarding the disability plan. [July 8, 2011]

### **Section 118. Item 402(b) – Executive Compensation; Compensation Discussion and Analysis**

## Question 118.01

**Question:** Is the guidance regarding Compensation Discussion and Analysis disclosure concerning option grants that is provided in Section II.A.2 of [Securities Act Release No. 8732A](#) applicable to other forms of equity compensation?

**Answer:** The same disclosure provisions governing required disclosure about option grants also govern disclosure about restricted stock and other non-option equity awards. This includes the example of potential material information identified in Item 402(b)(2)(iv) of Regulation S-K, which indicates that it may be appropriate to discuss how the determination is made as to when awards are granted, including awards of equity-based compensation such as options. [Jan. 24, 2007]

## Question 118.02

**Question:** In presenting Compensation Discussion and Analysis disclosure about prior option grant programs, plans or practices, are companies required to provide disclosures about programs, plans or practices that occurred outside the scope of the information contained in the tables and otherwise disclosed pursuant to Item 402 (including periods before and after the information contained in the tables and otherwise disclosed pursuant to Item 402)?

**Answer:** Yes, in certain cases, depending on a company's particular circumstances, disclosure may be required as contemplated by Instruction 2 to Item 402(b) of Regulation S-K. [Jan. 24, 2007]

## Question 118.03

**Question:** Are companies required to include disclosure about programs, plans or practices relating to option grants in the Compensation Discussion and Analysis disclosure for their first fiscal year ending on or after December 15, 2006, or is this disclosure only required for future fiscal periods?

**Answer:** Companies are required to include disclosure about programs, plans or practices relating to option grants in the Compensation Discussion and Analysis disclosure for fiscal years ending on or after December 15, 2006, as well as any other periods where necessary as contemplated by Instruction 2 to Item 402(b) of Regulation S-K. [Jan. 24, 2007]

## Question 118.04

**Question:** How does a company determine if it may omit disclosure of performance target levels or other factors or criteria under Instruction 4 to Item 402(b)?

**Answer:** A company should begin its analysis of whether it is required to disclose performance targets by addressing the threshold question of materiality in the context of the company's executive compensation policies or decisions. If performance targets are not material in this context, the company is not required to disclose the performance targets. Whether performance targets are material is a facts and circumstances issue, which

a company must evaluate in good faith.

A company may distinguish between *qualitative/subjective* individual performance goals (e.g., effective leadership and communication) and *quantitative/objective* performance goals (e.g., specific revenue or earnings targets). There is no requirement that a company provide quantitative targets for what are inherently subjective or qualitative assessments — for example, how effectively the CEO demonstrated leadership.

When performance targets are a material element of a company's executive compensation policies or decisions, a company may omit targets involving confidential trade secrets or confidential commercial or financial information *only if* their disclosure would result in competitive harm. A company should use the same standard for evaluating whether target levels (and other factors or criteria) may be omitted as it would use when making a confidential treatment request under Securities Act Rule 406 or Exchange Act Rule 24b-2; however, no confidential treatment request is required to be submitted in connection with the omission of a performance target level or other factors or criteria.

To reach a conclusion that disclosure would result in competitive harm, a company must undertake a competitive harm analysis taking into account its specific facts and circumstances and the nature of the performance targets. In the context of the company's industry and competitive environment, the company must analyze whether a competitor or contractual counterparty could extract from the targets information regarding the company's business or business strategy that the competitor or counterparty could use to the company's detriment. A company must have a reasoned basis for concluding, after consideration of its specific facts and circumstances, that the disclosure of the targets would cause it competitive harm. The company must make its determination based on the established standards for what constitutes confidential commercial or financial information, the disclosure of which would cause competitive harm. These standards have largely been addressed in case law, including *National Parks and Conservation Association v. Morton*, 498 F.2d 765 (D.C. Cir. 1974); *National Parks and Conservation Association v. Kleppe*, 547 F.2d 673 (D.C. Cir. 1976); and *Critical Mass Energy Project v. NRC*, 931 F.2d 939 (D.C. Cir. 1991), *vacated & reh'g en banc granted*, 942 F.2d 799 (D.C. Cir. 1991), *grant of summary judgment to agency aff'd en banc*, 975 F.2d 871 (D.C. Cir. 1992). To the extent that a performance target level or other factor or criteria otherwise has been disclosed publicly, a company cannot rely on Instruction 4 to withhold the information.

The competitive harm standard is the only basis for omitting performance targets if they are a material element of the registrant's executive compensation policies or decisions.

Because Compensation Discussion and Analysis will be subject to staff review, a company may be required to demonstrate that withholding target information meets the confidential treatment standard, and will be required to disclose the information if that standard is not met. Finally, a company that relies on Instruction 4 to omit performance targets is required by the instruction to discuss how difficult it will be for the executive or how likely it will be for the company to achieve the undisclosed target level or other factor or criteria. [July 3, 2008]

## Question 118.05

**Question:** Item 402(b)(2)(xiv) provides, as an example of material information to be disclosed in the Compensation Discussion and Analysis, depending on the facts and circumstances, "[w]hether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies)." What does "benchmarking" mean in this context?

**Answer:** In this context, benchmarking generally entails using compensation data about other companies as a reference point on which — either wholly or in part — to base, justify or provide a framework for a compensation decision. It would not include a situation in which a company reviews or considers a broad-based third-party survey for a more general purpose, such as to obtain a general understanding of current compensation practices. [July 3, 2008]

Question 118.06 *[same as Question 133.08]*

**Question:** Regarding the role of compensation consultants in determining or recommending the amount or form of executive and director compensation, on what basis should a company differentiate between the requirements of Item 407(e)(3)(iii) and Item 402(b)'s Compensation Discussion and Analysis disclosure?

**Answer:** The information regarding "any role of compensation consultants in determining or recommending the amount or form of executive and director compensation" required by Item 407(e)(3)(iii) is to be provided as part of the company's Item 407(e)(3) compensation committee disclosure. See [Release 33-8732A](#) at Section V.D, Corporate Governance Disclosure. If a compensation consultant plays a material role in the company's compensation-setting practices and decisions, then the company should discuss that role in the Compensation Discussion and Analysis section. [July 3, 2008]

## Question 118.07

**Question:** In Compensation Discussion and Analysis (CD&A), is a company required to discuss executive compensation, including performance target levels, to be paid in the current year or in future years?

**Answer:** No. The CD&A covers only compensation "awarded to, earned by, or paid to the named executive officers." Although Instruction 2 to Item 402(b) provides that the CD&A should also cover actions regarding executive compensation that were taken after the registrant's last fiscal year's end, such disclosure requirement is limited to those actions or steps that could "affect a fair understanding of the named executive officer's compensation for the last fiscal year." [Mar. 4, 2011]

## Question 118.08

**Question:** Instruction 5 to Item 402(b) provides that "[d]isclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G and Item 10(e); however, disclosure must be provided as to

how the number is calculated from the registrant's audited financial statements." Does this instruction extend to non-GAAP financial information that does not relate to the disclosure of target levels, but is nevertheless included in Compensation Discussion & Analysis ("CD&A") or other parts of the proxy statement - for example, to explain the relationship between pay and performance?

**Answer:** No. Instruction 5 to Item 402(b) is limited to CD&A disclosure of target levels that are non-GAAP financial measures. If non-GAAP financial measures are presented in CD&A or in any other part of the proxy statement for any other purpose, such as to explain the relationship between pay and performance or to justify certain levels or amounts of pay, then those non-GAAP financial measures are subject to the requirements of Regulation G and Item 10(e) of Regulation S-K.

In these pay-related circumstances only, the staff will not object if a registrant includes the required GAAP reconciliation and other information in an annex to the proxy statement, provided the registrant includes a prominent cross-reference to such annex. Or, if the non-GAAP financial measures are the same as those included in the Form 10-K that is incorporating by reference the proxy statement's Item 402 disclosure as part of its Part III information, the staff will not object if the registrant complies with Regulation G and Item 10(e) by providing a prominent cross-reference to the pages in the Form 10-K containing the required GAAP reconciliation and other information. [July 8, 2011]

### **Section 119. Item 402(c) — Executive Compensation; Summary Compensation Table**

#### Question 119.01

**Question:** If a person that was not a named executive officer in fiscal years 1 and 2 became a named executive officer in fiscal year 3, must compensation information be disclosed in the Summary Compensation Table for that person for all three fiscal years?

**Answer:** No, the compensation information only for fiscal year 3 need be provided in the Summary Compensation Table. [Jan. 24, 2007]

#### Question 119.02

**Question:** Should a discretionary cash bonus that was not based on any performance criteria be reported in the Bonus column (column (d)) of the Summary Compensation Table pursuant to Item 402(c)(2)(iv) or in the Non-equity Incentive Plan Compensation column (column (g)) pursuant to Item 402(c)(2)(vii)?

**Answer:** The bonus should be reported in the Bonus column (column (d)). In order to be reported in the Non-equity Incentive Plan Compensation column (column (g)) pursuant to Item 402(c)(2)(vii), the bonus would have to be pursuant to a plan providing for compensation intended to serve as incentive for performance to occur over a specified period that does not fall within the scope of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("FAS 123R"). The outcome with respect to the relevant

performance target must be substantially uncertain at the time the performance target is established and the target is communicated to the executives. The length of the performance period is not relevant to this analysis, so that a plan serving as an incentive for a period less than a year would be considered an incentive plan under Item 402(a)(6)(iii). Further, amounts earned under a plan that meets the definition of a non-equity incentive plan, but that permits the exercise of negative discretion in determining the amounts of bonuses, generally would still be reportable in the Non-equity Incentive Plan Compensation column (column (g)). The basis for the use of various targets and negative discretion may be material information to be disclosed in the Compensation Discussion and Analysis. If, in the exercise of discretion, an amount is paid over and above the amounts earned by meeting the performance measure in the non-equity incentive plan, that amount should be reported in the Bonus column (column (d)). [Jan. 24, 2007]

#### Question 119.03

**Question:** Instruction 2 to Item 402(c)(2)(iii) and (iv) provides that companies are to include in the Salary column (column (c)) or the Bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based, or other forms of non-cash compensation have been received instead by the named executive officer. In a situation where the value of the stock, equity-based or other form of non-cash compensation is the same as the amount of salary or bonus foregone at the election of the named executive officer, does this mean the amounts are only reported in the Salary or Bonus column and not in any other column of the Summary Compensation Table?

**Answer:** Yes, under Instruction 2 to Item 402(c)(2)(iii) and (iv) the amounts should be disclosed in the Salary or Bonus column, as applicable. The result would be different if the amount of salary or bonus foregone at the election of the named executive officer was less than the value of the equity-based compensation received instead of the salary or bonus, or if the agreement pursuant to which the named executive officer had the option to elect settlement in stock or equity-based compensation was within the scope of FAS123R (e.g., the right to stock settlement is embedded in the terms of the award). In the former case, the incremental value of an equity award would be reported in the Stock Awards or Option Awards columns, and in the latter case the award would be reported in the Stock Awards or Option Awards columns. In both of these special cases, the amounts reported in the Stock Awards and Option Awards columns would be the dollar amounts recognized for financial statement reporting purposes with respect to the applicable fiscal year, and footnote disclosure should be provided regarding the circumstances of the awards. Appropriate disclosure about equity-based compensation received instead of salary or bonus must be provided in the Grants of Plan-Based Awards Table, the Outstanding Equity Awards at Fiscal Year End Table and the Option Exercises and Stock Vested Table. [Aug. 8, 2007]

#### Question 119.04

Withdrawn Mar. 1, 2010

#### Question 119.05

Withdrawn Mar. 1, 2010

#### Question 119.06

**Question:** Instruction 3 to Item 402(c)(2)(viii) provides that where the amount of the change in the actuarial present value of the accumulated pension benefit computed pursuant to Item 402(c)(2)(viii)(A) is negative, the amount should be disclosed by footnote but should not be reflected in the sum reported in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column (column (h)). When a company aggregates all of the decreases and increases in the value of a named executive officer's individual pension plans, should the company subtract negative values from positive values or should any individual plan decreases be treated as a zero?

**Answer:** In applying this instruction, a company may subtract negative values when aggregating the changes in the actuarial present values of the accumulated benefits under the plans, and apply the "no negative number" position of the instruction for the final number after aggregating all plans. Under this approach, if one plan had a \$500 increase and another plan had a \$200 decrease, then the net change in the actuarial present value of the accumulated pension benefits would be \$300. [Jan. 24, 2007]

#### Question 119.07

**Question:** Item 402(c)(2)(ix)(A) and Instruction 4 to that item require a company to report as "All Other Compensation" perquisites and personal benefits if the total amount exceeds \$10,000, and to identify each such item by type, regardless of the amount. If the \$10,000 threshold is otherwise exceeded, must a company list by type those perquisites and personal benefits as to which there was no aggregate incremental cost to the company, or as to which the executive officer fully reimbursed the company for such cost?

**Answer:** If a perquisite or other personal benefit has no aggregate incremental cost, it must still be separately identified by type. Any item for which an executive officer has actually fully reimbursed the company should not be considered a perquisite or other personal benefit and therefore need not be separately identified by type. In this regard, for example, if a company pays for country club annual dues as well as for meals and incidentals and an executive officer reimburses the cost of meals and incidentals, then the company need not report meals and incidentals as perquisites, although it would continue to report the country club annual dues. If there was no such reimbursement, then the company would need to also report the meals and incidentals as perquisites. [July 3, 2008]

#### Question 119.08

**Question:** Item 402(c)(2)(ix)(C) indicates that stock purchased at a discount needs to be disclosed unless that discount is available generally to all security holders or to all salaried employees. The compensation cost, if any, is computed in accordance with FAS 123R. Footnote 221 to [Securities Act Release No. 8732A](#) seems to indicate that sometimes under FAS 123R there is no compensation cost. Does the footnote indicate that 423 plans must be disclosed?

**Answer:** No. Typically 423 plans need to be broad based and non-discriminatory to qualify for preferential tax treatment, which would be within the exception, even if they require some minimum of work hours — such as 10 hours a week — in order to be in the plan or the discount is larger than the 5% example in the footnote. The footnote explains that even if there is some discount, there may not be compensation cost under the accounting standard. [Jan. 24, 2007]

#### Question 119.09

**Question:** Item 402(c)(2)(ix)(G) requires disclosure of the dollar value of any dividends when those amounts were not factored into the grant date fair value required to be reported in the Grants of Plan-Based Awards Table. With regard to the treatment of dividends, dividend equivalents or other earnings on equity awards, is disclosure required in the All Other Compensation column (column (i)) if disclosure was not previously provided in the Grants of Plan-Based Awards Table for that named executive officer?

**Answer:** The company should analyze whether the dividends, dividend equivalents or other earnings would have been factored into the grant date fair value in accordance with FAS 123R. In this regard, the disclosure turns on how the rights to the dividends are structured and whether or not that brings them within the scope of FAS 123R for the purpose of the grant date fair value calculation. [Jan. 24, 2007]

#### Question 119.10

**Question:** Are deferred compensation payouts, lump sum distributions under Section 401(k) plans and earnings on 401(k) plans required to be disclosed in the Summary Compensation Table?

**Answer:** Non-qualified deferred compensation payouts are not disclosed in the Summary Compensation Table, but are rather disclosed in the Aggregate Withdrawals/ Distributions column (column (e)) of the Nonqualified Deferred Compensation Table. Lump sum distributions from 401(k) plans are not disclosed in the Summary Compensation Table, because the compensation that was deferred into the 401(k) plan was already disclosed in the Summary Compensation Table, as would be any company matching contributions. Earnings on 401(k) plans are not disclosed in the Summary Compensation Table because the disclosure requirement only extends to above-market or preferential earnings on non-qualified deferred compensation. [Jan. 24, 2007]

#### Question 119.11

Withdrawn Mar. 1, 2010

#### Question 119.12

Withdrawn Mar. 1, 2010

#### Question 119.13

**Question:** Item 402(c)(2)(ix)(D) requires disclosure in the "All Other Compensation" column of the amount paid or accrued to any named

executive officer pursuant to any plan or arrangement in connection with any termination of such executive officer's employment with the company or its subsidiaries, or a change in control of the company. For this purpose, what standard applies for determining whether such an amount is reportable because it is accrued?

**Answer:** Instruction 5 to Item 402(c)(2)(ix) states that for purposes of Item 402(c)(2)(ix)(D) an accrued amount is an amount for which payment has become due. If the named executive officer's performance necessary to earn an amount is complete, it is an amount that should be disclosed. For example, if the named executive officer has completed all performance to earn an amount, but payment is subject to a six-month deferral in order to comply with Internal Revenue Code Section 409A, the amount would be an accrued amount subject to Item 402(c)(2)(ix)(D) disclosure. In contrast, if an amount will be payable two years after a termination event if the named executive officer cooperates with (or complies with a covenant not to compete with) the company during that period, the amount is not reportable under Item 402(c)(2)(ix)(D) because the executive officer's performance is still necessary for the payment to become due. As noted in Footnote 217 to [Securities Act Release No. 8732A](#), such amounts that are payable in the future, as well as amounts reportable under Item 402(c)(2)(ix)(D), are reportable under Item 402(j). [Aug. 8, 2007]

#### Question 119.14

**Question:** Where the instructions to the Summary Compensation Table requiring footnote disclosure do not specifically limit the footnote disclosure to compensation for the company's last fiscal year, as do Instructions 3 and 4 to Item 402(c)(2)(ix), must the footnote disclosure cover the other years reported in the Summary Compensation Table?

**Answer:** If the instruction does not specifically limit footnote disclosure to compensation for the company's last fiscal year, footnote disclosure for the other years reported in the Summary Compensation Table would be required only if it is material to an investor's understanding of the compensation reported in the Summary Compensation Table for the company's last fiscal year. [July 3, 2008]

#### Question 119.15

Withdrawn Mar. 1, 2010

#### Question 119.16

**Question:** May a company provide the assumption information required by Instruction 1 to Item 402(c)(2)(v) and (vi) for equity awards granted in the company's most recent fiscal year by reference to the Grants of Plan-Based Awards Table if the company chooses to report that assumption information in that table?

**Answer:** Yes. [Mar. 1, 2010]

#### Question 119.17

**Question:** In 2008, a company enters into a retention agreement in which

it agrees to pay the CEO a cash retention bonus, conditioned on the CEO remaining employed by the company through December 31, 2010. The cash retention bonus is not a non-equity incentive plan award, as defined in Item 402(a)(6)(iii). When is the cash retention bonus reportable in the company's Summary Compensation Table? When should it be discussed in Compensation Discussion and Analysis?

**Answer:** The cash retention bonus is reportable in the Summary Compensation Table for the year in which the performance condition has been satisfied. The same analysis applies to any interest the company is obligated to pay on the cash retention bonus, assuming the interest is not payable unless and until the performance condition has been satisfied. Before the performance condition has been satisfied, Instruction 4 to Item 402(c) would not require it to be reported in the Summary Compensation Table as a bonus that has been earned but deferred, and the bonus would not be reportable in the Nonqualified Deferred Compensation Table. However, the company should discuss the cash retention bonus in its Compensation Discussion and Analysis for 2008 and subsequent years through completion of the performance necessary to earn it. [July 3, 2008]

#### Question 119.18

**Question:** A person who was a named executive officer in year 1, but not in year 2, will again be a named executive officer in year 3. Must compensation information for this person be disclosed in the Summary Compensation Table for all three fiscal years?

**Answer:** Yes. [May 29, 2009]

#### Question 119.19

**Question:** A person who is a named executive officer for year 1 is entitled to a gross-up payment in respect of taxes on perquisites or other compensation provided during the year. The tax gross-up payment is not payable by the company until year 2. Is the tax gross-up payment reportable in the Summary Compensation Table in year 1?

**Answer:** Yes. To provide investors with a clearer view of all costs to the company associated with providing the perquisites or other compensation for which tax gross-up payments are being made, Item 402(c)(2)(ix)(B) disclosure of the tax gross-up payment should be included in the Summary Compensation Table for the same year as the related perquisites or other compensation. [May 29, 2009]

#### Question 119.20

**Question:** Instruction 3 to the Stock Awards and Option Awards columns specifies that the value reported for awards subject to performance conditions excludes the effect of estimated forfeitures. Does the grant date fair value reported for awards subject to time-based vesting also exclude the effect of estimated forfeitures?

**Answer:** Yes. The amount to be reported is the grant date fair value. FASB ASC Paragraph 718-10-30-27 provides, in relevant part, that "service conditions that affect vesting are not reflected in estimating the fair value

of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which employees have not yet earned the right." [Jan. 20, 2010]

#### Question 119.21

**Question:** In April 2010, a company grants an equity award to an executive officer, and the terms of the award do not provide for acceleration of vesting if the executive officer leaves the company. The grant date fair value of the award is \$1,000. In November 2010, the executive officer will leave the company, and the company modifies the officer's same equity award to provide for acceleration of vesting upon departure. The fair value of the modified award, computed under FASB ASC Topic 718, is \$800, reflecting a decline in the company's stock price. What dollar amount is included in 2010 total compensation for purposes of identifying 2010 named executive officers and reported in the executive officer's 2010 stock column with respect to this award if he will be a named executive officer? How would the company report the equity award if the award modification and executive's departure occur in 2011?

**Answer:** Consistent with Instruction 2 to Item 402(c)(2)(v) and (vi), the incremental fair value of the modified award, computed as of the modification date in accordance with FASB ASC Topic 718, as well as the grant date fair value of the original award must be reported in the 2010 stock column. Applying the guidance in paragraph 55-116 of FASB ASC Section 718-20-55, incremental fair value is computed as follows: the fair value of the modified award at the date of modification minus the fair value of the original award at the date of modification equals the incremental fair value of the modified award. In this fact pattern, the fair value of the original award at the date of modification is zero, because the executive officer left the company in November and the original award would not have vested. Therefore, the incremental fair value of the modified award is \$800. As a result, the total amount reported is \$1,800, which reflects the two compensation decisions the company made for this award in 2010. The same amount is included in 2010 total compensation for purposes of identifying the company's 2010 named executive officers pursuant to Items 402(a)(3)(iii) and (iv).

If the award modification and executive's departure occur in 2011, the company would report \$1,000 in the 2010 stock column for the grant date fair value of the original award. In the 2011 stock column, the company would report \$800 for the incremental fair value of the modified award. [Feb. 16, 2010]

#### Question 119.22

**Question:** During 2010, a company grants an annual incentive plan award to a named executive officer. Because no right to stock settlement is embedded in the terms of the award, the award is not within the scope of FASB ASC Topic 718. Therefore, it is a non-equity incentive plan award as defined in Rule 402(a)(6)(iii). The named executive officer elects to receive the award in stock. Instruction 2 to Item 402(c)(2)(iii) and (iv) does not apply because the award is an incentive plan award rather than a bonus. Should the company report the award in the stock awards column (column (e)) or in the non-equity incentive plan award column (column (g)) in its

2010 Summary Compensation Table? How should the award be reported in the Grants of Plan-Based Awards Table?

**Answer:** The company should report the award in the non-equity incentive plan award column (column (g)) of the Summary Compensation Table, reflecting the compensation the company awarded, with footnote disclosure of the stock settlement. Similarly, in the Grants of Plan-Based Awards Table, the company should report the award in the estimated future payouts under non-equity incentive plan awards columns (columns (c)-(e)). The stock received upon settlement should not also be reported in the Grants of Plan-Based Awards Table because that would double count the award. [Feb. 16, 2010]

#### Question 119.23

**Question:** During 2010, a company grants annual incentive plan awards to its named executive officers. The awards permit the named executive officers to elect payment of the award for 2010 performance in company stock rather than cash, with the election to be made during the first 90 days of 2010. Such company stock will have a grant date fair value equal to 110% of the award that would be paid in cash. One named executive officer elects stock payment, and the others do not. How is the award reported for the named executive officer who elects stock payment? How is the award reported for the named executive officers who receive cash payment?

**Answer:** For the named executive officer who elects stock payment, the award is reported in the 2010 Summary Compensation Table and Grants of Plan-Based Awards Table as an equity incentive award. This is the case even if the amount of the award is not determined until early 2011 because all company decisions necessary to determine the value of the award are made in 2010. For the named executive officers who receive cash payment, the award is reported in the 2010 Summary Compensation Table and Grants of Plan-Based Awards Table as a non-equity incentive plan award. [Feb. 16, 2010]

#### Question 119.24

**Question:** In 2010, a company grants an executive officer an equity incentive plan award with a three-year performance period that begins in 2010. The equity incentive plan allows the compensation committee to exercise its discretion to reduce the amount earned pursuant to the award, consistent with Section 162(m) of the Internal Revenue Code. Under FASB ASC Topic 718, the fact that the compensation committee has the right to exercise "negative" discretion may cause, in certain circumstances, the grant date of the award to be deferred until the end of the three-year performance period, after the compensation committee has determined whether to exercise its negative discretion. If so, when and how should this award be reported in the Summary Compensation Table and Grants of Plan-Based Awards Table? In what year should this award be included in total compensation for purposes of determining if the executive officer is a named executive officer?

**Answer:** Use of grant date fair value reporting in Item 402 generally assumes that, as stated in FASB ASC Topic 718, "[t]he service inception date usually is the grant date." The service inception date may precede the

grant date, however, if the equity incentive plan award is authorized but service begins before a mutual understanding of the key terms and conditions is reached. In a situation in which the compensation committee's right to exercise "negative" discretion may preclude, in certain circumstances, a grant date for the award during the year in which the compensation committee communicated the terms of the award and performance targets to the executive officer and in which the service inception date begins, the award should be reported in the Summary Compensation Table and Grants of Plan-Based Awards Table as compensation for the year in which the service inception date begins. Notwithstanding the accounting treatment for the award, reporting the award in this manner better reflects the compensation committee's decisions with respect to the award. The amount reported in both tables should be the fair value of the award at the service inception date, based upon the then-probable outcome of the performance conditions. This same amount should be included in total compensation for purposes of determining whether the executive officer is a named executive officer for the year in which the service inception date occurs. [Mar. 1, 2010]

#### Question 119.25

**Question:** A company grants annual non-equity incentive plan awards to its executive officers in January 2010. The awards' performance criteria are communicated to the executives at that time and are based on the company's financial performance for the year. Executives will not know the total amount earned pursuant to the award until the end of the year, when the compensation committee can determine whether or to what extent the performance criteria have been satisfied.

After the end of the year, the amounts earned pursuant to the awards are determined and communicated to the executive officers. One executive decides not to receive any payment of earnings pursuant to the award. For that executive, should the award be included in total compensation for purposes of determining if the executive is a named executive officer for 2010? Should the award be reported in the Grants of Plan-Based Awards Table and the Summary Compensation Table for 2010?

**Answer:** Yes. The executive officer's decision not to accept payment of the award does not change the fact that award was granted in and earned for services performed during 2010. Accordingly, the grant of the award should be included in the Grants of Plan-Based Awards Table, which will reflect the compensation committee's decision to grant the award in 2010. The earnings pursuant to the award, even though declined, should be included in total compensation for purposes of determining if the executive is a named executive officer for 2010 and reported in the Summary Compensation Table. The company should disclose the executive's decision not to accept payment of the award, which it can do either by adding a column to the Summary Compensation Table next to column (g), "Nonequity Incentive Plan Compensation," reporting the amount of nonequity incentive plan compensation declined, or by providing footnote disclosure to the Summary Compensation Table. Moreover, in Compensation Discussion and Analysis, the company should consider discussing the effect, if any, of the executive's decision on how the company structures and implements compensation to reflect performance. [Mar. 12, 2010]

## Question 119.26

**Question:** A company has a practice of granting discretionary bonuses to its executive officers. Before the board of directors takes action to grant such bonuses for 2010, an executive officer advises the board that she will not accept a bonus for 2010. Should the company report in column (d) of the Summary Compensation Table the bonus award it would have granted her and include that amount in total compensation for purposes of determining if she is a named executive officer for 2010?

**Answer:** No, because the executive declined the bonus before it was granted, and therefore, no bonus was granted. [Mar. 12, 2010]

## Question 119.27

**Question:** In 2010, Company A acquires Company B and, as part of the merger consideration, agrees to assume all outstanding Company B options. The Company B options have not been modified other than to adjust the exercise price to reflect the merger exchange ratio. For Company B executives who are now Company A executives: Should the Company B options that were granted in 2010 be included in total compensation for purposes of determining if an executive is a named executive officer of Company A for 2010 and reported in the Summary Compensation Table and Grants of Plan-Based Awards Table for 2010? Should Company A report the Company B options in its Outstanding Equity Awards at Fiscal Year-End Table and Options Exercised and Stock Vested Table, as applicable, for 2010 and in subsequent years?

**Answer:** Because the assumed Company B options are part of the merger consideration, they do not reflect any 2010 executive compensation decisions by Company A. Therefore, Company A should not include Company B options granted in 2010 in total compensation for purposes of determining its 2010 named executive officers, and should not report the Company B options in its 2010 Summary Compensation Table and Grants of Plan-Based Awards Table. Because the Company B options are now Company A options, Company A should report them in its Outstanding Equity Awards at Fiscal Year-End Table and Options Exercised and Stock Vested Table, as applicable, for 2010 and subsequent years, with footnote disclosure describing the assumption of Company B options. [June 4, 2010]

## Question 119.28

**Question:** At the beginning of Year 1, the compensation committee sets the threshold, target and maximum levels for the number of shares that may be earned for Year 1 under the company's performance-based equity incentive plan. Incentive awards are paid in the form of restricted shares, which are issued early in Year 2 after the compensation committee has certified the company's Year 1 performance results. Can the amount reported in the Stock Awards column reflect the grant date fair value of the number of restricted shares actually issued for Year 1, rather than the amount that reflects the probable outcome of the performance conditions as of the grant date, as prescribed by Instruction 3 to Item 402(c)(2)(v) and (vi)?

**Answer:** No. The grant date fair value for stock and option awards subject

to performance conditions must be reported based on the probable outcome of the performance conditions as of the grant date, even if the actual outcome of the performance conditions - and therefore, the number of restricted shares actually awarded for Year 1 - is known by the time of the filing of the proxy statement. [July 8, 2011]

### **Section 120. Item 402(d) – Executive Compensation; Grants of Plan-Based Awards Table**

#### Question 120.01

**Question:** If an equity incentive plan award is denominated in dollars, but payable in stock, how is it disclosed in the Grants of Plan-Based Awards Table since the headings for equity-based awards (columns (f), (g) and (h)) only refer to numbers and not dollars?

**Answer:** The award should be disclosed in the Grants of Plan-Based Awards Table by including the dollar value and a footnote to explain that it will be paid out in stock in the form of whatever number of shares that amount translates into at the time of the payout. In this limited circumstance, and if all the awards in this column are structured in this manner, it is acceptable to change the captions for columns (f) through (h) to show "\$" instead of "#." [Aug. 8, 2007]

#### Question 120.02

**Question:** If all of the non-equity incentive plan awards were made for annual plans, where the awards have already been earned, may the company change the heading over columns (c), (d) and (e) of the Grants of Plan-Based Awards Table that refers to "Estimated future payouts under non-equity incentive plan awards?"

**Answer:** Yes, if the awards were made in the same year they were earned and the earned amounts are therefore disclosed in the Summary Compensation Table, the heading over columns (c), (d) and (e) may be changed to "Estimated possible payouts under non-equity incentive plan awards." [Jan. 24, 2007]

#### Question 120.03

Renumbered as [Question 122.04](#)

#### Question 120.04

Renumbered as [Question 122.05](#)

#### Question 120.05

Withdrawn Mar. 1, 2010

#### Question 120.06

**Question:** Under a long-term incentive plan, a named executive officer receives an award for a target number of shares at the start of a three-year

period, with one-third of this amount allocated to each of three single-year performance periods. How is grant date fair value determined for purposes of the disclosure required in column (l) of the table?

**Answer:** The grant date and grant date fair value are determined as provided in FAS 123R. Under paragraph A. 67 of FAS 123R, if all of the annual performance targets are set at the start of the three-year period, that is the grant date for the entire award. The grant date fair value for all three tranches of the award would be measured at that time, and would be reported in column (l). If each annual performance target is set at the start of each respective single-year performance period, however, paragraph A.68 of FAS 123R provides that each of those dates is a separate grant date for purposes of measuring the grant date fair value of the respective tranche. In this circumstance, only the grant date fair value for the first year's performance period would be measured and reported in column (l). [May 29, 2009]

#### Question 120.07

**Question:** During the fiscal year, an outstanding equity incentive plan award held by a named executive officer is amended or otherwise modified, resulting in incremental fair value under FAS 123R. Must the incremental fair value be reported in column (l) of the table?

**Answer:** Yes. This is required by Item 402(d)(2)(viii) and Instruction 7 to Item 402(d). [May 29, 2009]

### **Section 121. Item 402(e) – Executive Compensation; Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table**

None

### **Section 122. Item 402(f) – Executive Compensation; Outstanding Equity Awards at Fiscal Year-End Table**

#### Question 122.01

**Question:** A company has an equity incentive plan pursuant to which it grants awards that will vest, if at all, based on total shareholder return over a 3-year period. Awards were granted in 2005 ("2005 Awards") and will vest based on the company's total shareholder return from 1/1/05 through 12/31/07. 2006 was the second year of the 3-year performance period. Performance during 2005 was well above the maximum level. Performance during 2006 was below the threshold level. The combined performance for 2005 and 2006 would result in a payout at target if the performance period had ended on 12/31/06. Is it permissible to base disclosure on the actual multi-year performance to date (through the end of the last completed fiscal year)?

**Answer:** Yes. The number of shares or units reported in columns (d) or (i), and the payout value reported in column (j), should be based on achieving threshold performance goals, except that if performance during the last completed fiscal year (or, if the payout is based on performance to occur over more than one year, the last completed fiscal years over which

performance is measured) has exceeded the threshold, the disclosure shall be based on the next higher performance measure (target or maximum) that exceeds the last completed fiscal year's performance (or, if the payout is based on performance to occur over more than one year, the last completed fiscal years over which performance is measured). [Aug. 8, 2007]

#### Question 122.02

**Question:** Instruction 2 to Item 402(f)(2) requires footnote disclosure of the vesting dates of the awards reported in the Outstanding Equity Awards at Fiscal Year-End Table. Can a company comply with this instruction by including a column in this table showing the grant date of each award reported and including a statement of the standard vesting schedule that applies to the reported awards?

**Answer:** Yes, provided, however, that if there is any different vesting schedule applicable to any of the awards, then the table would also need to include disclosure about any such vesting schedule. [July 3, 2008]

#### Question 122.03

**Question:** A company's performance-based restricted stock unit ("RSU") plan measures performance over a three-year period. After the end of the three-year performance period (2007-2009), the compensation committee will evaluate performance to determine the number of RSUs earned by the named executive officers. The named executive officers must remain employed by the company for a subsequent two-year service-based vesting period (2010-2011). Upon completion of service-based vesting, the company will pay the named executive officers the shares underlying the RSUs. In the Outstanding Equity Awards at Fiscal Year-End Table for fiscal year 2009, how should information about the shares underlying the RSUs be reported?

**Answer:** The number of shares reported should be based on the actual number of shares underlying the RSUs that were earned at the end of the three-year performance period. This is the case even if this number will be determined after the 2009 fiscal year end. The shares should not be reported in columns (i) and (j) because they are no longer subject to performance-based conditions. Instead, the shares should be reported in columns (g) and (h) because they are subject to service-based vesting. [May 29, 2009]

#### Question 122.04

**Question:** Should a company include in the Outstanding Equity Awards at Fiscal Year-End Table in-kind earnings on restricted stock awards that have earned share dividends or share dividend equivalents?

**Answer:** Yes. Outstanding in-kind earnings at the end of the fiscal year should be included in the table. However, in-kind earnings that vested during the fiscal year, or in-kind earnings that are already vested when the dividends are declared, instead should be reported in the Option Exercises and Stock Vested Table under Item 402(g) of Regulation S-K. [Jan. 24, 2007]

## Question 122.05

**Question:** Instruction 3 to Item 402(f)(2) states that the issuer should report the market value of equity incentive plan awards using the closing market price at the end of the last completed fiscal year. The next sentence, however, states that the number of shares or units reported should be based on achieving threshold performance goals, "except that if the previous fiscal year's performance" has exceeded the threshold, disclosure is based on the next higher measure. Is the "previous fiscal year" the same year as the last completed fiscal year, or the year that preceded the last completed fiscal year?

**Answer:** For this purpose, the "previous fiscal year" means the same year as the "last completed fiscal year." [Aug. 8, 2007]

**Section 123. Item 402(g) – Executive Compensation; Option Exercises and Stock Vested Table**

## Question 123.01

**Question:** When reporting on the exercise or settlement of a stock appreciation right in the Number of Shares Acquired on Exercise column (column (b)) of the Option Exercises and Stock Vested Table, should a company report the net number of shares received upon exercise, or the gross number of shares underlying the exercised stock appreciation right?

**Answer:** As would be the case with the cashless exercise of options, the total number of shares underlying the exercised stock appreciation right should be reported in column (b), rather than just the amount representing the increase of the stock price since the grant of the award. A footnote or narrative accompanying the table could explain and quantify the net number of shares received. [Jan. 24, 2007]

**Section 124. Item 402(h) – Executive Compensation; Pension Benefits**

## Question 124.01

**Question:** Instruction 2 to Item 402(h)(2) indicates that the company must use the same assumptions used for financial reporting purposes under generally accepted accounting principles, except for the retirement age assumption, when computing the actuarial present value of a named executive officer's accumulated benefit under each pension plan. May the company deviate from the assumptions used for accounting purposes given the individual circumstances of the named executive officer or the plan?

**Answer:** No. [Jan. 24, 2007]

## Question 124.02

**Question:** Instruction 2 to Item 402(h)(2) specifies that in calculating the actuarial present value of a named executive officer's accumulated pension benefits, the assumed retirement age is to be the normal retirement age as defined in the plan, or, if not defined, the earliest time at which the named executive officer may retire without any benefit reduction. While many

plans have a specifically defined retirement age, some plans also have a provision that allows participants to retire at an earlier age without any benefit reduction. In this case, which age should the company use in making its calculation?

**Answer:** When a plan has a stated "normal" retirement age and also a younger age at which retirement benefits may be received without any reduction in benefits, the younger age should be used for determining pension benefits. The older age may be included as an additional column. [Jan. 24, 2007]

#### Question 124.03

**Question:** How do you measure the actuarial present value of the accumulated benefit of a pension plan in the situation where a particular benefit is earned at a specified age? For instance, if a named executive officer at age 40 is granted an award if he stays with his company until age 60, how should the company measure this benefit when the executive is age 50 and the normal retirement age under the plan is age 65?

**Answer:** The computation should be based on the accumulated benefit as of the pension measurement date, assuming that the named executive continues to live and will work at the company until retirement and thus will reach age 60 and receive the award. [Jan. 24, 2007]

#### Question 124.04

**Question:** Should assumptions regarding pre-retirement decrements be factored into the calculation of the actuarial present value of a named executive officer's accumulated benefit under a pension plan?

**Answer:** For purposes of calculating the actuarial present value for the Pension Benefits Table, the registrant should assume that each named executive officer will live to and retire at the plan's normal retirement age (or the earlier retirement age if the named executive officer may retire with unreduced benefits) and ignore for the purposes of the calculations what actuaries refer to as pre-retirement decrements. Therefore, the assumptions used for financial statement reporting purposes that should be used for calculating the actuarial present value are the discount rate, the lump sum interest rate (if applicable), post-retirement mortality, and payment distribution assumptions. Any contingent benefits arising upon death, early retirement or other termination of employment events should be disclosed in the post-employment narrative disclosure required under Item 402(j) of Regulation S-K. [Jan. 24, 2007]

#### Question 124.05

**Question:** A cash balance pension plan is a defined benefit plan in which the retiree's benefits may be determined by the amount represented in a hypothetical "account" for that participant. The "accrued benefit" is the amount credited to a participant's cash balance account as of any date, which the participant has the right to receive as a lump sum upon termination of employment. Can a company report, as the present value of the accumulated benefit for a cash balance plan, the "accrued benefit"?

**Answer:** No. The same as for other defined benefit plans, the amount disclosable in the Pension Benefits Table as the present value of accumulated benefit for a cash balance plan is the actuarial present value of the named executive officer's accumulated benefit under the plan, computed as of the same plan measurement date used for purposes of the company's audited financial statements for the last completed fiscal year. [Aug. 8, 2007]

### **Section 125. Item 402(i) – Executive Compensation; Nonqualified Defined Contribution and Other Nonqualified Deferred Compensation Plans**

#### Question 125.01

**Question:** The instruction to Item 402(i)(2) of Regulation S-K requires footnote disclosure quantifying the extent to which amounts reported in the table were reported as compensation in the Summary Compensation Table in the last completed fiscal year and in previous fiscal years. What should be noted by footnote when amounts were not previously reported (either because of the transition guidance in [Securities Act Release No. 8732A](#) or when a named executive officer appears in the table for the first time)?

**Answer:** The purpose of the instruction is to facilitate an understanding that non-qualified deferred compensation is reported elsewhere within the executive compensation disclosure over time. Amounts only need to be disclosed by footnote if they were actually previously reported in the Summary Compensation Table. [Jan. 24, 2007]

#### Question 125.02

**Question:** Item 402(i)(2)(iv) requires disclosure of the dollar amount of aggregate interest or other earnings accrued during the registrant's last fiscal year. What items, other than interest, are "earnings" for this purpose?

**Answer:** "Earnings" include dividends, stock price appreciation (or depreciation), and other similar items. The purpose of the table is to show changes in the aggregate account balance at fiscal year end for each named executive officer. Thus, "earnings" should encompass any increase or decrease in the account balance during the last completed fiscal year that is not attributable to contributions, withdrawals or distributions during the year. [Aug. 8, 2007]

#### Question 125.03

**Question:** Item 402(i)(1) calls for the Nonqualified Deferred Compensation Plan Table to provide the specified information "with respect to each defined contribution or other plan that provides for the deferral of compensation on a basis that is not tax-qualified." Does this item mean that this information should be provided on a plan-by-plan basis?

**Answer:** Yes. [July 3, 2008]

#### Question 125.04

**Question:** Item 402(i)(2)(iii) calls for disclosure of aggregate company

contributions to each nonqualified deferred compensation plan during the company's last fiscal year. For an excess plan related to a qualified plan, the contributions earned in 2008, which are reportable in the All Other Compensation column of the 2008 Summary Compensation Table, are not credited to the executive's account until January 2009. Are those contributions considered company contributions "during" 2008?

**Answer:** Yes. [July 3, 2008]

#### Question 125.05

**Question:** An equity award has vested, and the plan under which it was granted provides for the deferral of its receipt. Item 402(i)(1) calls for the Nonqualified Deferred Compensation Plan Table to provide the specified information "with respect to each defined contribution or other plan that provides for the deferral of compensation on a basis that is not tax-qualified." Does this item require the deferred receipt of the vested equity award to be included in the Nonqualified Deferred Compensation Plan Table?

**Answer:** Yes. This is the case whether the deferral is at the election of the named executive officer or pursuant to the terms of the equity award or plan. [Aug. 14, 2009]

### **Section 126. Item 402(j) – Executive Compensation; Potential Payments Upon Termination or Change-in-Control**

#### Question 126.01

**Question:** In the event that options are accelerated upon a termination or change-in- control, for purposes of Item 402(j) disclosure should the value of the accelerated options be calculated using the "spread" between exercise and market price (as of fiscal year end) or the FAS 123R value recognized in connection with the acceleration?

**Answer:** For purposes of Item 402(j), the company should use the "spread" to calculate the value of the award. Since Item 402(j) requires quantification of what a named executive officer would have received assuming the event took place on the last business day of the registrant's last completed fiscal year, disclosure of the "spread" at that date is consistent with Instruction 1 to 402(j), which prescribes using the closing market price per share of the registrant's securities on last business day of the registrant's last completed fiscal year. [Aug. 8, 2007]

#### Question 126.02

**Question:** A company's employee stock option plan provides for full and immediate vesting of all outstanding unvested awards upon a change-in-control of the company and this provision is included in each option recipient's award agreement (whether the recipient is an executive officer or an employee). Instruction 5 to Item 402(j) provides that a company need not provide information with respect to contracts, agreements, plans, or arrangements to the extent they are available generally to all salaried employees and do not discriminate in scope, terms, or operation, in favor of executive officers of the company. Can the company rely on Instruction 5 to

omit disclosure of these awards when quantifying the estimated payments and benefits that would be provided to named executive officers upon a change-in-control?

**Answer:** No. The Instruction 5 standard that the "scope" of arrangements not discriminate in favor of executive officers would not be satisfied where the option awards to executives are in amounts greater than those provided to all salaried employees. [Aug. 8, 2007]

### **Section 127. Item 402(k) — Executive Compensation; Compensation of Directors**

#### Question 127.01

**Question:** Is director compensation disclosure required under Item 402(k) of Regulation S-K for a person who served as a director for part of the last completed fiscal year, even if the person was no longer a director at the end of the last completed fiscal year?

**Answer:** Yes. If a person served as a director during any part of the last completed fiscal year the person must be included in the Director Compensation Table. [Jan. 24, 2007]

#### Question 127.02

**Question:** Is director compensation disclosure required under Item 402(k) of Regulation S-K for a person who served as a director during the last completed fiscal year but will not stand for re-election the next year?

**Answer:** Yes. If a person served as a director during any part of the last completed fiscal year the person must be included in the Director Compensation Table. [Jan. 24, 2007]

#### Question 127.03

**Question:** Does the Instruction to Item 402(k)(2)(iii) and (iv) require footnote disclosure, for each director, of the grant date fair value of each equity award outstanding or only of the awards granted during the company's last completed fiscal year?

**Answer:** Like the corresponding disclosure for named executive officers in the Grants of Plan-Based Awards Table, this Director Compensation Table requirement applies only to stock and option awards granted during the company's last completed fiscal year. [Aug. 8, 2007]

#### Question 127.04

**Question:** Does the Instruction to Item 402(k)(2)(iii) and (iv) requirement to provide footnote disclosure, for each director, of the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end include exercised options or vested stock awards?

**Answer:** No. Like the corresponding disclosure for named executive officers in the Outstanding Equity Awards at Fiscal Year-End Table, this

Director Compensation Table requirement applies only to unexercised option awards (whether or not exercisable) and unvested stock awards (including unvested stock units). [Aug. 8, 2007]

#### Question 127.05

**Question:** Can a charitable matching program that is available to all employees be excluded from the disclosure required of "director legacy or charitable awards programs" under Item 402(k)(2)(vii)(G) based on the exclusion for "information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees" in the Item 402(a)(6) (ii) definition of "plan"?

**Answer:** No. A charitable matching program available to all employees must be included in the Director Compensation Table. The Director Compensation Table disclosure applies to "the annual costs of payments and promises of payments pursuant to director legacy programs and similar charitable award programs." Any company-sponsored charitable award program in which a director can participate would be a "similar charitable award program." [Aug. 8, 2007]

### **Section 128. Items 402(l) to (r) – Executive Compensation; Smaller Reporting Companies**

None

### **Section 128A - Item 402(s) Narrative disclosure of the registrant's compensation policies and practices as they relate to the registrant's risk management**

#### Question 128A.01

**Question:** The requirement to provide narrative disclosure of the registrant's compensation policies and practices as they relate to the registrant's risk management is in Item 402(s), rather than included as part of Compensation Discussion and Analysis in Item 402(b). Where should a registrant present Item 402(s) disclosure in its filings?

**Answer:** The new rules do not specify where the disclosure should be presented. However, to ease investor understanding, the staff recommends that Item 402(s) disclosure be presented together with the registrant's other Item 402 disclosure. The staff would have concerns if the Item 402(s) disclosure is difficult to locate or is presented in a fashion that obscures it. [Jan. 20, 2010]

### **Section 128B – Item 402(t) Golden Parachute Compensation**

#### Question 128B.01

**Question:** Instruction 1 to Item 402(t)(2) provides that Item 402(t) disclosure will be required for those executive officers who were included in the most recently filed Summary Compensation Table. If a company files its annual meeting proxy statement in March 2011 (including the 2010

Summary Compensation Table), hires a new principal executive officer in May 2011 and prepares a merger proxy in September 2011, may the company rely on this instruction to exclude the new principal executive officer from the merger proxy's say on golden parachute vote and Item 402(t) disclosure?

**Answer:** No. Instruction 1 to Item 402(t) specifies that Item 402(t) information must be provided for the individuals covered by Items 402(a)(3)(i), (ii) and (iii) of Regulation S-K. Instruction 1 to Item 402(t)(2) applies only to those executive officers who are included in the Summary Compensation Table under Item 402(a)(3)(iii), because they are the three most highly compensated executive officers other than the principal executive officer and the principal financial officer. Under Items 402(a)(3)(i) and (ii), the principal executive officer and the principal financial officer are, per se, named executive officers, regardless of compensation level. Consequently, Instruction 1 to Item 402(t)(2) is not instructive as to whether the principal executive officer or principal financial officer is a named executive officer. This position also applies to Instruction 2 to Item 1011(b), which is the corresponding instruction in Regulation M-A. [Feb. 11, 2011]

### **Section 129. Item 403 — Security Ownership of Certain Beneficial Owners and Management**

#### Question 129.01

**Question:** If a director's term will not continue beyond the annual meeting, must that director's equity security holdings be disclosed pursuant to Item 403(b)?

**Answer:** Item 403(b), by its terms, requires the disclosure of shareholdings of all directors named in the registrant's proxy statement, including directors' qualifying shares, even if the terms of some directors will not continue beyond the annual meeting. [Mar. 13, 2007]

#### Question 129.02

**Question:** Are phantom stock units held in a nonqualified deferred compensation plan reportable in the table required by Item 403(b)?

**Answer:** If the units could be settled in stock at the holder's election, so that if the holder were terminated currently he or she would get the underlying stock without the need to satisfy any additional vesting requirements, the registrant should report the total number of shares and percent of class beneficially owned, including the shares and percent of class beneficially owned due to the potential exercise of rights acquired under the phantom stock units. This is because the holder would have the right to acquire the underlying stock within 60 days (see Exchange Act Rule 13d-3). In addition to including the shares underlying the units in the total number of shares and percent of class beneficially owned, the phantom stock units also should be presented in a manner that distinguishes them from stock owned outright - e.g., pursuant to a clear and succinct footnote explanation. In contrast, if the phantom stock units can be settled in stock only at the company's discretion, they should not be reported in the total number of shares and percent of class beneficially owned, because the

holder does not have a right to acquire the underlying stock within 60 days. Similarly, if the phantom stock units can be settled solely in cash, they should not be reported because the holder has no right to acquire the underlying stock. [Mar. 13, 2007]

#### Question 129.03

**Question:** If a named executive officer died since the beginning of the registrant's last fiscal year, must the deceased named executive officer be included in the Item 403(b) ownership table?

**Answer:** No. Although Item 403(b) requires disclosure for each of the named executive officers, as defined in Item 402(a)(3), a named executive officer who died since the beginning of the registrant's last fiscal year would not need to be included in the Item 403(b) ownership table. [Mar. 13, 2007]

#### Question 129.04

**Question:** Does the Item 403(b) requirement to indicate, by footnote or otherwise, the amount of shares that are pledged as security apply to a "negative pledge" of the company's stock by a director, nominee or named executive officer? (A "negative pledge" is a covenant granted by a borrower to a lender in which a promise is made not to convey the shares to a third party or to otherwise encumber them. Assuming a default by the borrower, the "negative pledge" would not transfer title by operation of law, but would instead require a foreclosure.)

**Answer:** Yes, because shares subject to a "negative pledge" may be subject to material risk or contingencies that do not apply to other shares beneficially owned by these persons, and such shares are pledged as security by operation of the negative pledge covenant. [Mar. 13, 2007]

#### Question 129.05

**Question:** Does the requirement in Item 403(c) to disclose "any arrangement . . . including any pledge . . . which may at a subsequent date result in a change in control of the registrant" apply to a "negative pledge" of the company's stock by a principal shareholder, as described in Question 129.04 above?

**Answer:** In the ordinary course, such an arrangement would not be disclosable under Item 403(c). However, the registrant should consider whether any circumstances, such as insolvency of the borrower or takeover activity with respect to the registrant, would render a change in control arising from such an arrangement foreseeable and, hence, disclosable under Item 403(c). [Mar. 13, 2007]

### **Section 130. Item 404 — Transactions with Related Persons, Promoters and Certain Control Persons**

#### Question 130.01

**Question:** If a company with a class of securities registered under the Exchange Act that is current in its Exchange Act reports files a Form S-1

that does not incorporate information by reference, must Item 404(a) disclosure be provided for fiscal years ending before December 15, 2006 if the company already provided Item 404 disclosure for these years under the pre-2006 Item 404 requirements in a Commission filing?

**Answer:** No. Companies do not have to "restate" Item 404(a) disclosure under the 2006 Item 404 requirements if it was previously reported under the pre-2006 requirements. [Mar. 13, 2007]

#### Question 130.02

**Question:** If a company files a registration statement for an initial public offering on Form S-1, or files a Form 10 to register a class of securities under the Exchange Act, must the company provide Item 404(a) disclosure pursuant to the 2006 Item 404 requirements for fiscal years ending before December 15, 2006?

**Answer:** Yes. Disclosure must be provided in these filings pursuant to the 2006 Item 404 requirements for the period specified in Instruction 1 to Item 404. [Mar. 13, 2007]

#### Question 130.03

**Question:** Item 404(a) requires, in pertinent part, disclosure of any transaction since the beginning of the registrant's last fiscal year between the registrant and any 5 percent shareholder where the amount involved exceeds \$120,000 and the 5 percent shareholder has a direct or indirect material interest in the transaction. Is disclosure required of such a transaction that occurred since the beginning of the registrant's last fiscal year, but prior to the date the person became a 5 percent shareholder?

**Answer:** Disclosure is required if the transaction: (a) was continuing (such as through the ongoing receipt of payments) after the date the person became a 5 percent shareholder; or (b) resulted in the person becoming a 5 percent shareholder. If the transaction concluded before the person became a 5 percent shareholder, disclosure would not be required. [Mar. 13, 2007]

#### Question 130.04

**Question:** How does a company value unexercised, in-the-money stock options for purposes of determining whether the \$120,000 threshold of Item 404(a) has been met?

**Answer:** The value of unexercised, in-the-money options should be determined for Item 404(a) purposes by determining the difference between the fair market value of the securities underlying the options and the exercise or base price of the options. Use of the Black-Scholes or binomial option pricing method also would be appropriate, provided that such use and the underlying assumptions are clearly disclosed and the value thus calculated is greater than zero and is otherwise reasonably related to the unrealized gain. [Mar. 13, 2007]

#### Question 130.05

**Question:** Is the condition that loans be made on substantially the same terms as for "comparable loans with persons not related to the lender" in Instruction 4.c.ii. to Item 404(a) satisfied if a bank makes loans available on the same terms to all of its employees, the vast majority of whom are not "related persons" as defined in Item 404, but the same terms are not offered to non-employees?

**Answer:** No. The term "persons not related to the lender" means persons with no relationship at all with the lender other than the lending relationship, such as regular customers. Employees are considered related to the lender by virtue of their employment relationship. [Mar. 13, 2007]

#### Question 130.06

**Question:** Must a company include disclosure regarding policies for the review, approval or ratification of related person transactions under Item 404(b)(1) even when the company does not have to report any transactions under Item 404(a)?

**Answer:** Yes. Item 404(b)(1) requires disclosure regarding policies for the review, approval or ratification of the types of related person transactions that would be disclosed under Item 404(a). [Mar. 13, 2007]

#### Question 130.07

**Question:** Is a smaller reporting company required to describe its policies and procedures for review, approval or ratification of transactions with related persons as specified by Item 404(b) of Regulation S-K if a schedule or form being used for a filing requires the company to furnish the information required by Item 404(b)?

**Answer:** No. Smaller reporting companies are not required to furnish Item 404(b) disclosure in these circumstances. Smaller reporting companies comply with the requirements of Item 404 by furnishing the information called for by Item 404(d) of Regulation S-K, the paragraph of Item 404 labeled "Smaller reporting companies," which does not require Item 404(b) disclosure. [July 3, 2008]

### **Section 131. Item 405 — Compliance with Section 16(a) of the Exchange Act**

None

### **Section 132. Item 406 — Code of Ethics**

None

### **Section 133. Item 407 — Corporate Governance**

#### Question 133.01

**Question:** If a non-listed issuer has independence definitions that are more stringent than those of a national securities exchange, may that issuer provide disclosure based on its own independence definitions in accordance

with Item 407(a)(1)(i), rather than provide the disclosure required by Item 407(a)(1)(ii)?

**Answer:** The non-listed issuer must provide the disclosure required by Item 407(a)(1)(ii). If the non-listed issuer believes that its own independence definitions are more stringent than those of the exchange identified in the required Item 407(a)(1)(ii) disclosure, it may, in addition, disclose that belief and provide the disclosures called for by Item 407(a)(1)(i) based on its own definitions, provided that it also complies with Item 407(a)(2) regarding disclosure of its own definitions of independence. [Mar. 13, 2007]

#### Question 133.02

**Question:** May a company indicate that the nominating committee's processes, policies, or minimum director nominee qualifications are included in the company's governance policies posted on the company's website, rather than including descriptions of the nominating committee's processes, policies, or minimum nominee qualifications in the proxy statement?

**Answer:** No. Item 407(c)(2) requires that the descriptions of the processes, policies, and nominee qualifications be included in the proxy statement, and no mechanism for reference to website posting of this information is provided for with respect to the Item 407(c)(2) disclosure. [Mar. 13, 2007]

#### Question 133.03

**Question:** Item 407(c)(2)(vii) requires the identification of the category of persons or entities that recommended each nominee for director, other than executive officers or nominees that are directors who are standing for re-election. If a director who did not stand for election by shareholders last year (but rather had been named as a director by the board during the year) is to be nominated for election by shareholders for the first time, is disclosure under Item 407(c)(2)(vii) required for that nominee?

**Answer:** Yes. The nominee for director would not be considered as standing for "re-election"; therefore, disclosure of the category of persons or entities that recommended the nominee is required by Item 407(c)(2)(vii). [Mar. 13, 2007]

#### Question 133.04

**Question:** Does Item 407(d)(3)(i)(D) require the audit committee to state whether it recommended inclusion of the audited financial statements in the Form 10-K for periods prior to the last completed fiscal year?

**Answer:** No. Item 407(d)(3)(i)(D) requires the audit committee to state whether it recommended inclusion of the audited financial statements in the Form 10-K. This statement need not cover financial statements for periods prior to the last completed fiscal year. [Mar. 13, 2007]

#### Question 133.05

**Question:** Should all compensation consultants engaged by the company that played a role in determining or recommending the amount or form of executive or director compensation be disclosed, or only those that consulted with the board of directors or the compensation committee?

**Answer:** All compensation consultants with any role in determining or recommending the amount or form of executive or director compensation must be disclosed under Item 407(e)(3)(iii). [Mar. 13, 2007]

#### Question 133.06

**Question:** Is the consent of a compensation consultant required under Securities Act Rule 436 if a compensation consultant is identified in accordance with Item 407(e)(3)(iii) in a filing that is incorporated by reference into a Securities Act registration statement?

**Answer:** No. Item 407(e)(3) requires a "narrative description of the registrant's processes and procedures for the consideration and determination of executive and director compensation including ... (iii) [a]ny role of compensation consultants in determining or recommending the amount or form of executive and director compensation." Identifying a compensation consultant and the role that the compensation consultant had in determining or recommending the amount or form of executive and director compensation does not result in the compensation consultant being deemed an "expert" for the purposes of the Securities Act, or mean that the compensation consultant has expertized any portion of the disclosure regarding executive and director compensation or compensation committee processes. Therefore, a consent would not be required. [Mar. 13, 2007]

#### Question 133.07

**Question:** Which names of directors must be included below the disclosure required in the Compensation Committee Report by Item 407(e)(5)?

**Answer:** Item 407(e)(5)(ii) requires that the name of each member of the compensation committee (or other board committee performing equivalent functions, or in the absence of any such committee, the entire board of directors) must appear below the required disclosure in the Compensation Committee Report. The members of the compensation committee (or the full board) who participated in the review, discussions and recommendation with respect to the Compensation Discussion and Analysis must be identified. New members who did not participate in such activities and departed members who are no longer directors need not be included. Members who resigned from the compensation committee during the course of the year, but remain directors of the issuer, may need to be named under the disclosure in the Compensation Committee Report pursuant to Item 407(e)(5)(ii). [Mar. 13, 2007]

#### Question 133.08 *[same as Question 118.06]*

**Question:** Regarding the role of compensation consultants in determining or recommending the amount or form of executive and director compensation, on what basis should a company differentiate between the requirements of Item 407(e)(3)(iii) and Item 402(b)'s Compensation Discussion and Analysis disclosure?

**Answer:** The information regarding "any role of compensation consultants in determining or recommending the amount or form of executive and director compensation" required by Item 407(e)(3)(iii) is to be provided as part of the company's Item 407(e)(3) compensation committee disclosure. See [Release 33-8732A](#) at Section V.D, Corporate Governance Disclosure. If a compensation consultant plays a material role in the company's compensation-setting practices and decisions, then the company should discuss that role in the Compensation Discussion and Analysis section. [July 3, 2008]

#### Question 133.09

**Question:** When is a smaller reporting company required to provide the audit committee financial expert disclosure as required by Item 407(d)(5)?

**Answer:** While all smaller reporting companies are required to provide the audit committee report required by Item 407(d)(3), pursuant to Item 407(g), smaller reporting companies are not required to provide the audit committee financial expert disclosure required by Item 407(d)(5) until their first annual report after their initial registration statement under the Securities Act or Exchange Act becomes effective. The statement in the original version of the adopting release for Item 407(g) (Release No. 33-8876, Dec. 19, 2007) that smaller reporting companies are not required to provide an audit committee report was incorrect. [July 3, 2008]

#### Question 133.10

**Question:** Are the "additional services" provided by executive compensation consultants that are subject to the disclosure requirements of Items 407(e)(3)(iii)(A) and (B) limited to services for non-executives?

**Answer:** No. [Jan. 20, 2010]

#### Question 133.11

**Question:** If a compensation consultant's role is limited to consulting on broad-based plans that do not discriminate in favor of executive officers or directors and to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the consultant does not provide advice, then such services do not need to be disclosed under Item 407(e)(3)(iii), so long as these are the *only* services provided by the consultant. If the consultant's role extends beyond these two types of services, then disclosure of all of the consultant's services, including consulting on broad-based plans and providing non-customized information, will be required under Item 407(e)(3)(iii), subject to the disclosure threshold in this item. Are the fees for these two types of services considered to be for "determining or recommending the amount or form of executive and director compensation" or are such fees considered to be for "additional services"?

**Answer:** The answer depends on the facts and circumstances of each service. Fees for consulting on broad-based, non-discriminatory plans in which executive officers or directors participate and for providing information relating to executive and director compensation, such as survey

data (in each case, that would otherwise qualify for the exclusion from disclosure if they are the only services provided), are considered to be fees for "determining or recommending the amount or form of executive and director compensation" for purposes of reporting fees under the rule. However, "consulting" on broad-based non-discriminatory plans does not also include any related services, such as benefits administration, human resources services, actuarial services and merger integration services, all of which are "additional services" subject to the disclosure requirements of Items 407(e)(3)(iii)(A) and (B). In addition, if the non-customized information relates to matters other than executive and director compensation, then the fees for such information would be for "additional services." [Jan. 20, 2010]

#### Question 133.12

**Question:** Under Item 407(e)(3)(iii)(A)-(B), compensation consultant fees are required to be disclosed if the consultant provides advice on executive and director compensation and also provides "additional services" in an amount in excess of \$120,000 during the last completed fiscal year. Is there any limitation on the types of services that are included as "additional services"? If, in addition to services, the consultant also sells products to the company, do the revenues generated from such sales also have to be disclosed?

**Answer:** There is no limitation on the types of services that are included in "additional services." If the consultant also sells products to the company, then the revenues generated from such sales should be included in "aggregate fees for any additional services provided by the compensation consultant or its affiliates." [Mar. 12, 2010]

### **Section 134. Item 501 — Forepart of Registration Statement and Outside Front Cover Page of Prospectus**

#### Question 134.01

**Question:** Is Item 501(b)(8)(iii)'s requirement to disclose the presence or absence of arrangements to place funds in escrow applicable only when the best-efforts offering is conditioned on a minimum number of securities being sold?

**Answer:** Yes. [July 3, 2008]

#### Question 134.02

**Question:** When should the legend specified in Item 501(b)(10) be included on a prospectus?

**Answer:** The legend specified in Item 501(b)(10) should be printed on all preliminary prospectuses used before the effective date of the registration statement and, in accordance with Item 501(b)(11), in any prospectus contained in an effective registration statement omitting Rule 430A information that is used after effectiveness and prior to the pricing. [July 3, 2008]

#### Question 134.03

**Question:** How should the prospectus date and "Subject to Completion" legend required by Items 501(b)(9) and (10) of Regulation S-K be placed on the cover page of the prospectus?

**Answer:** The placement of the prospectus date and "Subject to Completion" legend on the prospectus cover page should be such that the information is presented in a clear, concise, and understandable manner. [July 3, 2008]

### **Section 135. Item 502 — Inside Front and Outside Back Cover Pages of Prospectus**

None

### **Section 136. Item 503 — Prospectus Summary, Risk Factors and Ratio of Earnings to Fixed Charges**

Question 136.01

**Question:** When is the ratio of earnings to fixed charges required in registration statements?

**Answer:** The ratio of earnings to fixed charges required by Item 503(d) is required for registration statements relating to both short and long term debt. However, if the ratio already is contained in a Form 10-K filed by the issuer, it can be incorporated by reference into the registration statement, provided the registration form permits such incorporation and the issuer is eligible to incorporate the information by reference. [July 3, 2008]

### **Section 137. Item 504 — Use of Proceeds**

None

### **Section 138. Item 505 — Determination of Offering Price**

None

### **Section 139. Item 506 — Dilution**

None

### **Section 140. Item 507 — Selling Security Holders**

Question 140.01

**Question:** Does the term "security holders" in Item 507 refer to beneficial holders?

**Answer:** Yes. The term "security holders," as used in Item 507, means beneficial holders, not nominee holders or other such holders of record. [July 3, 2008]

Question 140.02

**Question:** Must identification of an entity as a selling shareholder in the registration statement include disclosure of the persons who have sole or shared voting or investment power over the entity?

**Answer:** Yes. The company must identify in the registration statement the person or persons who have voting or investment control over the company's securities that the entity owns. Use Rule 13d-3 by analogy to make the determination. [July 3, 2008]

#### Question 140.03

**Question:** How should registration statements for secondary offerings reflect the addition of selling shareholders or the substitution of new selling shareholders for already named selling shareholders?

**Answer:** If the company is eligible to rely on Rule 430B when the registration statement was originally filed, the company may add or substitute selling shareholders to a registration statement related to a specific transaction by prospectus supplement. The supplement is filed under Rule 424(b)(7).

If the company is not eligible to rely on Rule 430B when the registration statement is initially filed, it must file a post-effective amendment to add selling shareholders to a registration statement related to a specific transaction that was completed prior to the filing of the resale registration statement. A Rule 424(b) prospectus supplement may be used to post-effectively update the selling shareholder table to reflect a transfer from a previously identified selling shareholder. The new investor's shares must have been acquired or received from a selling shareholder previously named in the resale registration statement and the aggregate number of securities or dollar amount registered cannot change. [Apr. 24, 2009]

### Section 141. Item 508 — Plan of Distribution

#### Question 141.01

**Question:** Does Item 508(a) of Regulation S-K, which calls for disclosure of the identity of "principal underwriters" and their material relationships with the registrant, require disclosure as to each member of the selling group?

**Answer:** No. The disclosure is limited to those underwriters who are in privity of contract with the issuer with respect to the offering. [July 3, 2008]

### Section 142. Item 509 — Interests of Named Experts and Counsel

None

### Section 143. Item 510 — Disclosure of Commission Position on Indemnification for Securities Act Liabilities

None

### Section 144. Item 511 — Other Expenses of Issuance and

**Distribution**

None

**Section 145. Item 512 – Undertakings**

## Question 145.01

**Question:** Must a registration statement on Form S-8, covered by Rule 415, include all applicable undertakings in Item 512 of Regulation S-K, including specifically those in Items 512(a), (b) and (h)?

**Answer:** Yes. However, the Form S-8 does not have to include the undertakings contained in Items 512(a)(5)(i), 512(a)(5)(ii), and 512(a)(6). [July 3, 2008]

## Question 145.02

**Question:** Should a Form S-3 for an automatic shelf registration statement include the Item 512(h) undertaking or the indemnification disclosure required by Item 510 of Regulation S-K?

**Answer:** A Form S-3 for an automatic shelf registration statement, other than for a dividend reinvestment plan, should include the Item 512(h) undertaking rather than the indemnification disclosure required by Item 510, even though the registrant will not request acceleration of effectiveness. For automatic shelf registration statements relating to dividend reinvestment plans, the Item 510 disclosure should be included in lieu of the Item 512(h) undertaking. [July 3, 2008]

## Question 145.03

**Question:** Item 512(a) of Regulation S-K, which is applicable to Rule 415 offerings, sets forth three circumstances requiring a post-effective amendment: Section 10(a)(3) updating, fundamental changes and material changes to the plan of distribution. Can a Rule 424(b) supplement be used for these purposes if the offering is registered on Form S-3 or Form F-3?

**Answer:** Yes. In a Form S-3 or Form F-3, issuers may satisfy the Item 512 (a) undertaking by incorporating by reference from Exchange Act reports containing the required information or by filing a Rule 424(b) prospectus. [July 3, 2008]

**Section 146. Item 601 – Exhibits**

## Question 146.01

**Question:** Instruction 1 to Item 601(a) of Regulation S-K provides that when filing amendments to registration statements, a registrant need not include copies of exhibits which have been modified only to correct minor typographical errors or to put in pricing terms. May the incomplete exhibits already on file that do not reflect the pricing or typographical modifications noted above be incorporated by reference in any subsequent filing?

**Answer:** No. Instruction 1 also states that incomplete exhibits already on file that do not reflect these modifications may not be incorporated by reference in any subsequent filing. [July 3, 2008]

#### Question 146.02

**Question:** Under Item 601(a)(2), must the exhibit index for each year's Form 10-K list each of the exhibits required in the Form 10-K, even if some of the exhibits have previously been filed?

**Answer:** Yes. Of course, the previously filed exhibits may be incorporated by reference from the prior year's Form 10-K or another appropriate document. [July 3, 2008]

#### Question 146.03

**Question:** Must a Form 10-Q include the full exhibit index specified by Item 601(a)(2)?

**Answer:** No. The exhibit index in a Form 10-Q can be limited to those exhibits actually filed as part of, or incorporated by reference into, the Form 10-Q. [July 3, 2008]

#### Question 146.04

**Question:** If a registrant is party to an oral contract that would be required to be filed as an exhibit pursuant to Item 601(b)(10) if it were written, should the registrant provide a written description of the contract similar to that required for oral contracts or arrangements pursuant to Item 601(b)(10)(iii)?

**Answer:** Yes. [July 3, 2008]

#### Question 146.05

**Question:** If a company enters into a new material contract, when should the contract be filed as an exhibit to a Form 10-Q or Form 10-K?

**Answer:** Instruction 2 to Item 601(b)(10) indicates that Exhibit 10 material contracts need to be filed with the periodic report covering the period during which the contract is executed or becomes effective. [July 3, 2008]

#### Question 146.06

**Question:** A company entered into a material agreement. However, the agreement was no longer material to the company by the end of the reporting period during which the contract was entered into. Must the agreement be filed as an exhibit to the periodic report?

**Answer:** Yes. Item 601(a)(4) provides that if a material contract "is executed or becomes effective during the reporting period," then it shall be filed as an exhibit. [July 3, 2008]

## Question 146.07

**Question:** When may consents that are filed with an Exchange Act document be incorporated by reference into a Securities Act registration statement?

**Answer:** Item 601(b)(23)(ii) of Regulation S-K and Securities Act Rule 439 (a) permit the incorporation by reference of consents filed with Exchange Act reports only into an already effective Securities Act registration statement. Consents may not be incorporated by reference into a registration statement that becomes effective after the filing of the consent with an Exchange Act document. [July 3, 2008]

## Question 146.08

**Question:** An issuer is filing a special financial report on Form 10-K. Must the issuer file with the report the certification required by Item 601(b)(31)?

**Answer:** Yes. However, the issuer may omit paragraphs 4 and 5 of the certification because the report will contain only audited financial statements and not Item 307 or Item 308 of Regulation S-K disclosures. [July 3, 2008]

## Question 146.09

**Question:** Does Item 601(b)(10)(iii)(A) of Regulation S-K, which describes management contracts and compensatory plans, contracts and arrangements in which named executive officers participate that must be filed as exhibits to registration statements and reports, require a smaller reporting company to define the term "named executive officer" by referring to the definition of that term in Item 402(a)(3) of Regulation S-K instead of the definition of that term available to smaller reporting companies in Item 402(m)(2)?

**Answer:** No. If a smaller reporting company has chosen to use the definition of "named executive officer" in Item 402(m)(2) in its registration statement or report, by providing the disclosure permitted under Items 402(m) through 402(r) instead of the disclosure required under Items 402(a) through 402(k), the staff will interpret Item 601(b)(10)(iii)(A) to refer to the definition of "named executive officer" in Item 402(m)(2) and only require the filing as exhibits of plans, contracts and arrangements in which named executive officers as defined under Item 402(m)(2) participate. [July 3, 2008]

## Question 146.10

**Question:** Should a copy of the employee benefit plan under which the registered securities will be issued be filed as an exhibit to the registration statement on Form S-8?

**Answer:** Yes. [July 3, 2008]

## Question 146.11

**Question:** Does a written arrangement whereby officers are provided company cars and other perquisites have to be filed as a "material contract"?

**Answer:** If the perquisite is separately identified and quantified in the proxy statement, then the written arrangement pursuant to which the officer receives the perquisite need not be filed as a "material contract." [July 3, 2008]

#### Question 146.12

**Question:** Even though interactive data exhibits are not required for initial public offerings, can a filer voluntarily submit an interactive data exhibit for an IPO on Form S-1?

**Answer:** Yes. If the filer chooses to submit an interactive data exhibit with an IPO on Form S-1, however, it must include the exhibit as soon as the registration statement contains a price or price range and subsequent amendments also must include the interactive data exhibit if the financial statements are changed. [May 29, 2009]

#### Question 146.13

**Question:** If a Form 8-K contains audited annual financial statements that are a revised version of financial statements previously filed with the Commission and have been revised to reflect the effects of certain subsequent events, such as discontinued operations, a change in reportable segments or a change in accounting principle, then under Item 601(b)(101)(i) of Regulation S-K, the filer must submit an interactive data file with the Form 8-K for those revised audited annual financial statements. Paragraph 6(a) of General Instruction C of Form 6-K contains a similar requirement. Item 601(b)(101)(ii) of Regulation S-K and Paragraph 6(b) of General Instruction C of Form 6-K permit a filer to voluntarily submit an interactive data file with a Form 8-K or 6-K, respectively, under specified conditions. Is a filer permitted to voluntarily submit an interactive data file with a Form 8-K or 6-K for other financial statements that may be included in the Form 8-K or 6-K, but for which an interactive data file is not required to be submitted? For example, if the Form 6-K contains interim financial statements other than pursuant to the nine-month updating requirement of Item 8.A.5 of Form 20-F?

**Answer:** Yes, if the filer otherwise complies with Item 601(b)(101)(ii) of Regulation S-K and Paragraph 6(b) of General Instruction C of Form 6-K, as applicable. [Sep. 14, 2009]

#### Question 146.14

**Question:** How does a filer determine when it is required to submit interactive data and to "detail tag" the financial statement footnotes and schedules in its interactive data?

**Answer:** A filer first assesses its filing status at the end of each fiscal year (by looking to its public float as of the end of the most recently completed second quarter) and then follows the phase-in provisions for that status in the filings it makes during the immediately following fiscal year.

For example, as of December 31, 2009, a calendar-year domestic filer is a large accelerated filer with a public float under \$5 billion on the last business day of its second quarter ended June 30, 2009. For purposes of its 2010 filings, the filer will follow the submission requirements of Item 601(b)(101)(i)(B) of Regulation S-K and the detail tagging requirements of Rule 405(f)(2) of Regulation S-T. Accordingly, the filer is required to submit interactive data with its Forms 10-Q for the quarters ended June 30 and September 30, 2010 but need not detail tag the financial statement footnotes and schedules until its Form 10-Q for the quarter ended June 30, 2011, assuming that, as of December 31, 2010, it is a large accelerated filer with a public float under \$5 billion on the last business day of its second quarter ended June 30, 2010.

If the filer, as of December 31, 2010, is no longer a large accelerated filer, for purposes of its 2011 filings, it will follow the submission requirements of Item 601(b)(101)(i)(C) of Regulation S-K and the detail tagging requirements of Rule 405(f)(3) of Regulation S-T. Accordingly, the filer would not be required to submit interactive data with its Form 10-K for the year ended December 31, 2010 or Form 10-Q for the quarter ended March 31, 2011, but it would be required to submit interactive data with its Forms 10-Q for the quarters ended June 30 and September 30, 2011. The filer would not be required to detail tag the financial statement footnotes and schedules until its Form 10-Q for the quarter ended June 30, 2012.

Conversely, if the filer, as of December 31, 2010, is a large accelerated filer with a public float *over* \$5 billion on the last business day of its second quarter ended June 30, 2010, it will follow the submission requirements of Item 601(b)(101)(i)(A) of Regulation S-K and the detail tagging requirements of Rule 405(f)(1) of Regulation S-T. Accordingly, the filer would be required to submit interactive data with its Form 10-K for the year ended December 31, 2010 and Forms 10-Q for the quarters ended March 31, June 30 and September 30, 2011 and to detail tag the financial statement footnotes and schedules in the interactive data it submits with all of these forms, even though the filer is in its first year of interactive data reporting. A filer that is required to begin detail tagging within its first year of interactive data reporting may apply for a continuing hardship exemption pursuant to Rule 202 of Regulation S-T if it cannot detail tag without undue burden or expense. Such applications will be considered on a case-by-case basis. [Sept. 17, 2010]

#### Question 146.15

**Question:** In detail tagging financial statement footnotes and schedules in its interactive data file, a filer must, among other things, "block-text" tag "[e]ach significant accounting policy within the significant accounting policies footnote" under Rule 405(d)(2) of Regulation S-T. Must the filer also block-text tag significant accounting policies that are described in footnotes outside of a significant accounting policies footnote, either because the significant accounting policies footnote is not the only footnote that describes significant accounting policies or because there is no significant accounting policies footnote?

**Answer:** Yes. [Sept. 17, 2010]

#### Question 146.16

**Question:** In detail tagging financial statement footnotes and schedules in its interactive data file, a filer must also, among other things, tag separately "[e]ach amount (i.e., monetary value, percentage, and number)" within each footnote and financial statement schedule under Rules 405(d)(4)(i) and 405(e)(2)(i), respectively, of Regulation S-T. Are there any monetary values, percentages or numbers in footnotes and financial statement schedules that do not need to be tagged separately?

**Answer:** Yes. Examples of the types of monetary values, percentages and numbers that the staff has agreed are not within the purpose of the current interactive data requirements and, as a result, need not be tagged separately to comply with Rules 405(d)(4)(i) and 405(e)(2)(i) include:

- attributed increased sales to the \$1.99 pancake special (the increased sales figure itself would need to be tagged);
- sales of 1% fat milk (the sales figure itself would need to be tagged);
- docket number 34-4589;
- 22nd district court;
- FASB Accounting Standards Codification Section 605-40-15;
- altitude of 27,000 feet;
- drilling 700 feet;
- open new stores no less than 2 miles from existing stores;
- founded a new subsidiary in 2009;
- each restaurant now offers at least 20 entrees under 500 calories; and
- number of the footnote itself. [Sept. 17, 2010]

#### **Section 147. Item 701 – Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities**

##### Question 147.01

**Question:** Does Item 701(f) require a registrant to report how it anticipates using the proceeds of an offering?

**Answer:** No. The reporting of use of proceeds requires the reporting of actual expenditures of the funds. Merely earmarking funds for future use should not be reported. [July 3, 2008]

#### **Section 148. Item 702 – Indemnification of Directors and Officers**

None

**Section 149. Item 703 — Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

## Question 149.01

**Question:** Item 703 requires tabular disclosure regarding any purchase made by or on behalf of the issuer or any affiliated purchaser of shares or other units of any class of the issuer's equity securities that are registered by the issuer under Exchange Act Section 12. In connection with an employee benefit plan, an employee exercises an option using a process known as "net" option exercise. Is this transaction a repurchase by the issuer that the issuer must disclose under Item 703?

**Answer:** No. If, however, any shares are withheld in addition to the shares necessary to pay taxes or satisfy the exercise price, the company must disclose the repurchase of the additional shares under Item 703. Similarly, if the option exercise price is paid with company stock that the option holder otherwise owns, the company must report the repurchase of the stock under Item 703. [July 3, 2008]

## Question 149.02

**Question:** Is disclosure required by Item 703 of Regulation S-K if a holder of restricted stock subject to vesting conditions forfeits the stock upon failure to satisfy vesting condition if he or she was granted them for no consideration?

**Answer:** No. [July 3, 2008]

**Section 150. Items 801 and 802 — Industry Guides**

None

**Section 151. Items 901 through 915 — Roll-up Transactions**

## Question 151.01

**Question:** Are the roll-up rules in the Item 900 Series of Regulation S-K applicable to transactions exempt from registration under the Securities Act?

**Answer:** Pursuant to Item 901(c)(2)(ii), a "roll-up transaction" does not include transactions in which the securities to be issued or exchanged are not required to be, and are not, registered under the Securities Act. The roll-up rules are not applicable except from an anti-fraud perspective. See Release No. 33-6922 (Oct. 30, 1991). [July 3, 2008]

**Section 152. Items 1000-1016 — Regulation M-A**

None

**Section 153. Items 1100-1123 — Regulation AB**

None

## **Section 154. Items 1201-1208 — Disclosure by Registrants Engaged in Oil and Gas Producing Activities**

### Question 154.01

**Question:** For a recently drilled well, where there is only a limited amount of production data and the production rate is expected to decline in a hyperbolic manner but the evidence to date indicates only an exponential decline, can you assume that the production rate will eventually begin to decline in a hyperbolic manner and claim that as proved reserves?

**Answer:** Yes, but only at such time when additional production data, such as from offset wells, exists demonstrating that there will be a change in the manner of decline from exponential to hyperbolic. [Oct. 26, 2009]

### Question 154.02

**Question:** Should reserve quantities attributable to equity method investees be combined with reserve quantities attributable to consolidated entities for purposes of identifying countries containing 15% or more of the registrant's reserves under Item 1202 of Regulation S-K.

**Answer:** Yes. [Oct. 26, 2009]

### Question 154.03

**Question:** If an issuer engages a third party to prepare or audit its reserve estimates, or to conduct a process review, of a limited amount of its reserves, does it need to file the third party's report under Item 1202(a)(8) of Regulation S-K?

**Answer:** If the issuer discloses in its filing that it engaged a third party to prepare or audit its reserve estimates, or to conduct a process review, of a limited amount of its reserves, then the issuer must file the third party's report. [Oct. 26, 2009]

## **INTERPRETIVE RESPONSES REGARDING PARTICULAR SITUATIONS**

### **Section 201. Regulation S-K — General Guidance**

None

### **Section 202. Item 10 — General**

**202.01** For purposes of the definition of the term "smaller reporting company" in Item 10(f)(1) of Regulation S-K, in calculating an issuer's revenues to determine the application of the definition of "smaller reporting company," when the issuer has a public float of zero and is seeking to determine whether it meets the terms of the definition on the basis of revenues, the issuer should include all revenues on a consolidated basis. As such, a holding company would meet the terms of the definition only if it has less than \$50 million in consolidated revenues. [July 3, 2008]

### **Section 203. Item 101 — Description of Business**

**203.01** In the narrative description of business, a registrant is required to specify "the number of persons employed by the registrant." In industries where registrants' general practice is to hire independent contractors (sometimes called "contract employees" or "freelancers") rather than "employees" to perform the work of the company, this disclosure should indicate the number of persons retained as independent contractors, as well as the number of regular employees. [July 3, 2008]

#### **Section 204. Item 102 – Description of Property**

None

#### **Section 205. Item 103 – Legal Proceedings**

**205.01** The bank subsidiary of a one bank holding company initiates a lawsuit to collect a debt that exceeds 10% of the current assets of the bank and its holding company parent. Due to the unusual size of the debt, Item 103 requires disclosure of the lawsuit, even though the collection of debts is a normal incident of the bank's business. [July 3, 2008]

**205.02** Contrary to Release No. 33-5170 (July 19, 1971), it is no longer the practice of the Division to require registrants automatically to furnish, as supplemental information, either a description of civil rights litigation omitted from a newly-filed disclosure document or the reasons for the omission. [July 3, 2008]

#### **Section 206. Item 201 – Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters**

**206.01** An equity compensation plan has received Bankruptcy Court approval, but not shareholder approval. Such a plan should be reported in the "not approved by security holders" category for the purposes of the Equity Compensation Plan Information table. A footnote may be added to disclose the Bankruptcy Court approval. [Mar. 13, 2007]

**206.02** A compensation plan that permits awards to be settled in either cash or stock must be disclosed under Item 201(d). A plan that permits awards to be settled only in cash need not be disclosed under Item 201(d), because the purpose of Item 201(d) is to show dilution and cash-only plans are not dilutive. However, pursuant to Item 10 of Schedule 14A, if a company is seeking shareholder approval of any plan pursuant to which cash (or non-cash) compensation may be paid or distributed, the company is required to include in its proxy statement Item 201(d) disclosure with respect to its plans under which company equity securities are authorized for issuance. [Mar. 13, 2007]

**206.03** Instruction 1 to Item 201(d) provides that no disclosure is required with respect to any employee benefit plan that is intended to meet the qualification requirements of Internal Revenue Code Section 401(a). The same treatment would apply to a foreign employee benefit plan that is similar in substance to a Section 401(a) qualified plan in terms of being broad-based, compensatory and non-discriminatory. The same analysis applies for purposes of determining whether a plan must be filed as an exhibit pursuant to Item 601(b)(10)(iii)(B) of Regulation S-K, based on the exclusion provided by Item 601(b)(10)(iii)(C)(4) of Regulation S-K. [Mar.

13, 2007] [\[same as C&DI 246.11\]](#)

**206.04** A company has stock appreciation rights that are exercisable for an amount of its common stock with a value equal to the increase in the fair market value of the common stock from the date the stock appreciation rights were granted. For these instruments, the company may use the fair market value of its common stock at fiscal year end for the purposes of reporting the number of shares to be issued upon exercise of the stock appreciation rights pursuant to Item 201(d)(2)(i). The company should also describe this assumption in a footnote to the Equity Compensation Plan Information table. [Mar. 13, 2007]

**206.05** As a general rule, when a registrant changes the entities comprising a self-constructed index from the index used in the prior year, the reasons for the change must be explained and the total return must be compared with that of both the newly constructed index and the prior index. See Item 201(e)(4) and Release No. 34-32723 (Aug. 6, 1993) at IV.B.1. Two limited exceptions are set forth in Release No. 34-32723. Presentation on the old basis is not required: (i) if an entity is omitted solely because it is no longer in the line of business or industry; or (ii) the changes in the composition of the index are the result of application of pre-established objective criteria. In these two cases, a specific description of, and the bases for, the change must be disclosed, including the names of the companies deleted from the new index. [Mar. 13, 2007]

**206.06** If a company becomes listed on an exchange that is different from the exchange it was listed on in the prior year, the change needs to be reflected in the performance graph if the company also changes its broad market indices as a result. For example, if a company that had been listed on the American Stock Exchange becomes listed on a different exchange and now plans to use the S&P 500 as its broad market index rather than the American Stock Exchange Composite Index, the company must provide a narrative explanation of the change in indices and compare returns based upon the old and new index on the graph. [Mar. 13, 2007]

**206.07** In lieu of data for the last trading day prior to the end of a given fiscal year, a registrant may use data for the last day in that year made available by a third-party index provider. [Mar. 13, 2007]

**206.08** A registrant created by a spin-off may begin its Performance Graph presentation on the effective date of the registration of its common stock under Section 12 of the Exchange Act. [Mar. 13, 2007]

**206.09** A registrant that spins off a portion of its business should treat that transaction as a special dividend, make the appropriate adjustments to its shareholder return data, and disclose the occurrence of the transaction and resultant adjustments in its performance graph. [Mar. 13, 2007]

**206.10** A merger or other acquisition involving the registrant, where the registrant remains in existence and its common stock remains outstanding, does not change the presentation of the registrant's performance graph. [Mar. 13, 2007]

**206.11** A registrant with several distinct lines of business may construct a composite peer group index composed of entities from different industry

groups, representing each of the registrant's lines of business (with the lines of business weighted by revenues or assets). The basis and amount of the weighting should be disclosed. Alternatively, the registrant may plot a separate peer index line for each of its lines of business. [Mar. 13, 2007]

**206.12** If a company selects its own peer group and subsequently changes the group, an additional line showing the newly selected index should be added to the performance graph. [Mar. 13, 2007]

**206.13** Companies that have a short fiscal year (for example, following an initial public offering, as the result of a spin-off, or after emerging from bankruptcy) must do a stock performance graph for the short year unless the short year is 30 days or less. [Mar. 13, 2007]

**206.14** A company is preparing its first proxy statement following its emergence from bankruptcy. The new class of stock that was issued under the bankruptcy plan started trading in Mar. 2006. The measurement period for the graph is from Mar. 2006 through December 2006. However, the company may plot the graph on a monthly basis and can continue the graph beyond December 2006 as long as the December 2006 plotting point is clearly shown. The same principle applies to initial public offerings and spin-off situations with a short fiscal year. [Mar. 13, 2007]

**206.15** A "published industry or line-of-business index" is one that is "accessible to the registrant's security holders" and, if prepared by the registrant or an affiliate, is also "widely recognized and used." Certain guidance concerning the use of trade group indices and of composite indices composed of more than one published index is given in Release No. 34-32723 (Aug. 6, 1993) at Section IV.B.2. Self-constructed indices (which term includes those prepared by a third party for the registrant and which are not "published") are not prohibited or discouraged by Item 201(e), they just must be weighted by market capitalization (as are most published indices) and include identification of the component issuers. See Instruction 5 to Item 201(e). [Mar. 13, 2007]

#### **Section 207. Item 202 — Description of Registrant's Securities**

None

#### **Section 208. Item 301 — Selected Financial Data**

None

#### **Section 209. Item 302 — Supplementary Financial Information**

None

#### **Section 210. Item 303 — Management's Discussion and Analysis of Financial Condition and Results of Operations**

None

#### **Section 211. Item 304 — Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

**211.01** Item 304(a)(1)(iv) uses the phrase "the registrant's two most recent fiscal years and any subsequent interim period preceding such resignation, declination or dismissal," whereas Item 304(a)(1) uses the phrase, "the registrant's two most recent fiscal years or any subsequent interim period." The Division staff has been asked whether the period referenced in Item 304(a)(1)(iv) is coterminous with the period referenced in Item 304(a)(1), or instead refers to a period of such duration preceding the accountant's resignation or dismissal, as the language would literally suggest. The Division staff takes the position that Item 304(a)(1)(iv) refers to the time period preceding the resignation or dismissal. [July 3, 2008]

### **Section 212. Item 305 – Quantitative and Qualitative Disclosures About Market Risk**

None

### **Section 213. Item 306 [Reserved]**

None

### **Section 214. Item 307 – Disclosure Controls and Procedures**

**214.01** As discussed in Question and Answer 3 (FAQ 3) of "Management's Report on Internal Control over Financial Reporting and Certification of Disclosure Controls in Exchange Act Periodic Reports – Frequently Asked Questions (revised Sept. 24, 2007)," issued by the Office of the Chief Accountant and the Division of Corporation Finance, under limited and specified circumstances, the staff will not object to management excluding an acquired business from management's assessment of the registrant's internal control over financial reporting. FAQ 3 relates only to omitting an assessment of an acquired business's internal control over financial reporting from the assessment of the registrant's internal control over financial reporting. By its terms, it does not address management's evaluation of disclosure controls and procedures. In light of the overlap between a company's disclosure controls and procedures and its internal control over financial reporting, in those situations in which a registrant may properly rely on FAQ 3, management's evaluation of disclosure controls and procedures may exclude an assessment of those disclosure controls and procedures of the acquired entity that are subsumed by internal control over financial reporting. In addition, consistent with FAQ 3, we would expect the registrant to indicate the significance of the acquired business to the registrant's consolidated financial statements. [July 3, 2008]

**214.02** A royalty trust attempted to limit its conclusion regarding the effectiveness of its disclosure controls and procedures by stating that it relied on the working interest owners for disclosure in the document. Although a royalty trust can explain its reliance on working interest owners, it cannot thereby limit the scope of its conclusion. [July 3, 2008]

### **Section 215. Items 308 and 308T – Internal Control over Financial Reporting**

**215.01** Notwithstanding the introductory note to Item 308T, which states that it applies only to annual reports, any Form 10-Q that is required to

include Item 308T disclosure pursuant to Item 4T of Form 10-Q must include the disclosure required by Item 308T(b). Quarterly reports need not include Item 308T(a) disclosure. [July 3, 2008]

**215.02** The guidance provided in Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Frequently Asked Questions No. 3 does not relate to reverse acquisitions between an issuer and a private operating company, and the surviving issuer in a reverse acquisition is not a "newly public company" as that term is used in Exchange Act Release No. 54942 (Dec. 15, 2006). However, the staff acknowledges that it might not always be possible to conduct an assessment of the private operating company or accounting acquirer's internal control over financial reporting in the period between the consummation date of a reverse acquisition and the date of management's assessment of internal control over financial reporting required by Item 308(a) of Regulation S-K. We also recognize that in many of these transactions, such as those in which the legal acquirer is a non-operating public shell company, the internal controls of the legal acquirer may no longer exist as of the assessment date or the assets, liabilities, and operations may be insignificant when compared to the consolidated entity. In the instances described above, the staff would not object if the surviving issuer were to exclude management's assessment of internal control over financial reporting in the Form 10-K covering the fiscal year in which the transaction was consummated. However, when the transaction is consummated shortly after year-end and surviving issuer is required to file an amended Form 8-K to update its financial statements for its most recent year-end, that filing is equivalent to the first annual report subsequent to the consummation of the transaction and future annual reports should not exclude management's report on internal control over financial reporting. Similar conclusions may also be reached in transactions involving special-purpose acquisition companies.

In lieu of management's report, the issuer should disclose why management's assessment has not been included in the report, specifically addressing the effect of the transaction on management's ability to conduct an assessment and the scope of the assessment if one were to be conducted.

In addition, the staff notes that a reverse acquisition between two operating companies may often present facts that would preclude an issuer from concluding that management's assessment may be excluded from the issuer's Form 10-K. Consequently, issuers in this situation are encouraged to discuss with the staff whether it is appropriate to exclude management's report on internal control over financial reporting.

Notwithstanding management's exclusion of its report, the issuer must include the internal control over financial reporting language in the introductory portion of paragraph 4 of the Section 302 certification, as well as paragraph 4(b), because the issuer is subject to Section 404(a) of the Sarbanes-Oxley Act. [Apr. 24, 2009]

### **Section 216. Item 401 — Directors, Executive Officers, Promoters and Control Persons**

**216.01** Item 401(d) requires disclosure where a director's wife is the first

cousin of an executive officer of the same company since the director and executive officer are related by marriage "not more remote than first cousin." [July 3, 2008]

**216.02** A director of a public company is the general partner (and 50% owner) of limited partnership A which, in turn, is the general partner of limited partnership B, now in bankruptcy. Disclosure of the bankruptcy is required in the public company's filings under Item 401(f)(1), because the director's general partnership in, and percentage ownership of, A are evidence of control of A, the general partner of B. [July 3, 2008]

**216.03** The president of a company about to go public is convicted within the past year of misdemeanor criminal offenses, involving two small checks of \$30 and \$50, respectively. Counsel argues that disclosure is not required under Item 401(f) because of the exclusion of Item 401(f)(2) for "traffic violations and other minor offenses." The Division staff disagrees, taking the position that such disclosure is "material to an evaluation of the ability or integrity of any . . . executive officer of the registrant" (emphasis added). [July 3, 2008]

**216.04** Item 401(f) would require the disclosure by an issuer of an order temporarily restraining another corporation from pursuing a tender offer where a director of the issuer, who is the president of the other corporation, has been specifically named in the order. [July 3, 2008]

#### **Section 217. Item 402(a) — Executive Compensation; General**

**217.01** Whether a spin-off is treated like the IPO of a new "spun-off" registrant for purposes of Item 402 disclosure depends on the particular facts and circumstances. When determining whether disclosure of compensation before the spin-off is necessary, the "spun-off" registrant should consider whether it was a reporting company or a separate division before the spin-off, as well as its continuity of management. For example, if a parent company spun off a subsidiary which conducted one line of the parent company's business, and before and after the spin-off the executive officers of the subsidiary: (1) were the same; (2) provided the same type of services to the subsidiary; and (3) provided no services to the parent, historical compensation disclosure likely would be required. In contrast, if a parent company spun off a newly formed subsidiary consisting of portions of several different parts of the parent's business and having new management, it is more likely that the spin-off could be treated as the IPO of a new "spun-off" registrant. [Jan. 24, 2007]

**217.02** Following a merger among operating companies, there is no concept of "successor" compensation. Therefore, the surviving company in the merger need not report on compensation paid by predecessor corporations that disappeared in the merger. Similarly, a parent corporation would not pick up compensation paid to an employee of its subsidiary prior to the time the subsidiary became a subsidiary (i.e., when it was a target). Moreover, income paid by such predecessor companies need not be counted in computing whether an individual is a named executive officer of the surviving corporation. A different result may apply, however, in situations involving an amalgamation or combination of companies. A different result also applies where an operating company combines with a shell company, as defined in Securities Act Rule 405, as provided in

Interpretive Response 217.12, below. [Aug. 8, 2007]

**217.03** A subsidiary of a public company is going public. The officers of the subsidiary previously were officers of the parent, and in some cases all of the work that they did for the parent related to the subsidiary. The registration statement of the subsidiary would not be required to include compensation previously awarded by the parent corporation. The subsidiary would start reporting as of the IPO date. [Jan. 24, 2007]

**217.04** Instruction 1 to Item 402(a)(3) states that the generally required compensation disclosure regarding highly compensated executive officers need not be set forth for an executive officer (other than the principal executive officer or principal financial officer) whose total compensation for the last fiscal year, reduced by the amount required to be disclosed by Item 402(c)(2)(viii), did not exceed \$100,000. A reporting company that recently changed its fiscal year end from December 31st to June 30th is preparing its transition report for the 6-month period ended June 30th, having filed its Form 10-K for the fiscal year ended 6 months earlier on December 31st. The reporting company generally has a group of executive officers that earn in excess of \$100,000 each year. In addition, during the 6-month period, the company made an acquisition that resulted in new executive officers that, on an annual basis, will earn more than \$100,000. During the 6-month period, however, none of these existing or new officers earned more than \$100,000 in total compensation. The company asked whether disclosure under Item 402 regarding these officers therefore would not be required in the report being prepared for the 6-month period. The Division staff advised that no disclosure need be provided with respect to executive officers that started employment with the company during the 6-month period and did not, during that period of employment, earn more than \$100,000. With respect to executive officers that were employed by the company both during and before the 6-month period, however, Item 402 disclosure would have to be provided for those who earned in excess of \$100,000 during the one-year period ending June 30th (the same ending date as the six-month period, but extending back over 6 months of the preceding fiscal year). [Jan. 24, 2007]

**217.05** If a company changes its fiscal year, report compensation for the "stub period," and do not annualize or restate compensation. In addition, report compensation for the last three full fiscal years, in accordance with Item 402 of Regulation S-K. For example, in late 1997 a company changed its fiscal year end from June 30 to December 31. In the Summary Compensation Table, provide disclosure for each of the following four periods: July 1, 1997 to December 31, 1997; July 1, 1996 to June 30, 1997; July 1, 1995 to June 30, 1996; and July 1, 1994 to June 30, 1995. Continue providing such disclosure for four periods (three full fiscal years and the stub period) until there is disclosure for three full fiscal years after the stub period (December 31, 2000 in the example). If the company was not a reporting company and was to do an IPO in February 1998, it would furnish disclosure for both of the following periods in the Summary Compensation Table: July 1, 1997 to December 31, 1997; and July 1, 1996 to June 30, 1997. [Jan. 24, 2007]

**217.06** Compensation of both incoming and departing executives should not be annualized. [Jan. 24, 2007]

**217.07** A caller asked whether an executive officer, other than the

principal executive officer or principal financial officer, could be considered a "named executive officer" if the executive officer became a non-executive employee during the last completed fiscal year and did not depart from the registrant. If an executive officer becomes a non-executive employee of a registrant during the preceding fiscal year, consider the compensation the person received during the entire fiscal year for purposes of determining whether the person is a named executive officer for that fiscal year. If the person thus would qualify as a named executive officer, disclose all of the person's compensation for the full fiscal year, i.e. compensation for when the person was an executive officer and for when the person was a non-executive employee. [Jan. 24, 2007]

**217.08** A parent and its subsidiary are both Exchange Act reporting companies. Some of the executive officers of the parent may receive a portion of their compensation from the subsidiary corporation. The Division staff advised that if an executive spends 100% (or near 100%) of the executive's time for the subsidiary but is paid by the parent, then the compensation paid by the parent has to be reported in the executive compensation table of the subsidiary. However, if an allocation of the monies paid by the parent would be necessary because the executive officer splits time between the parent and the subsidiary, the payments allocable to services to the parent need not be included in the subsidiary's executive compensation table. In addition, in the event that the subsidiary pays a management fee to the parent for use of the executives, disclosure of the structure of the management agreement and fees would have to be reported under Item 404. Compensation paid by the subsidiary to executives of the parent company must be included in the parent's executive compensation table if such payments are paid directly by the subsidiary. If the payments are part of a management contract, disclosure of the structure of the management agreement and fees would have to be reported under Item 404. [July 3, 2008] *[same as C&DI 230.11]*

**217.09** Parent and its consolidated subsidiary are public companies. X was CEO of parent for all of 2007, and was CEO of subsidiary for part of 2007. Y was an executive officer of the parent for 2007, and was CFO of the subsidiary for 2007. Even though parent made all salary and bonus payments to X and to Y, pursuant to intercompany accounting: 60% of X's 2007 salary and bonus was allocated to the subsidiary; and 85% of Y's 2007 salary and bonus was allocated to the subsidiary. If 100% of Y's salary and bonus are included, Y would be one of parent's three most highly compensated executive officers for 2007, but if the 85% allocable to subsidiary is excluded, Y would not be a parent NEO.

On these facts, the staff takes the view that 100% of the salary and bonus of each of X and Y should be counted in determining the parent's three most highly compensated executive officers and disclosed in the parent's Summary Compensation Table. Parent's NEO determinations and compensation disclosures should not be affected by whether its subsidiary is public or private. The staff also takes the view that subsidiary's Summary Compensation Table should report the respective percentages (60% for X and 85% for Y) of salary and bonus allocated to the subsidiary's books. Each Summary Compensation Table should include footnote disclosure noting the extent to which the same compensation is reported in both tables. [July 3, 2008]

**217.10** A company's reimbursement to an officer of legal expenses with

respect to a lawsuit in which the officer was named as a defendant, in her capacity as an officer, is not disclosable pursuant to Item 402 of Regulation S-K. [Jan. 24, 2007]

**217.11** A caller inquired whether a filing that is made on January 2 must include compensation for the previous year ended December 31 when compensation information may not be incorporated by reference into the filing. The Division staff's position is that compensation must be included for such year because registrants should have those numbers available. However, if bonus or other amounts for the prior year have not yet been determined, this should be noted in a footnote together with disclosure regarding the date the bonus will be determined, any formula or criteria that will be used and any other pertinent information. When determined, the bonus or other amount must be disclosed in a filing under Item 5.02(f) of Form 8-K. Further, where the compensation disclosure depends upon assumptions used in the financial statements and those financial statements have not yet been audited, it is permissible for the company to note this fact in the compensation disclosure. [Jan. 24, 2007]

**217.12** Shareholders of a shell company, as defined in Securities Act Rule 405, will vote on combining the shell company with an operating company. The combination will have the effect of making the operating company subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act. The disclosure document soliciting shareholder approval of the combination (whether a proxy statement, Form S-4, or Form F-4) needs to disclose: (1) Item 402 disclosure for the shell company before the combination; (2) Item 402 disclosure regarding the operating company that the operating company would be required to make if filing a 1934 Act registration statement, including Compensation Discussion and Analysis disclosure; and (3) Item 402 disclosure regarding each person who will serve as a director or an executive officer of the surviving company required by Item 18(a)(7)(ii) or 19(a)(7)(ii) of Form S-4, including Compensation Discussion and Analysis disclosure that may emphasize new plans or policies (as provided in the [Release 33-8732A](#) text at n. 97). The Form 10-K of the combined entity for the fiscal year in which the combination occurs would provide Item 402 disclosure for the named executive officers and directors of the combined entity, complying with Item 402(a)(4) of Regulation S-K and Instruction 1 to Item 402(c) of Regulation S-K. [Aug. 8, 2007]

**217.13** Options or other rights to purchase securities of the parent or a subsidiary of the registrant should be reported in the same manner as compensatory options to purchase registrant securities. [Jan. 24, 2007]

**217.14** Item 402(c)(2)(ix)(G) requires Summary Compensation Table disclosure of the dollar value of any insurance premiums paid by, or on behalf of, the registrant during the covered fiscal year with respect to life insurance for the benefit of a named executive officer. Item 402(j) requires description and quantification of the estimated payments and benefits that would be provided in each covered termination circumstance, including the proceeds of such life insurance payable upon a named executive officer's death. However, if an executive officer dies during the last completed fiscal year, the proceeds of a life insurance policy funded by the registrant and paid to the deceased executive officer's estate need not be taken into consideration in determining the compensation to be reported in the Summary Compensation Table, or in determining whether the executive is

among the registrant's up to two additional individuals for whom disclosure would be required under Item 402(a)(3)(iv). [May 29, 2009]

**Section 218. Item 402(b) – Executive Compensation; Compensation Discussion and Analysis**

None

**Section 219. Item 402(c) – Executive Compensation; Summary Compensation Table**

**219.01** A registrant need not report earnings on compensation that is deferred on a basis that is not tax qualified as above-market or preferential earnings within the meaning of Item 402(c)(2)(viii)(B) where the return on such earnings is calculated in the same manner and at the same rate as earnings on externally managed investments to employees participating in a tax-qualified plan providing for broad-based employee participation. See n. 43 to Release No. 34-31327 (Oct. 16, 1992); American Society of Corporate Secretaries (Jan. 6, 1993). For example, many issuers provide for deferral of salary or bonus amounts not covered by tax-qualified plans where the return on such amounts is the same as the return paid on amounts invested in an externally managed investment fund, such as an equity mutual fund, available to all employees participating in a non-discriminatory, tax-qualified plan (e.g., 401(k) plan). Although this position generally will be available for so-called "excess benefit plans" (as defined for Rule 16b-3(b)(2) purposes), it may not be appropriately applied in the case of a pure "top-hat" plan or SERP (Supplemental Employee Retirement Plan) that bears no relationship to a tax-qualified plan of the issuer. When in doubt, consult the staff. For a deferred compensation plan with a cash-based, interest-only return, earnings would not be reportable as "above-market" unless the rate of interest exceeded 120% of the applicable federal long-term rate, as stated in Instruction 2 to Item 402(c)(2)(viii). Non-qualified deferred compensation plan earnings that are "above-market or preferential" are reportable even if the deferred compensation plan is unfunded and thus subject to risk of loss of principal. [Jan. 24, 2007]

**219.02** Item 402(c)(2)(ix)(G) requires disclosure in the "All Other Compensation" column of the dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award. If a company credits stock dividends on unvested restricted stock units, but does not actually pay them out until the restricted stock units vest, those dividends should be reported in the year credited, rather than the year vested (and actually paid). [Aug. 8, 2007]

**219.03** Item 402(c)(2)(viii) of Regulation S-K and Item 402(h)(2)(iii) and (iv) of Regulation S-K require amounts that are computed as of the same pension plan measurement date used for financial reporting purposes with respect to the company's audited financial statements for the last completed fiscal year. The rules reference the same pension plan measurement date as is used for financial statement reporting purposes so that the company would not have to use different assumptions when computing the present value for executive compensation disclosure and financial reporting purposes. The pension plan measurement date for most pension plans is September 30, which, in the case of calendar-year

companies, does not correspond with the company's fiscal year. This means that the pension benefit information will be presented for a period that differs from the fiscal year period covered by the disclosure. Under recent changes in pension accounting standards, the pension measurement date will be changed to be the same as the end of the company's fiscal year. In the year in which companies change their pension measurement date, they may use an annualized approach for the disclosure of the change in the value of the accumulated pension benefits in the Summary Compensation Table (thereby adjusting the 15 month period to a 12 month period) when the transition in pension plan measurement date occurs, so long as the company includes disclosure explaining it has followed this approach. The actuarial present value computed on the new measurement date should be reported in the Pension Benefits Table. [Jan. 24, 2007]

**219.04** If the actuarial present value of the accumulated pension benefit for a named executive officer on the pension measurement date of the prior fiscal year was \$1,000,000, and the present value of the accumulated pension benefit on the pension measurement date of the most recently completed fiscal year is \$1,000,000, but during the most recently completed fiscal year the named executive officer earned and received an in-service distribution of \$200,000, then \$200,000 should be reported as the increase in pension value in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column (column (h)) of the Summary Compensation Table. [Jan. 24, 2007]

#### **Section 220. Item 402(d) – Executive Compensation; Grants of Plan-Based Awards Table**

**220.01** Where a named executive officer exercises "reload" options and receives additional options upon such exercise, the registrant is required to report the additional options as an option grant in the Grants of Plan-Based Awards Table. In the Summary Compensation Table, the registrant would include the grant date fair value of the additional options in the aggregate amount reported. [Mar. 1, 2010]

**220.02** If plans do not include thresholds or maximums (or equivalent items), the registrant need not include arbitrary sample threshold and maximum amounts. For example, for a non-equity incentive plan that does not specify threshold or maximum payout amounts (for example, a plan in which each unit entitles the executive to \$1.00 of payment for each \$.01 increase in earnings per share during the performance period), threshold and maximum levels need not be shown as "0" and "N/A" because the payouts theoretically may range from nothing to infinity. Rather, an appropriate footnote should state that there are no thresholds or maximums (or equivalent items). [Jan. 24, 2007]

#### **Section 221. Item 402(e) – Executive Compensation; Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table**

None

#### **Section 222. Item 402(f) – Executive Compensation; Outstanding Equity Awards at Fiscal Year-End Table**

**222.01** A company grants stock options that provide for immediate exercise in full as of the grant date, subject to the company's right to repurchase (at the exercise price) if the executive terminates employment with the company before a specified date. If the executive officer exercises the option before the repurchase restriction lapses, he or she effectively receives restricted stock subject to forfeiture until the repurchase restriction lapses. In this circumstance, the Outstanding Equity Awards table should show the shares received as stock awards that have not vested (columns (g) and (h)) until the repurchase restriction lapses, and the exercise should not be reported in the Option Exercises and Stock Vested Table. Instead, as the shares acquired by the executive officer cease to be subject to the repurchase provision, those shares should be reported as stock awards (columns (d) and (e)) in the Option Exercises and Stock Vested Table. If the executive officer exercises the option after the repurchase restriction lapses, it is reported in the same manner as a regular stock option. [Aug. 8, 2007]

**Section 223. Item 402(g) – Executive Compensation; Option Exercises and Stock Vested Table**

None

**Section 224. Item 402(h) – Executive Compensation; Pension Benefits**

None

**Section 225. Item 402(i) – Executive Compensation; Nonqualified Defined Contribution and Other Nonqualified Deferred Compensation Plans**

None

**Section 226. Item 402(j) – Executive Compensation; Potential Payments Upon Termination or Change-in-Control**

**226.01** Item 402(j) requires quantitative disclosure of estimated payments and benefits, applying the assumptions that the triggering event took place on the last business day of the company's last completed fiscal year and the price per share of the company's securities is the closing market price as of that date. The date used for Item 402(j) quantification disclosure can affect the quantification of tax gross-ups with respect to the Internal Revenue Code Section 280G excise tax on excess parachute payments, such as by suggesting that benefits would be accelerated or by changing the five-year "base period" for computing the average annual taxable amount to which the parachute payment is compared. Where the last business day of the last completed fiscal year for a calendar year company is not December 31, the company may calculate the excise tax and related gross-up on the assumption that the change-in-control occurred on December 31, rather than the last business day of its last completed fiscal year, using the company stock price as of the last business day of its last completed fiscal year. The company may not substitute January 1 of the current year for the last business day of the company's last completed fiscal year, which would change the five-year "base period" to include the company's last completed fiscal year. [Aug. 8, 2007]

**226.02** Following the end of the last completed fiscal year (2006), but before the proxy statement is filed, a named executive officer leaves the company (in early 2007). A Form 8-K disclosing this termination is filed, as required by Item 5.02(b) of Form 8-K. This named executive officer is not the principal executive officer or the principal financial officer and will not be a named executive officer for the current fiscal year (2007) based on Item 402(a)(3)(iv). The severance package that applied to the named executive officer's termination is not newly negotiated but instead has the same terms that otherwise would apply. In these limited circumstances, it is permissible to provide Item 402(j) disclosure for the named executive officer only for the triggering event that actually occurred (even though beyond the scope of Instruction 4 to Item 402(j) because it took place after the end of the last completed fiscal year), rather than providing the disclosure for several additional scenarios that no longer can occur. [Aug. 8, 2007]

**226.03** A company will file a proxy statement for its regular annual meeting that also will solicit shareholder approval of a transaction in which the company would be acquired. The company has post-termination compensation arrangements that apply generally. Assuming that the acquisition is approved, however, all the named executive officers will be covered by termination agreements that that will be specific to the acquisition. The company cannot satisfy Item 402(j) by disclosing *only* the termination agreements that are specific to the pending acquisition for the following reasons: If the company's shareholders and/or any applicable regulatory authority do not approve the acquisition, the company's generally applicable post-termination arrangements will continue to apply. In addition, comparison of the acquisition-specific agreements with the generally applicable post-termination arrangements may be material. [Aug. 8, 2007]

### **Section 227. Item 402(k) — Executive Compensation; Compensation of Directors**

**227.01** Consulting arrangements between the registrant and a director are disclosable as director compensation under Item 402(k)(2)(vii), even where such arrangements cover services provided by the director to the issuer other than as director (e.g., as an economist). [Jan. 24, 2007]

**227.02** A company has an executive officer (who is not a named executive officer) who is also a director. This executive officer does not receive any additional compensation for services provided as a director, and the conditions in Instruction 5.a.ii to Item 404(a) of Regulation S-K are satisfied. The compensation that this director receives for services as an executive officer does not need to be reported in the Director Compensation Table under Item 402(k) of Regulation S-K. The director may be omitted from the table, provided that footnote or narrative disclosure explains that the director is an executive officer, other than a named executive officer, who does not receive any additional compensation for services provided as a director. [Aug. 8, 2007]

**227.03** A company has a director who also is an employee (but not an executive officer). Item 404(a) requires disclosure of the transaction pursuant to which the director is compensated for services provided as an employee. (Instruction 5 to Item 404(a) does not apply because the person is not an executive officer or does not have compensation reported for

services as a director in the Director Compensation Table required by Item 402(k).) However, disclosure of this employee compensation transaction in the Director Compensation Table typically would result in a clearer, more concise presentation of the information. In this situation, if the employee compensation transaction is reported in the Director Compensation Table, it need not be repeated with the other Item 404(a) disclosure. Footnote or narrative disclosure to the Director Compensation Table should explain the allocation to services provided as an employee. [Aug. 8, 2007]

**227.04** A current director previously was an employee of the company and receives a pension that was earned for services rendered as a company employee. If payment of the pension is not conditioned on his or her service as a director, the pension benefits do not need to be disclosed in the Director Compensation Table, whether or not the director receives compensation for services provided as a director. If service as a director generates new accruals to the pension, disclosure would be required in column (f) of the Director Compensation Table. [Aug. 8, 2007]

### **Section 228. Items 402(l) to (r) – Executive Compensation; Smaller Reporting Companies**

None

### **Section 229. Item 403 – Security Ownership of Certain Beneficial Owners and Management**

**229.01** A limited partnership holds restricted voting securities in a company that plans to make a public offering of its securities. The limited partnership agreement requires the limited partnership to distribute the restricted securities to its general and limited partners within 60 days following such public offering. In light of the beneficial ownership provisions of Section 13(d), the beneficial ownership of shares to be held by the general and limited partners whose holdings will be in excess of 5 percent (or if such persons are directors or named executive officers) following such distribution should be included in the beneficial ownership table contained in the company's prospectus. [Mar. 13, 2007]

**229.02** When asked whether an issuer would be required to consider Form 13-F reports of "investment discretion" in determining the identity of 5 percent beneficial owners under Item 403(a), the Division staff advised that the concept of "investment discretion" was not the same as "beneficial ownership," noting that investment managers subject to Form 13-F reporting would also have to file Schedule 13D or Schedule 13G if their interest in the securities constituted beneficial ownership. The Division staff emphasized the statement in Item 403 that the issuer could rely on Schedules 13D and 13G, but that such reliance could not be exclusive if it had knowledge (or has reason to believe that such information is not complete or accurate or that a statement or amendment that should have been filed was not) of any 5 percent beneficial owners who had not filed such reports. [Mar. 13, 2007]

**229.03** The tax consequences under Section 409A of the Internal Revenue Code that apply if a "key employee" receives a stock distribution within six months after leaving the company do not affect the analysis as to whether the person has a right to acquire the stock within 60 days under Rule 13d-3

(d)(1). This is because Section 409A results in a negative economic consequence rather than a prohibition upon receipt of the shares. [Mar. 13, 2007]

### **Section 230. Item 404 — Transactions with Related Persons, Promoters and Certain Control Persons**

**230.01** The term "any immediate family member," as used in Item 404, is defined to include, among others, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and stepchildren and stepparents. For purposes of this item, such relatives are deemed to be: (1) only those persons who are currently related to the primary reporting person (e.g., a person who is divorced from a director's daughter would no longer be a son-in-law whose transactions must be reported); and (2) only those persons who are related by blood or step relationship to the primary reporting person or his spouse (e.g., the sister of a director's spouse is considered a sister-in-law for purposes of this item; the sister's husband, however, is not considered a brother-in-law for purposes of this item). [Mar. 13, 2007]

**230.02** A is an officer and director of Y corporation, a wholly-owned subsidiary of registrant X. A is not an officer or director of X and holds only a nominal amount of X's shares. Y does business in an amount in excess of \$120,000 with B, A's brother. That relationship need not be disclosed in X's reports under Item 404(a), since A is not a person described in Instruction 1 to Item 404(a). [Mar. 13, 2007]

**230.03** A corporation enters into a lease in an amount substantially in excess of \$120,000 with a lessor completely unaffiliated with the corporation. The lease, however, is negotiated through a related person specified in Instruction 1 to Item 404(a), who is paid a commission that is less than \$120,000 by the lessor for those services. Since the amount of that person's commission is dependent upon the value of the lease, that person is considered to have an interest in the lease transaction, and the transaction, together with the commission, should be reported if the interest is determined to be a direct or indirect material interest. [Mar. 13, 2007]

**230.04** Y, the President and a director of Z Corporation, a supplier of the registrant, is a member of the registrant's board of directors. The registrant solicited bids from Z and various other companies on a supply contract involving an amount in excess of the \$120,000 threshold of Item 404(a). The registrant plans to award the contract to Z, even though this supplier did not submit the lowest bid in what purportedly was a competitive bidding contest. Under these circumstances, the registrant cannot avail itself of the exclusion in Instruction 7.a. to Item 404(a) for transactions where the rates or charges involved are determined by competitive bids. [Mar. 13, 2007]

**230.05** Instruction 7.a. to Item 404(a) of Regulation S-K does not permit non-disclosure of an equipment lease transaction between a company owned by a director of a reporting company and the reporting company, simply because the reporting company solicited proposals from other unrelated persons and selected the director's company only after an internal analysis of the available terms. The procedure used was not deemed to be a competitive bid because it did not involve the formal

procedures normally associated with competitive bidding situations. There were no specifications established for the lease being bid upon and there was no indication of the basis upon which a bid was accepted. [Mar. 13, 2007]

**230.06** A contract between a reporting company and the fund manager of the company's pension plan, who is also a more than 5 percent beneficial owner under Rule 13d-3, should be disclosed under Item 404(a) where the amount involved in the contract exceeds \$120,000. [Mar. 13, 2007]

**230.07** X is a director of the registrant. X's child is employed by the registrant and receives yearly compensation exceeding \$120,000. The child's compensation is not reported under Item 402 since the child is not one of the registrant's named executive officers, nor is the child an officer or director. The child's compensation is required to be disclosed under Item 404(a) because the child is a related person and has a material interest in his or her yearly compensation. [Aug. 14, 2009]

**230.08** An agreement by a company with a related person to repurchase company shares from the related person's estate upon death with the proceeds of a life insurance policy paid for by the company should be disclosed pursuant to Item 404(a). [Mar. 13, 2007]

**230.09** In connection with a move of company headquarters, a company purchased and resold the homes owned by all affected employees. The price paid was determined by an independent appraiser. The company was advised that the Division staff will raise no objection if the company discloses under Item 404(a) only the general features of the program (including how the price was determined) and the total amount spent by the company on the program. [Mar. 13, 2007]

**230.10** Item 404(a) requires disclosure of nonaccrual, past due, restructured and potential problem loans from banks, savings and loan associations or broker-dealers extending credit under Federal Reserve Regulation T. Instruction 4.c. of Item 404(a) refers to Industry Guide 3, Statistical Disclosure by Bank Holding Companies, for determining if loans are nonaccrual, past due, restructured or potential problem loans. Guide 3 requires disclosure of loans in these categories the end of each "reported period." In a proxy statement, therefore, where the reported period is the last fiscal year, only those loans which were in these categories at the end of the last fiscal year are required to be reported. [Mar. 13, 2007]

**230.11** A parent and its subsidiary are both Exchange Act reporting companies. Some of the executive officers of the parent may receive a portion of their compensation from the subsidiary corporation. The Division staff advised that if an executive spends 100% (or near 100%) of the executive's time for the subsidiary but is paid by the parent, then the compensation paid by the parent has to be reported in the executive compensation table of the subsidiary. However, if an allocation of the monies paid by the parent would be necessary because the executive officer splits time between the parent and the subsidiary, the payments allocable to services to the parent need not be included in the subsidiary's executive compensation table. In addition, in the event that the subsidiary pays a management fee to the parent for use of the executives, disclosure of the structure of the management agreement and fees would have to be

reported under Item 404. Compensation paid by the subsidiary to executives of the parent company must be included in the parent's executive compensation table if such payments are paid directly by the subsidiary. If the payments are part of a management contract, disclosure of the structure of the management agreement and fees would have to be reported under Item 404. [July 3, 2008] [\*\[same as C&DI 217.08\]\*](#)

**230.12** When the transaction under consideration is an employment arrangement, "the amount involved in the transaction" includes all compensation, not just the salary of the employee. [Aug. 8, 2007]

**230.13** The compensation of an executive officer who is not a named executive officer is approved by the Board's compensation committee, and the executive officer's compensation is not disclosed under Item 404(a) pursuant to Instruction 5.a to Item 404(a). An immediate family member of this executive officer also is employed by the company. The immediate family member's compensation is disclosed under Item 404(a). In this regard, Instruction 5.a to Item 404(a) does not apply to the immediate family member because she was not an executive officer. [Aug. 8, 2007]

### **Section 231. Item 405 — Compliance with Section 16(a) of the Exchange Act**

**231.01** Item 405 requires the company to disclose delinquent filings required by Section 16(a) of the Exchange Act during the most recent fiscal year or prior years. An insider's Form 5 with respect to 2007, due in February 2008, was filed late. If this late Form 5 is disclosed in the company's Form 10-K for the year ended December 31, 2007 and the proxy statement for the 2008 annual meeting, this Item 405 disclosure need not be repeated in the company's Form 10-K for the year ended December 31, 2008 and the proxy statement for the 2009 annual meeting. [July 3, 2008]

### **Section 232. Item 406 — Code of Ethics**

None

### **Section 233. Item 407 — Corporate Governance**

**233.01** The "total number of meetings of the board of directors" specified as the basis for calculation of director's attendance in Item 407(b)(1) does not include board action by written consent. [Mar. 13, 2007]

**233.02** If the only disclosure that a registrant is required to provide pursuant to Item 407(e)(4) is the identity of the members of the compensation committee, because the registrant has no transactions or relationships that trigger a disclosure obligation, the registrant may omit the Item 407(e)(4) caption ("Compensation Committee Interlocks and Insider Participation"). [Mar. 13, 2007]

**233.03** The Compensation Committee Report must be separately captioned to identify it clearly as specified in Item 407(e)(5). Where there are multiple committees on the board with responsibility for different components of compensation (e.g., a stock option committee) and those committees review and discuss the Compensation Discussion and Analysis with management and, based on that review and discussion, recommend

the inclusion of the Compensation Discussion and Analysis in the registrant's filings, each of these committees has a disclosure obligation under Item 407(e)(5). [Mar. 13, 2007]

#### **Section 234. Item 501 — Forepart of Registration Statement and Outside Front Cover Page of Prospectus**

**234.01** Counsel for a company named Geo-Search was informed that if the company registered under the Exchange Act, the Division staff would not suggest a name change solely because there is an existing registrant named Geosearch. [July 3, 2008]

**234.02** The cover page of a prospectus relating to a secondary equity offering, registered for the shelf pursuant to Rule 415, need not contain the tabular or other presentation required by Item 501(b)(3) where the offering will not be underwritten, the securities will be offered at the market, and brokerage commissions will be negotiated at the time of the offering. The reason is that no meaningful figures as to "price to the public" and "underwriter's discounts" would be available. [July 3, 2008]

#### **Section 235. Item 502 — Inside Front and Outside Back Cover Pages of Prospectus**

None

#### **Section 236. Item 503 — Prospectus Summary, Risk Factors and Ratio of Earnings to Fixed Charges**

None

#### **Section 237. Item 504 — Use of Proceeds**

None

#### **Section 238. Item 505 — Determination of Offering Price**

None

#### **Section 239. Item 506 — Dilution**

None

#### **Section 240. Item 507 — Selling Security Holders**

**240.01** Item 507 of Regulation S-K requires certain disclosure concerning each selling shareholder for whose account the securities being registered are to be offered. The Division staff has permitted this disclosure to be made on a group basis, as opposed to an individual basis, where the aggregate holding of the group is less than 1% of the class prior to the offering. Where the aggregate holding of the group is less than 1% of the class but for a few major shareholders, the disclosure for the members of the group other than the major shareholders also may be made on a group basis. [July 3, 2008]

**240.02** Revised and moved to Question 140.03 [Aug. 14, 2009]

**240.03** An investment advisor manages security holder accounts in the advisor's exclusive discretion. Although the account agreements give the advisor complete discretionary authority to vote and sell securities held in the managed accounts, the account holders may revoke this authority within 60 days. Both the investment advisor and the individual account holders must be identified under Item 507 of Regulation S-K because both are viewed as security holders given their shared power to vote and sell the securities held in the managed accounts. [July 3, 2008]

**240.04** An issuer with a resale registration statement naming several investment funds as selling security holders must name the natural persons who have or share voting or investment power for each fund as part of its Item 507 of Regulation S-K disclosure, even if voting or investment power for any fund is controlled by an investment committee consisting of a large number of individuals who each have a vote to approve the exercise of such power and therefore no single person exclusively possesses the power to vote, acquire or dispose of securities held by the fund. [July 3, 2008]

#### **Section 241. Item 508 – Plan of Distribution**

**241.01** Stabilizing transactions begun on the day a registration statement became effective, but prior to the time of effectiveness (e.g., stabilizing began at 10:00 A.M. and the registration statement was declared effective at 2:00 P.M.), are not deemed to be "before the effective date of the registration statement" for purposes of Item 508(l)(2). Accordingly, the disclosure set forth in Item 508(l)(2) need not be made for such transactions. [July 3, 2008]

#### **Section 242. Item 509 – Interests of Named Experts and Counsel**

**242.01** A legal fee incurred in the preparation of a registration statement, even if in excess of \$50,000, is not the kind of "substantial interest" in the registrant requiring disclosure under Item 509. Such fees, of course, are normally disclosed in Part II of the registration statement. [July 3, 2008]

**242.02** Where a registrant's attorney has a 10% limited partnership interest in a limited partnership in which the registrant has a 50% limited partnership interest, the registrant's relationship to the partnership is sufficiently analogous to a parent-subsidiary relationship to warrant furnishing the disclosure required by Item 509 of Regulation S-K. [July 3, 2008]

**242.03** A law firm is charging a flat fee to a registrant for services performed in connection with preparation of the registrant's Securities Act registration statement. However, as the company will declare bankruptcy if the offering is unsuccessful, the law firm is not certain it will be paid unless the offering is successful. The Division staff has taken the position that this is not a form of "contingent interest" the disclosure of which was contemplated by Item 509. [July 3, 2008]

#### **Section 243. Item 510 – Disclosure of Commission Position on Indemnification for Securities Act Liabilities**

None

#### **Section 244. Item 511 — Other Expenses of Issuance and Distribution**

None

#### **Section 245. Item 512 — Undertakings**

**245.01** A Rule 415 offering provides that purchasers within the first 60 days will receive a security with a higher yield than that to be received by subsequent purchasers. The registrant wished to extend the preferential purchase period for an additional 30 days. The Division staff has taken the position that such an extension is a material change in the plan of distribution, which according to the Item 512(a)(iii) undertaking would require a post-effective amendment (or, for registration statements on Form S-3 or F-3, compliance with one of the methods in Item 512(a)(1)(B)). [July 3, 2008]

**245.02** In an offering of limited partnership interests registered under the Securities Act, the undertaking required by Item 512(f) that the issuer provide certificates to the underwriter need not be included in the registration statement where no certificates will be used. [July 3, 2008]

#### **Section 246. Item 601 — Exhibits**

**246.01** Item 601(b)(3) requires that the entire amended text of the articles or by-laws be filed, along with the text of the new amendments. This could be accomplished by filing the entire amended text, redlined to show the new amendments. [July 3, 2008]

**246.02** The exhibits to be filed with a Form 10-Q need only include instruments defining the rights of security holders with respect to long-term debt that was issued during the quarter covered by the form. Thus, documents defining the rights of commercial paper holders are not required to be filed as exhibits since commercial paper is not long-term indebtedness. [July 3, 2008]

**246.03** Item 601 of Regulation S-K provides that a Form 10-Q must include, among other things, the exhibits required by Item 601(b)(4) (viz., instruments defining the rights of security holders, including indentures). However, an indenture need be filed with a Form 10-Q only in those situations where the Form 10-Q discloses a new debt issue in the quarter for which the report is filed. See Item 601(b)(4)(v). If the indenture has already been filed as part of a Securities Act registration statement, it can be incorporated by reference into the Form 10-Q pursuant to Exchange Act Rules 12b-23 and 12b-32. [July 3, 2008]

**246.04** A registrant adopts a resolution providing confidential proxy voting rights for shareholders and asks whether the resolution should be filed as an "instrument defining the rights of security holders" pursuant to Regulation S-K Item 601(b)(4). The Division staff has advised that it should be so filed. [July 3, 2008]

**246.05** Subparagraph (ii) of Item 601(b)(4) requires filing as an exhibit

instruments defining the rights of holders of long-term debt. Subparagraph (iii)(A) excludes from this requirement such instruments where the amount of indebtedness authorized thereunder does not exceed 10% of the total assets of the company and there is filed an agreement to furnish a copy of the instrument to the Commission upon request. The confidential treatment procedures set forth in Rule 83(c) would apply to such documents furnished upon request. [July 3, 2008]

**246.06** A company issues a series of notes, amounting to 5% of its total assets, in a private placement and pursuant to an indenture. Since the amount involved is less than 10 percent of its total assets, the indenture is not required to be filed pursuant to Item 601(b)(4) as an exhibit to the Form 10-K and, although not made in the ordinary course of business, the indenture would not be required to be filed as a material contract pursuant to Item 601(b)(10). [July 3, 2008]

**246.07** In connection with a rights offering, a foreign company registering: (1) warrants evidencing the rights to purchase American depository shares representing ordinary shares; (2) provisional allotment letters ("PALs") evidencing rights to purchase ordinary shares; and (3) ordinary shares underlying the warrants and PALs, must provide an opinion of counsel as to the legal issuance of the warrants and PALs and the fact that they are valid and binding obligations of the company, in addition to the opinion regarding the valid issuance and fully-paid and non-assessable nature of the ordinary shares. [July 3, 2008]

**246.08** Two companies propose a joint Form S-4 registration statement for a stock-for-assets acquisition. Although the company to be acquired is not the registrant, it should file as exhibits any contracts or other documents that would be material to the new entity. [July 3, 2008]

**246.09** Item 601(b)(10) requires the filing of material contracts. Pursuant to Item 601(b)(10)(ii)(C), a contract for the acquisition of real estate must be filed if consideration in excess of 15% of the fixed assets of the company is paid for the real estate. When computing the consideration paid for the real estate, an issuer should include the cash purchase price plus the amount of any indebtedness assumed as a result of the purchase. [July 3, 2008]

**246.10** For purposes of Form 10-K, Item 601(b)(10)(iii) of Regulation S-K requiring disclosure of remunerative contracts would apply to a deferred compensation plan entered into during the fiscal year, even though the officer/director retired during that fiscal year and no longer was an officer/director. [July 3, 2008]

**246.11** Instruction 1 to Item 201(d) provides that no disclosure is required with respect to any employee benefit plan that is intended to meet the qualification requirements of Internal Revenue Code Section 401(a). The same treatment would apply to a foreign employee benefit plan that is similar in substance to a Section 401(a) qualified plan in terms of being broad-based, compensatory and non-discriminatory. The same analysis applies for purposes of determining whether a plan must be filed as an exhibit pursuant to Item 601(b)(10)(iii)(B) of Regulation S-K, based on the exclusion provided by Item 601(b)(10)(iii)(C)(4) of Regulation S-K. [Mar. 13, 2007] [same as C&DI 206.03](#)

**246.12** A remuneration plan applicable to 300 key executives in a company with 18,000 employees would not be considered a plan available to employees generally. Therefore, it would not fall within the exemption provided by Item 601(b)(10)(iii)(C)(4) and would have to be filed as an exhibit. In this regard, if a compensatory plan, contract or arrangement is available generally to all officers and directors but is not available to all employees of the company, the plan, contract or arrangement does not fall within this exemption. [July 3, 2008]

**246.13** A company files its first Form 10-K containing management's report on internal control over financial reporting. The company inadvertently omits the internal control over financial reporting language from the introductory portion of paragraph 4 of the Section 302 certification, as well as paragraph 4(b). Because companies were permitted to omit these portions of the certification during the transition period to Section 404(a) compliance, if this error occurs in the company's first Form 10-K containing management's report, the staff will permit the company to file a Form 10-K/A that contains only the cover page, explanatory note, signature page and paragraphs 1, 2, 4 and 5 of the Section 302 certification. However, if the same company were to make this mistake in the following year, it would be required to file a Form 10-K/A containing full Item 9A disclosure as well as the company's financial statements. [July 3, 2008]

**246.14** The following errors in a certification required by Item 601(b)(31) are examples of errors that will require the company to file a corrected certification that is accompanied by the entire periodic report: (1) the company identifies the wrong periodic report in paragraph 1 of the certification; (2) the certification omits a conformed signature above the signature line at the end of the certification; (3) the certification fails to include a date; and (4) the individuals who sign the certification are neither the company's principal executive officer nor the principal financial officer, or persons performing equivalent functions. [July 3, 2008]

**246.15** Consistent with the requirements of Item 601(b)(10)(iii), a company files its nonqualified deferred compensation plan as an exhibit. The company subsequently establishes a rabbi trust under the nonqualified deferred compensation plan. Establishment of the rabbi trust would trigger filing under Item 601(b)(10)(iii) only if it materially modifies participants' rights under the previously filed nonqualified deferred compensation plan. [May 29, 2009]

### **Section 247. Item 701 — Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities**

**247.01** If the only warrants in an offering were issued to underwriters as compensation, and if the proceeds from the exercise of the warrants will be de minimis with respect to the overall proceeds, the Division staff may deem the obligation to report use of proceeds from an initial offering to be completed. Ordinarily, however, when purchase warrants remain outstanding, an offering is ongoing for purposes of reporting use of proceeds. [July 3, 2008]

**247.02** Use of proceeds disclosure is required in the issuer's first periodic report filed following the effective date of its first registration statement

filed under the Securities Act, even if the registration statement covered a best-efforts offering that has not closed on the due date of that periodic report. [July 3, 2008]

**247.03** If a registrant's first filing under the Securities Act is a secondary offering, no disclosure need be provided in response to Item 701(f) since there is no use of proceeds. However, such a secondary offering would not constitute "the first registration statement filed under the Act by an issuer" for purposes of Rule 463. Accordingly, the first primary Securities Act offering by that registrant would necessitate disclosure under Item 701(f). [July 3, 2008]

**247.04** On the same registration statement, in its initial public offering, a company registered X shares for sale to the public and Y shares for issuance pursuant to employee benefit plans. The Division staff agreed with the company's analysis that it need report the use of proceeds as required by Rule 463 and Item 701(f) of Regulation S-K only for the shares sold to the public, and could omit the information relating to the employee benefit plan shares in reliance on Rule 463(d)(3). The Division staff's response is premised on the representation that the employee benefit plan shares were originally registered for that purpose; had it been a matter of converting shares originally registered for sale to the public that remained unsold to the employee benefit purpose, this position would not apply. [July 3, 2008]

#### **Section 248. Item 702 — Indemnification of Directors and Officers**

None

#### **Section 249. Item 703 — Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

**249.01** If a company receives its shares back from a vendor in settlement of litigation, these shares must be disclosed under Item 703 of Regulation S-K. [July 3, 2008]

**249.02** An investor purchased stock from an issuer in a private placement. The investor paid the consideration with a promissory note, which was secured by the stock. When it became apparent that the investor could not repay the note, the parties agreed that the investor would forfeit the stock in exchange for cancellation of the note. The forfeiture of the pledged stock to the issuer is an issuer repurchase that requires Item 703 of Regulation S-K disclosure. [July 3, 2008]

#### **Section 250. Items 801 and 802 — Industry Guides**

None

#### **Section 251. Items 901 through 915 — Roll-up Transactions**

None

*<http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>*

**APPENDIX B-IV**

***Staff Observations in the Review of Executive Compensation  
Disclosure (Oct. 9, 2007)***



## U.S. Securities and Exchange Commission

### **Staff Observations in the Review of Executive Compensation Disclosure**

#### **Division of Corporation Finance**

#### **Executive Summary**

The Division of Corporation Finance has completed its initial review of the executive compensation and related disclosure of 350 public companies under the Securities and Exchange Commission's new and revised rules relating to executive compensation disclosure. Two principal themes emerge from our reviews and our individualized comments to these companies.

First, the Compensation Discussion and Analysis needs to be focused on *how* and *why* a company arrives at specific executive compensation decisions and policies. This does not mean that disclosure needs to be longer or more technical; indeed shorter, crisper, and clearer would often be better. The focus should be on helping the reader understand the basis and the context for granting different types and amounts of executive compensation.

Second, the manner of presentation matters — in particular, using plain English and organizing tabular and graphical information in a way that helps the reader understand a company's disclosure. The executive compensation rules require companies to disclose a great deal of information. Techniques such as providing an executive summary, or creating tables or charts tailored to a company's particular executive compensation program, can make the disclosure more useful and meaningful. We encourage companies to continue thinking about how executive compensation information — from the big picture to the details — can be better organized and presented for both the lay reader and the professional.

#### **Introduction**

The Securities and Exchange Commission's new and revised rules relating to executive compensation disclosure became effective on November 7, 2006. These rules have significantly changed the disclosure a public company provides about how it compensates its most highly paid executive officers, including its principal executive officer and its principal financial officer, and its directors. On December 22, 2006, the Commission further amended the disclosure requirements for executive and director compensation with respect to how a public company discloses stock and option award compensation. The revised rules also update and clarify the related person transaction disclosure requirements and consolidate and add corporate governance disclosure requirements.

In the Division of Corporation Finance's regular review of public company current and periodic reports, we routinely provide comments to companies in which we seek clarification of current disclosure or additional information

so we may better understand why a company made a particular disclosure. In some instances, we may ask a company to revise or enhance its disclosure by amending the document in which it has provided it. In other instances, we may ask a company to revise or enhance its disclosure in future filings.

In 2007, we undertook a project to review the executive compensation and other related disclosure of 350 public companies to evaluate compliance with the revised rules and provide guidance on how those companies could improve their disclosure. In identifying 350 companies for review, we sought to cover a broad range of industries. No one should interpret our selection of any company for review as part of this project as any indication of our views regarding the quality of that company's disclosure.

We have provided comments to companies based on a company's individual facts and circumstances and the nature and extent of its disclosure. Our goal in providing comments to companies is to assist them in enhancing the overall disclosure in their filings. These reviews are ongoing. Not less than 45 days after we complete our review of a company's filing, we will post the correspondence containing our comments and company responses to our comments on the SEC's EDGAR system.

In this report, we discuss the principal comments we provided to companies. Because our reviews are ongoing, our discussion is limited to our initial comments and does not reflect how companies may propose to revise their disclosure in response to them. We encourage companies to review their disclosure and prepare future disclosure consistent with the principles and themes of our comments. In our comments, we seek, where applicable, more direct, specific, clear and understandable disclosure. We believe this will foster enhanced and more informative executive compensation disclosure.

### **Manner of Presentation**

Item 402 of Regulation S-K requires a company to provide "clear, concise, and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers . . . and directors . . . by any person for all services, rendered in all capacities . . . ."

In a number of instances, we suggested ways we thought companies could improve the manner in which they presented their executive compensation disclosure. For example, in a significant percentage of the filings we reviewed, we suggested that companies should consider making some items of their disclosure more prominent. Throughout our long history of reviewing company disclosure, we have often found that where a company emphasizes material information and de-emphasizes less important information, investor understanding of the company's disclosure is improved. As another example of our comments in this area, we suggested that companies could improve their presentation by emphasizing in their Compensation Discussion and Analysis how and why they established compensation levels, and de-emphasizing and shortening lengthy discussions of compensation program mechanics.

### **Format**

For the most part, we found the format of executive compensation and other related disclosure to be relatively consistent across the 350 company filings. We commented on the format or manner of presentation where we

found it adversely affected the overall readability of the company's disclosure. In adopting the revised rules, the Commission stated that the Compensation Discussion and Analysis is meant to be a narrative overview at the beginning of the compensation disclosure, putting into perspective the numbers in the tables that follow it. Where a company placed its required compensation tables before the Compensation Discussion and Analysis, we asked it to relocate those tables so that they would follow the Compensation Discussion and Analysis.

Approximately two-thirds of the companies we reviewed included charts, tables and graphs not specifically required by the revised rules. In almost every instance, we found these additional presentations to be helpful. For example, we found that a number of companies voluntarily included a table in which they presented information regarding potential payments upon termination or change-in-control. To enhance investor understanding of these tables, we suggested to some companies that they disclose the total amounts they would be required to pay their named executive officers upon termination or a change-in-control.

We encourage methods of presentation that are tailored to a particular company's circumstances, which we believe can be useful to investor understanding. Of the 350 companies we reviewed, a few companies included alternative summary compensation tables. Where a company presented an alternative summary compensation table that we found to be confusing or one which included compensation amounts calculated in a manner inconsistent with the revised rules, we asked the company to de-emphasize the alternative table and ensure that it was not presented more prominently than the required table. To the extent that a company's discussion or presentation of an alternative summary compensation table did not overshadow or detract from the required tables, we generally did not comment. Where the title of an alternative summary compensation table could lead a reader to assume that the alternative table was part of the required compensation tables, we asked the company to change the title. Where necessary, we asked companies to state that an alternative summary compensation table is not a substitute for the information the revised rules require. Finally, we asked those companies that presented alternative summary compensation tables to explain differences between compensation amounts presented in those tables and compensation amounts presented in the required tables.

### **Clarity**

When the Commission adopted the revised rules it affirmed its support of plain English principles by stating that "[c]learer, more concise presentation of executive and director compensation, related person transactions, beneficial ownership and corporate governance matters can facilitate more informed investing and voting decisions in the face of complex information about these important areas." Companies are required to follow the drafting principles presented in Exchange Act Rules 13a-20 and 15d-20 when presenting their executive and director compensation, related person transactions, beneficial ownership and corporate governance disclosures in reports they are required to file under Exchange Act Section 13(a) or 15(d). These rules contain the plain English requirements.

It is important to recognize that disclosure can be clear and understandable yet not meaningful or responsive to disclosure requirements. Conversely, disclosure can be responsive in content, but not clear and understandable. As we discuss below, we found that, in several instances, companies made

a good faith effort to provide clear and understandable disclosure, but fell short of full compliance with the underlying disclosure requirements. For example, we found that a significant number of companies could improve their analyses of how and why they made certain executive compensation decisions. Where we ask a company to add analysis, or enhance its analysis, we do not necessarily think that it should lengthen its disclosure. Rather, careful drafting consistent with plain English principles could result in a shorter, more concise and effective discussion that complies with our rules.

In adopting the revised rules, the Commission stated that “[t]he purpose of the Compensation Discussion and Analysis disclosure is to provide material information about the compensation objectives and policies for named executive officers without resorting to boilerplate disclosure.” Where we found that a company presented boilerplate disclosure, we asked it to provide a clear and concise discussion of its own facts and circumstances. For example, we asked a significant number of companies to replace boilerplate discussions of individual performance with more specific analysis of how the compensation committee considered and used individual performance to determine executive compensation. Where a company repeated information from the required compensation tables, we asked it to replace that disclosure with a clear and concise analysis of the information in the required compensation tables or to relocate the discussion to the narrative following the appropriate tables or the footnotes to those tables. Where a company’s disclosure appeared identical to language in a compensation plan or employment agreement, we asked it to present the information in a clear and understandable manner.

Although we recognize that several of the required tables require companies to present a number of columns, we asked some companies to be mindful of font size in their tables and related footnote presentations and to increase, where practicable, font size to enhance readability.

### **Compensation Discussion and Analysis**

When the Commission adopted the revised rules, it stated that they “are intended to provide investors with a clearer and more complete picture of compensation to principal executive officers, principal financial officers, the other highest paid executive officers and directors.” To bring this picture into focus, the Commission adopted a new principles-based requirement for a company to provide material information about compensation objectives and policies for its named executive officers, the Compensation Discussion and Analysis.

In adopting the Compensation Discussion and Analysis, the Commission presented a disclosure concept and provided both principles and examples to help companies identify disclosure applicable to their own facts and circumstances. The Commission expressly stated that the Compensation Discussion and Analysis “strikes an appropriate balance that will effectively elicit meaningful disclosure, even as new compensation vehicles develop over time.” The principles-based disclosure concept allows each company to assess its own facts and circumstances and determine what elements of the company’s compensation policies and decisions are material and warrant disclosure.

The Commission explained that the primary focus of the Compensation Discussion and Analysis should be “[m]uch like the overview that we have encouraged companies to provide with their Management’s Discussion and

Analysis of Financial Condition and Results of Operations. . . .” The Commission stated that “the new Compensation Discussion and Analysis calls for a discussion and analysis of the material factors underlying compensation policies and decisions reflected in the data presented in the tables.” Further, the Commission advised companies that “the Compensation Discussion and Analysis requirement is principles-based, in that it identifies the disclosure concept and provides several illustrative examples.” The Commission also made clear that, in addition to discussing its compensation policies and decisions, a company responding to the principles-based disclosure requirement must analyze the material factors underlying those policies and decisions.

In many of our comment letters, we asked companies to enhance their analyses of compensation policies and discussions, including how they determined the amounts of specific compensation elements. In providing these comments to companies, our goal is to help companies enhance their discussions of *how* they arrived at the particular levels and forms of compensation that they chose to award to their named executive officers and *why* they pay that compensation, giving investors an *analysis* of the results of their compensation decisions. We discuss a number of these comment areas below.

### **Compensation philosophies and decision mechanics**

We found that a number of companies discussed their compensation philosophies and decision mechanics in great detail. We asked a substantial number of companies to refocus their Compensation Discussion and Analysis presentations on the substance of their compensation decisions and to disclose how they analyzed information and why their analyses resulted in the compensation they paid. For example, where a company provided a lengthy discussion about its compensation philosophies, we suggested that it improve its Compensation Discussion and Analysis by explaining how and why those philosophies resulted in the numbers they presented in the required tables. Similarly, where a company provided a lengthy discussion about its decision-making process, we suggested that, rather than explaining the process, it explain how its analysis of relevant information resulted in the decisions it made.

We asked a significant number of companies to discuss the extent to which the amounts paid or awarded under each compensation element affected the decisions they made regarding amounts they paid or awarded under other compensation elements. Consistent with Item 402(b)(1)(vi), we asked these companies to place in context how and why the determinations they made with regard to one compensation element may or may not have influenced decisions they made with respect to other compensation elements they contemplated or awarded. Where a company disclosed that its compensation committee analyzed “tally sheet” information, for example, we asked the company to explain what “tally sheet” information was and discuss how it impacted the committee’s decision on compensation awards.

### **Differences in compensation policies and decisions**

Item 402(b) requires companies to discuss their compensation policies and their decisions regarding compensation of their named executive officers. When adopting this requirement, the Commission stated that “[t]he Compensation Discussion and Analysis should be sufficiently precise to identify material differences in compensation policies and decisions for

individual named executive officers where appropriate. Where policies or decisions are materially similar, officers can be grouped together. Where, however, the policy or decisions for a named executive officer are materially different, for example in the case of a principal executive officer, his or her compensation should be discussed separately." Where a company's disclosure, including that in the Summary Compensation Table, led us to believe that its policies and decisions for individual named executive officers may be materially different, we reminded the company of the Commission's statement.

### **Performance targets**

Item 402(b)(2) provides fifteen examples of items that may be material elements of a company's compensation policies and decisions. Among the elements of a company's compensation policies and decisions that may be material and warrant disclosure is the company's use of corporate and individual performance targets. Evaluating whether corporate and individual performance targets warrant disclosure is not a new concept for public companies in preparing their executive compensation disclosure. Prior to 2006, the Commission's executive compensation disclosure rules required a company's compensation committee to describe each measure of company performance on which it based the Chief Executive Officer's compensation. Companies were not required to disclose target levels involving confidential commercial or business information where disclosure would have had an adverse effect on the company.

In adopting the revised rules, the Commission carefully considered public company disclosure practices and the differing views of a wide variety of commenters. Rather than presenting a specific requirement to disclose corporate and individual performance targets, the Commission adopted a principles-based disclosure model in which a company determines whether performance targets are a material element of its compensation policies and decisions. If a company determines they are material, Item 402 provides the disclosure framework for the company to follow.

We found that a substantial number of companies alluded to using, or disclosed that they used, corporate and individual performance targets to set compensation policies and make compensation decisions. We found that corporate performance targets ranged from financial targets such as earnings per share, EBITDA, and growth in net sales, to operational or strategic goals such as increases in market share or targets specific to a particular division or business unit. Most companies we reviewed disclosed that their compensation committees considered individual performance in making executive compensation decisions, although few companies disclosed how they analyzed individual performance or whether they focused on specific individual performance goals as part of that analysis.

We issued more comments regarding performance targets than any other disclosure topic in our review of the executive compensation and other related disclosure of the 350 companies. We often found it difficult to understand how companies used these performance targets or considered qualitative individual performance to set compensation policies and make compensation decisions. In making these comments, we do not seek to require companies to defend what may properly be subjective assessments in terms of purely objective or quantitative criteria, but rather only to clearly lay out the way that qualitative inputs are ultimately translated into objective pay determinations.

Where it appeared that performance targets were material to a company's policy and decision-making processes and the company did not disclose those targets, we asked it to disclose the targets or demonstrate to us that disclosure of the particular targets could cause it competitive harm.<sup>1</sup> We reminded companies of Instruction 4 to Item 402(b) which requires them to discuss how difficult it will be for the executive or how likely it will be for the company to achieve undisclosed target levels or other factors. Where a company omitted a performance target amount but discussed how difficult or likely it would be for the company or individual to achieve that target, we often sought more specific disclosure that would enhance investor understanding of the difficulty or likelihood.

Where a company presented a non-GAAP financial figure as a performance target and the company did not disclose how it would calculate that figure, consistent with Instruction 5 to Item 402(b)(2), we asked it to disclose how it would do so. For example, where a company disclosed total shareholder return as a performance target, we asked the company to disclose how it would calculate total shareholder return and describe how it would influence compensation decisions.

In adopting the revised rules and addressing commenters' requests for clarification about whether the Compensation Discussion and Analysis is limited to compensation for the last fiscal year or should also address prior or current year matters, the Commission stated:

While the Compensation Discussion and Analysis may also require discussion of post-termination compensation arrangements, on-going compensation arrangements, and policies that the company will apply on a going-forward basis, Compensation Discussion and Analysis should also cover actions regarding executive compensation that were taken after the last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.

While disclosure will always depend upon each company's particular facts and circumstances, there are a number of situations where a company may find it necessary to discuss prior and current year performance targets to place its disclosure in context or affect a fair understanding of a named executive officer's compensation. It also may be material for a company to disclose whether the company or the named executive officer achieved or failed to achieve targets in prior years. Those situations may include, for example, where a company has a multiple year compensation plan or where target levels vary materially between years. Where a company's disclosure implied that its current or prior year targets were material to an understanding of a named executive officer's compensation for the last fiscal year or were otherwise material in the context of that company's Compensation Discussion and Analysis, consistent with Instruction 2 to Item 402(b) of Regulation S-K, we asked it to disclose prior year and current year targets.

### **Benchmarks**

When a company discloses that it has used compensation information from other companies to determine its own compensation levels, the company

may be engaging in benchmarking its total compensation or other material elements of compensation. Benchmarking is presented in Item 402(b)(2) as an example of information that may be material to an individual company's compensation policies and decisions. If a company uses benchmarking, and it is material to its compensation policies and decisions, Item 402 requires it "to identify the benchmark and, if applicable, its components (including component companies)."

In a substantial number of comments, we asked companies to provide a more detailed explanation of how they used comparative compensation information and how that comparison affected compensation decisions. Where a company stated that it used comparative compensation information, but retained discretion on how to use it, we asked it to provide appropriate disclosure. For example, if a company stated that it benchmarked its compensation, but it retained discretion to benchmark to a different point or range, or to not benchmark at all, we asked it to disclose the nature and extent of that discretion and whether or how it exercised that discretion.

Where a company indicated that it benchmarked compensation to its peers, but did not identify the peers or provide sufficient details concerning the benchmarking it used, we asked it to identify the companies to which it compared itself as well as the compensation components it used in that comparison. In addition, where a company indicated that it benchmarked compensation to a vague or broad range of data regarding those companies, we asked it to explain more specifically where its compensation fell within that range.

### **Change-in-control and termination arrangements**

We found that a significant number of companies could enhance their Compensation Discussion and Analysis by discussing and analyzing their decisions regarding change-in-control and termination arrangements with the named executive officers. Item 402(b)(1)(v) requires a company to disclose how it determines the amount and formula, where applicable, to pay for each compensation element. Item 402(b)(1)(vi) requires a company to discuss how each compensation element, and the company's decisions regarding that element, fit into the company's overall compensation objectives and affect decisions regarding other compensation elements. We asked a number of companies to disclose why they structured the material terms and payment provisions in their change-in-control and termination arrangements as they did. We also asked companies to discuss how potential payments and benefits under these arrangements may have influenced their decisions regarding other compensation elements.

### **Executive and Director Compensation Tables**

We did not detect any common themes in our reviews of the required named executive officer and director compensation tables, the footnotes to the tables, or the narratives that followed them. Overall, we issued relatively few comments to companies on this area of their disclosure. Our comments regarding the required tables generally related to specific disclosure requirements or other information concerning a particular company's individual facts and circumstances. For example, if it appeared that a company made undisclosed assumptions in valuing option awards, we asked it to disclose those assumptions in the footnotes to the required table or provide an appropriate cross-reference to the discussion of the

assumptions elsewhere in the company's filing. As another example, in the Grants of Plan-Based Awards table, where it appeared that a company did not disclose each grant of an award made to a named executive officer in the last completed fiscal year under any plan, we asked it to do so. Finally, where a company did not disclose the vesting dates of options, shares of stock, and equity incentive plan awards held at fiscal-year end by footnote to the applicable column in its Outstanding Equity Awards at Fiscal Year-End table, we asked it to do so.

### **Compensation Committee Report**

A number of companies furnished compensation committee reports that did not include all of the information our rules require. For example, some companies did not indicate whether the compensation committee reviewed and discussed the Compensation Discussion and Analysis with management. We asked these companies to revise their future reports to include all required information.

### **Related Person Transaction Disclosure**

We issued relatively few comments on related person transaction disclosure. We did, however, ask a number of companies to provide a statement that their policies and procedures for review, approval, or ratification of related person transactions are in writing and, if not, to explain how they evidence their policies and procedures. Furthermore, as the Commission stated when adopting the revised rules, disclosure regarding related person transactions is integral to "a materially complete picture of financial relationships with a company," and we will continue to review company disclosures with this standard in mind.

### **Corporate Governance**

Our comments on corporate governance matters primarily focused on who was involved in making compensation decisions. We identified a number of areas where a company could provide a more complete picture of which individuals and which procedures it relied upon to consider and determine executive and director compensation, consistent with the requirements of Item 407(e)(3). Where a company's disclosure was unclear about exactly who made the compensation decisions, we asked for clarification. Item 407(e)(3)(ii) requires a company to describe the role of executive officers in determining or recommending the amount or form of executive and director compensation. Where a company indicated that its principal executive officer had a role in the compensation decision-making process, we asked it to describe his or her role. Item 407(e)(3)(iii) requires companies to disclose the role compensation consultants played in the decision-making process, and we asked a number of companies to do so. In particular, we asked companies to more specifically disclose the nature and scope of a consultant's assignment and material instructions the company gave it.

<sup>1</sup> Those companies that believe their explanation to us should receive confidential treatment should determine whether requesting confidential treatment of that explanation pursuant to Rule 83 is appropriate. SEC Rule 200.83 governs the procedures under which a company may request confidential treatment for information contained in a response letter or for supplemental information it provides to us. Rule 83 requires the company to submit a written request for confidential treatment at the time it

<http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm>

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Modified: 10/09/2007

**B-V**

**December 2009 SEC Release adopting Changes to the Rules**

**SECURITIES AND EXCHANGE COMMISSION****17 CFR Parts 229, 239, 240, 249 and 274**

[Release Nos. 33-9089; 34-61175; IC-29092; File No. S7-13-09]

RIN 3235-AK28

**Proxy Disclosure Enhancements****AGENCY:** Securities and Exchange Commission.**ACTION:** Final rule.

**SUMMARY:** We are adopting amendments to our rules that will enhance information provided in connection with proxy solicitations and in other reports filed with the Commission. The amendments will require registrants to make new or revised disclosures about: compensation policies and practices that present material risks to the company; stock and option awards of executives and directors; director and nominee qualifications and legal proceedings; board leadership structure; the board's role in risk oversight; and potential conflicts of interest of compensation consultants that advise companies and their boards of directors. The amendments to our disclosure rules will be applicable to proxy and information statements, annual reports and registration statements under the Securities Exchange Act of 1934, and registration statements under the Securities Act of 1933 as well as the Investment Company Act of 1940. We are also transferring from Forms 10-Q and 10-K to Form 8-K the requirement to disclose shareholder voting results.

**DATES:** *Effective Date:* February 28, 2010.

**FOR FURTHER INFORMATION CONTACT:** N. Sean Harrison, Special Counsel, at (202) 551-3430 or Anne Krauskopf, Senior Special Counsel, at (202) 551-3500, in the Division of Corporation Finance; or with respect to questions regarding investment companies, Alberto Zapata, Senior Counsel, Division of Investment Management, at (202) 551-6784, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** We are adopting amendments to Items 401,<sup>1</sup> 402,<sup>2</sup> and 407<sup>3</sup> of Regulation S-K;<sup>4</sup> Schedule 14A<sup>5</sup> and Forms 8-K,<sup>6</sup> 10-Q,<sup>7</sup>

and 10-K<sup>8</sup> under the Securities Exchange Act of 1934 ("Exchange Act");<sup>9</sup> and Forms N-1A,<sup>10</sup> N-2,<sup>11</sup> and N-3,<sup>12</sup> registration forms used by management investment companies to register under the Investment Company Act of 1940 ("Investment Company Act")<sup>13</sup> and to offer their securities under the Securities Act of 1933 ("Securities Act").<sup>14</sup>

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VII. Statutory Authority and Text of the Amendments

**I. Background and Overview of the Amendments**

On July 10, 2009, we proposed a number of revisions to our rules that were designed to improve the disclosure shareholders of public companies receive regarding compensation and corporate governance.<sup>15</sup> As discussed in detail below, we have taken into consideration the comments received on the proposed amendments and are adopting several amendments to our rules. Among other improvements, the new disclosure requirements adopted today enhance the information provided in annual reports, and proxy and information statements to better enable shareholders to evaluate the leadership of public companies.

As discussed more fully in the Proposing Release, during the past few years, investors have increasingly focused on corporate accountability and have expressed the desire for additional information that would enhance their ability to make informed voting and investment decisions. The disclosure enhancements we are adopting respond to this focus, and will significantly improve the information companies provide to shareholders with regard to the following:

- **Risk:** By requiring disclosure about the board's role in risk oversight and, to the extent that risks arising from a company's compensation policies and practices are reasonably likely to have a material adverse effect on the company, disclosure about such policies and practices as they relate to risk management;

- **Governance and Director Qualifications:** By requiring expanded disclosure of the background and qualifications of directors and director nominees and new disclosure about a company's board leadership structure, and accelerating the reporting of information regarding voting results; and

- **Compensation:** By revising the reporting of stock and option awards in the Summary Compensation Table<sup>16</sup> and Director Compensation Table,<sup>17</sup> and requiring disclosure of potential conflicts of interest of compensation consultants in certain circumstances. We believe that providing a more transparent view of these key risk, governance and compensation matters

<sup>1</sup> 17 CFR 229.401.<sup>2</sup> 17 CFR 229.402.<sup>3</sup> 17 CFR 229.407.<sup>4</sup> 17 CFR 229.10 *et al.*<sup>5</sup> 17 CFR 240.14a-101.<sup>6</sup> 17 CFR 249.308.<sup>7</sup> 17 CFR 249.308a.<sup>8</sup> 17 CFR 249.310.<sup>9</sup> 15 U.S.C. 78a *et seq.*<sup>10</sup> 17 CFR 239.15A and 274.11A.<sup>11</sup> 17 CFR 239.14 and 274.11a-1.<sup>12</sup> 17 CFR 239.17a and 274.11b.<sup>13</sup> 15 U.S.C. 80a-1 *et seq.*<sup>14</sup> 15 U.S.C. 77a *et seq.*<sup>15</sup> See Release No. 33-9052 (July 10, 2009) [74 FR 35076] ("Proposing Release").<sup>16</sup> Item 402(c) and 402(n) of Regulation S-K [17 CFR 229.402(c) and 229.402(n)].<sup>17</sup> Item 402(k) and 402(r) of Regulation S-K [17 CFR 229.402(k) and 229.402(r)].

will help shareholders make more informed voting and investment decisions.

We received over 130 comment letters in response to the proposed amendments.<sup>18</sup> These letters came from corporations, pension funds, professional associations, trade unions, accounting firms, law firms, consultants, academics, individual investors and other interested parties. In general, the commenters supported the objectives of the proposed new requirements. Most investors supported the manner in which we proposed to achieve these objectives and, in some cases, urged us to require additional disclosure from companies. Other commenters, however, opposed some of the proposed revisions and suggested modifications to the proposals.

We have reviewed and considered all of the comments that we received on the proposed amendments. The adopted rules reflect changes made in response to many of these comments. We discuss our revisions with respect to each proposed rule amendment in more detail throughout this release. The amendments that we are adopting will require:

- To the extent that risks arising from a company's compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company, discussion of the company's compensation policies or practices as they relate to risk management and risk-taking incentives that can affect the company's risk and management of that risk;
- Reporting of the aggregate grant date fair value of stock awards and option awards granted in the fiscal year in the Summary Compensation Table and Director Compensation Table to be computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation—Stock Compensation (“FASB ASC Topic 718”),<sup>19</sup> rather than the dollar amount recognized for financial statement purposes for the fiscal year, with a

<sup>18</sup> The public comments we received are available on our Web site at <http://www.sec.gov/comments/s7-13-09/s71309.shtml>. Comments are also available for Web site viewing and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m.

<sup>19</sup> Both our rule proposal and the former disclosure requirement used the nomenclature Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004) *Share-Based Payment* (FAS 123R). We are updating our references in this release and the final rules to reflect that the FASB Accounting Standards Codification has superseded all references to previous FASB standards for interim or annual periods ending on or after September 15, 2009.

special instruction for awards subject to performance conditions;

- New disclosure of the qualifications of directors and nominees for director, and the reasons why that person should serve as a director of the company at the time at which the relevant filing is made with the Commission; the same information would be required in the proxy materials prepared with respect to nominees for director nominated by others;

- Additional disclosure of any directorships held by each director and nominee at any time during the past five years at any public company or registered investment company;

- New disclosure regarding the consideration of diversity in the process by which candidates for director are considered for nomination by a company's nominating committee;

- Additional disclosure of other legal actions involving a company's executive officers, directors, and nominees for director, and lengthening the time during which such disclosure is required from five to ten years;

- New disclosure about a company's board leadership structure and the board's role in the oversight of risk;

- New disclosure about the fees paid to compensation consultants and their affiliates under certain circumstances; and

- Disclosure of the vote results from a meeting of shareholders on Form 8-K generally within four business days of the meeting.

With respect to management investment companies that are registered under the Investment Company Act (“funds”),<sup>20</sup> the amendments we are adopting will require expanded disclosure regarding director and nominee qualifications; past directorships held by directors and nominees; and legal proceedings involving directors, nominees, and executive officers to funds; and new disclosure about leadership structure and the board's role in the oversight of risk.

The Proposing Release also included several proposed amendments to our rules governing the proxy solicitation process. We have decided to defer consideration of those proposed amendments at this time, pending our consideration of our proposal intended

<sup>20</sup> Management investment companies typically issue shares representing an interest in a changing pool of securities, and include open-end and closed-end companies. An open-end company is a management company that is offering for sale or has outstanding any redeemable securities of which it is the issuer. A closed-end company is any management company other than an open-end company. See Section 5 of the Investment Company Act [15 U.S.C. 80a-5].

to facilitate shareholder director nominations in companies' proxy materials.<sup>21</sup>

## II. Discussion of the Amendments

### A. Enhanced Compensation Disclosure

#### 1. Narrative Disclosure of the Company's Compensation Policies and Practices as They Relate to the Company's Risk Management

We proposed amendments to our Compensation Discussion and Analysis (“CD&A”) requirements to broaden their scope to include a new section regarding how the company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk. We are adopting the disclosure requirements generally as proposed, but we are revising the placement of the new required disclosures and the disclosure threshold, as suggested by commenters.

##### a. Proposed Amendments

Under the amendments we proposed, companies would be required to discuss and analyze their broader compensation policies and overall actual compensation practices for employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a material effect on the company. As we stated in the Proposing Release, we believe that disclosure of a company's compensation policies and practices in certain circumstances can help investors identify whether the company has established a system of incentives that can lead to excessive or inappropriate risk taking by employees.

The proposed amendments enumerated a non-exclusive list of situations where compensation programs may raise material risks to companies, and several examples of the types of issues that would be appropriate for a company to discuss and analyze. The illustrative examples, consistent with the principles-based approach of the CD&A, were intended to help identify the types of situations in which the disclosure may be required.

##### b. Comments on the Proposed Amendments

Comments on the proposal were mixed. Individual investors, trade unions, institutional investors and pension funds supported the proposals.<sup>22</sup> Some of these commenters

<sup>21</sup> See Release No. 33-9046 (June 10, 2009) [74 FR 29024].

<sup>22</sup> See, e.g., letters from American Federation of Labor and Congress of Industrial Organizations

believed the new CD&A disclosure would improve the ability of investors to make informed investment decisions.<sup>23</sup> Other commenters believed the amendments would significantly improve shareholders' understanding of both the process by which pay is set and the substantive policies that guide companies' risk assessment or incentive considerations in structuring compensation policies or awarding compensation.<sup>24</sup>

Most companies, law firms and bar groups opposed the proposal.<sup>25</sup> Concerns that were expressed included, for example, that the proposed amendments would not lead to meaningful disclosures,<sup>26</sup> and that the CD&A was already long and the proposed amendments would add length without a corresponding benefit to shareholders.<sup>27</sup> Another concern expressed by commenters was that the linkage between risk-taking and executive compensation is not well understood, and that the disclosures provided under the proposed amendments would likely be boilerplate that could give investors a false sense of comfort regarding risk and risk-taking.<sup>28</sup>

Other commenters argued that it was not appropriate to expand the CD&A beyond the named executive officers to include disclosure of the company's broader compensation policies and overall compensation practices for employees generally.<sup>29</sup> Some of these commenters argued that expanding the CD&A would represent a fundamental shift in the approach to the CD&A.<sup>30</sup> Concerns were also expressed that risk management, risk-taking incentives and

related business strategy are complex subjects that could not be adequately analyzed in CD&A without adding voluminous text to an already lengthy proxy statement.<sup>31</sup>

Comments also were mixed on the illustrative examples included with the proposed amendments. Some commenters supported the list, noting that the additional disclosures would provide investors with a better understanding of a company's compensation policies and how such policies can create incentives that could affect the company's risk profile and ability to manage that risk.<sup>32</sup> Other commenters asserted that the proposed revisions would lead to boilerplate disclosures and information that would not be meaningful to investors.<sup>33</sup>

Several commenters recommended that we revise the disclosure threshold in the proposed amendments, which we proposed as "may have a material effect" on the company.<sup>34</sup> Suggested alternatives included changing the standard to "likely to have a material effect," "reasonably likely to have a material effect," or "will likely have a material effect."<sup>35</sup> Some commenters believed the "may have a material effect" standard was too speculative and that basing the disclosure standard on whether the risks are "reasonably likely to have a material effect" would give companies more certainty and provide investors with more meaningful disclosure.<sup>36</sup> Commenters also noted that, to avoid voluminous and extraneous disclosure, the requirement should focus on compensation arrangements that are likely to promote risk-taking behavior that could have a significant and damaging impact on the company's operations.<sup>37</sup>

### c. Final Rule

After considering the comments, we are adopting the disclosure requirement substantially as proposed with some modifications. We continue to believe that it is important for investors to be informed of the compensation policies and practices that are likely to expose

the company to material risk, but we recognize that, consistent with the comments received, we should revise our proposals. We have tailored the final amendments to address many of the concerns expressed by commenters, consistent with the purposes to be advanced by the disclosure.

The final rule requires a company to address its compensation policies and practices for all employees, including non-executive officers, if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company.<sup>38</sup> As noted above, the proposed rules would have required discussion and analysis of compensation policies if risks arising from those compensation policies "may have a material effect on the company." We agree with the suggestions of several commenters that the new requirements should have a "reasonably likely" disclosure threshold. Companies are familiar with the "reasonably likely" disclosure threshold used in our Management Discussion and Analysis ("MD&A") rules,<sup>39</sup> and this approach would parallel the MD&A requirement, which requires risk-oriented disclosure of known trends and uncertainties that are material to the business. We believe that the "reasonably likely" threshold also addresses concerns of some commenters that the proposed requirements might have caused companies attempting compliance to burden shareholders and investors with voluminous disclosure of potentially insignificant and unnecessarily speculative information about their compensation policies. By focusing on risks that are "reasonably likely to have a material adverse effect" on the company, the amendments are intended to elicit disclosure about incentives in the company's compensation policies and practices that would be most relevant to investors.<sup>40</sup> This change from the proposal also addresses concerns some commenters raised that the proposal did not allow companies to consider compensating or offsetting steps or controls designed to limit risks of certain compensation arrangements.<sup>41</sup> If a company has compensation policies and practices for different groups that

("AFL-CIO"), American Association of Retired Persons ("AARP"), Grahall Partners LLC, Institute of Internal Auditors ("IIA"), Pfizer Inc., Risk and Insurance Management Society, Inc. ("RIMS"), State of Connecticut Treasurer's Office ("CTO"), State of Wisconsin Investment Board ("SWIB"), Ralph S. Saul, Teachers Insurance and Annuity Association of America—College Retirement and Equities Fund ("TIAA-CREF"), and Mark Whitton.

<sup>23</sup> See, e.g., letters from California State Teachers' Retirement System ("CalSTRS"), and RIMS.

<sup>24</sup> See, e.g., letters from Service Employees International Union ("SEIU"), and Walden Asset Management.

<sup>25</sup> See, e.g., letters from the American Bar Association ("ABA"), Robert Ahrenholz, American Electric Power, Business Roundtable, StanCorp Financial Group, and Wisconsin Electric Corporation.

<sup>26</sup> See, e.g., letters from Association Corporate Counsel ("ACC"), BorgWarner Inc., NACCO Industries, Inc. ("NACCO"), and Sullivan & Cromwell ("S&C").

<sup>27</sup> See, e.g., letters from National Association of Corporate Directors ("NACD") and S&C.

<sup>28</sup> See, e.g., letters from ABA and DolmatConnell Partners, Inc. ("DolmatConnell").

<sup>29</sup> See, e.g., letters from BorgWarner, NACCO and the Society of Corporate Secretaries and Corporate Governance Professionals ("SCSGP").

<sup>30</sup> See, e.g., letters from BorgWarner and NACCO.

<sup>31</sup> See e.g., letter of NACD.

<sup>32</sup> See, e.g., letters from CalSTRS, Council of Institutional Investors ("CII"), Glass Lewis & Co ("Glass Lewis"), and RIMS.

<sup>33</sup> See e.g., letters of Business Roundtable and Cleary Gottlieb Steen & Hamilton LLP ("Cleary Gottlieb").

<sup>34</sup> See letters from ACC, BorgWarner, Davis Polk & Wardwell LLP ("Davis Polk"), Honeywell International Inc. ("Honeywell"), NACCO, and SCSGP.

<sup>35</sup> See letters from ABA, ACC, BorgWarner, Davis Polk, Honeywell, NACCO, and SCSGP.

<sup>36</sup> See letters from ABA and Davis Polk.

<sup>37</sup> See letters from ABA and Pearl Meyer & Partners ("Pearl Meyer").

<sup>38</sup> See new Item 402(s) of Regulation S-K. As we noted in the Proposing Release, to the extent that risk considerations are a material aspect of the company's compensation policies or decisions for named executive officers, the company is required to discuss them as part of its CD&A under the current rules.

<sup>39</sup> See Item 303 of Regulation S-K [17 CFR 229.303].

<sup>40</sup> See note 36 above and accompanying text.

<sup>41</sup> See letters from ABA and Center on Executive Compensation.

mitigate or balance incentives, these could be considered in deciding whether risks arising from the company's compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company as a whole.

In addition, we have modified the proposal to provide that disclosure is only required if the compensation policies and practices are reasonably likely to have a material "adverse" effect on the company, as opposed to any "material effect" as proposed. As noted in the Proposing Release, well-designed compensation policies can enhance a company's business interests by encouraging innovation and appropriate levels of risk-taking. By focusing the disclosure on material *adverse* effects, the final rule should help avoid voluminous and unnecessary discussion of compensation arrangements that may mitigate inappropriate risk-taking incentives.

We are also moving the new requirements into a separate paragraph in Item 402 of Regulation S-K.<sup>42</sup> As adopted, the new disclosure requirements will not be a part of the CD&A.<sup>43</sup> We were persuaded by commenters who asserted that it would be potentially confusing to expand the CD&A beyond the named executive officers to include disclosure of the company's broader compensation policies and practices for employees. CD&A provides discussion and analysis of the compensation of the named executive officers and the information contained in the Summary Compensation Table and other required tables, and the new disclosure requirements would be inconsistent with that approach because they would cover all employees, not just the named executive officers.<sup>44</sup>

The final rule will contain, as proposed, the non-exclusive list of situations where compensation programs may have the potential to raise material risks to companies, and the examples of the types of issues that would be appropriate for a company to address. Under the amendments, the

situations that would require disclosure will vary depending on the particular company and its compensation program. We believe situations that potentially could trigger discussion include, among others, compensation policies and practices:

- At a business unit of the company that carries a significant portion of the company's risk profile;
- At a business unit with compensation structured significantly differently than other units within the company;
- At a business unit that is significantly more profitable than others within the company;
- At a business unit where the compensation expense is a significant percentage of the unit's revenues; and
- That vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time.

This is a non-exclusive list of situations where compensation programs may have the potential to raise material risks to the company. There may be other features of a company's compensation policies and practices that have the potential to incentivize its employees to create risks that are reasonably likely to have a material adverse effect on the company. However, disclosure under the amendments is only required if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company. We note that in the situations listed above, a company may under appropriate circumstances conclude that its compensation policies and practices are not reasonably likely to have a material adverse effect on the company.

We are adopting, as proposed, the illustrative examples of the issues that would potentially be appropriate for a company to address. As we stated in the Proposing Release, the examples are non-exclusive and that the application of an example should be tailored to the facts and circumstances of the company. We believe that a principles-based approach, similar to our CD&A requirements, utilizing illustrative examples strikes an appropriate balance that will effectively elicit meaningful disclosure. If a company determines that disclosure is required, we believe examples of the issues that companies may need to address regarding their compensation policies or practices include the following:

- The general design philosophy of the company's compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by those employees on behalf of the company, and the manner of their implementation;
- The company's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation;
- How the company's compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;
- The company's policies regarding adjustments to its compensation policies and practices to address changes in its risk profile;
- Material adjustments the company has made to its compensation policies and practices as a result of changes in its risk profile; and
- The extent to which the company monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.

We believe using illustrative examples helps to identify the types of disclosure that may be applicable. However, companies must assess the information that is identified by the example in light of the company's particular situation. Thus, for example, we would not expect to see generic or boilerplate disclosure that the incentives are designed to have a positive effect, or that compensation levels may not be sufficient to attract or retain employees with appropriate skills in order to enable the company to maintain or expand operations.

Consistent with the approach taken in the proposals, smaller reporting companies will not be required to provide the new disclosure, even though the new rule will not be part of CD&A.<sup>45</sup> At this time, we believe that such companies are less likely to have the types of compensation policies and practices that are intended to be addressed in this rulemaking.<sup>46</sup>

<sup>45</sup> Because smaller reporting companies are not required to provide CD&A disclosure, we did not propose to require that they provide the new disclosure.

<sup>46</sup> See, e.g., letter of Committee on Securities Law of the Business Law Section of the Maryland State Bar Association ("In our view smaller reporting

<sup>42</sup> See new Item 402(s) of Regulation S-K.

<sup>43</sup> In making this change, we also revised the final rule from what was proposed by eliminating the term "generally." Previously, we believed this term was helpful to distinguish the proposed amendments from the CD&A for the named executive officers by emphasizing that it also applied to non-executive officers. Because we are moving the new requirements into a separate paragraph, we do not believe the term is needed. Moreover, one commenter noted that the term could be confusing in light of the examples listed in the rule. See letter from ABA.

<sup>44</sup> See letters from BorgWarner, NACCO and SCSGP.

In the Proposing Release, we requested comment on whether we should require a company to affirmatively state that it has determined that the risks arising from its compensation policies are not reasonably expected to have a material effect on the company if it has concluded that disclosure was not required. Commenters were mixed in their response to this request. Several commenters believed that companies should be required to affirmatively state that they have determined that the risks arising from their broader compensation policies are not reasonably expected to have a material effect.<sup>47</sup> Others believed that the proposed amendments should not require an affirmative statement because it would not provide investors with useful information and would create potential liability for companies.<sup>48</sup> Another commenter noted that our disclosure rules have not traditionally required companies to address affirmatively matters that the company has determined are not applicable to it.<sup>49</sup> We believe an approach consistent with our prior practice is appropriate and the final rule does not require a company to make an affirmative statement that it has determined that the risks arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company.

## 2. Revisions to the Summary Compensation Table

We proposed to amend Item 402 of Regulation S-K to revise Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant date fair value of awards computed in accordance with FASB ASC Topic 718. The revised disclosure<sup>50</sup> would replace previously mandated disclosure of the dollar amount recognized for financial statement reporting purposes for the

companies and their compensation structures generally are not geared towards the kind of disclosure that would be required by the proposal. The amendments will not alter the reporting requirements for smaller reporting companies under Item 402. Specifically, smaller reporting companies are permitted to provide the scaled disclosures specified in Items 402(l) through (r) of Regulation S-K, rather than the disclosure specified in Items 402(a) through (k) of Regulation S-K.

<sup>47</sup> See, e.g., letters from Calvert Group, Ltd. ("Calvert"), Grahall Partners and Integrated Governance Solutions.

<sup>48</sup> See, e.g., letters from the Business Roundtable, Honeywell, Pfizer and S&C.

<sup>49</sup> See letter from ABA.

<sup>50</sup> Items 402(c)(2)(v) and (vi), 402(k)(2)(iii) and (iv), 402(n)(2)(v) and (vi), and 402(r)(2)(iii) and (iv) of Regulation S-K.

fiscal year in accordance with FASB ASC Topic 718, and would affect the calculation of total compensation, including for purposes of determining who is a named executive officer.<sup>51</sup> We are adopting the revisions substantially as proposed with some changes in response to comments.

### a. Proposed Amendments

As we stated in the Proposing Release, we proposed these amendments because of comments we previously received from a variety of sources that the information that investors would find most useful and informative in the Summary Compensation Table and Director Compensation Table is the full grant date fair value of equity awards made during the covered fiscal year. Investors may consider compensation decisions made during the fiscal year, which usually are reflected in the full grant date fair value measure but not in the financial statement recognition measure, to be material to voting and investment decisions.

We also proposed to rescind the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table<sup>52</sup> and the corresponding footnote disclosure to the Director Compensation Table<sup>53</sup> because these disclosures may be considered duplicative of the aggregate grant date fair value to be provided in the amended Summary Compensation Table. In addition, we proposed to amend Instruction 2 to the salary and bonus columns of the Summary Compensation Table so that companies would not be required to report in those columns the amount of salary or bonus forgone at a named executive officer's election, and the non-cash awards received instead of salary or bonus would be reported in the column applicable to the form of award elected. As proposed, the Summary Compensation Table disclosure would reflect the form of compensation ultimately received by the named executive officer.

### b. Comments on the Proposed Amendments

A broad spectrum of commenters supported the proposal to revise the Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant

<sup>51</sup> Items 402(a)(3)(iii) and (iv) and 402(m)(2)(ii) and (iii) of Regulation S-K.

<sup>52</sup> Item 402(d)(2)(viii) of Regulation S-K and Instruction 7 to Item 402(d).

<sup>53</sup> Instruction to Item 402(k)(2)(iii) and (iv) of Regulation S-K.

date fair value of awards.<sup>54</sup> Most commenters agreed that because aggregate grant date fair value disclosure better reflects compensation committee decisions with respect to stock and option awards,<sup>55</sup> it is more informative to voting and investment decisions<sup>56</sup> and a better measure for purposes of identifying named executive officers.<sup>57</sup> However, some commenters objected that use of grant date fair value to identify named executive officers may result in relatively frequent changes in the named executive officer group based on grants of "one time" multi-year awards to newly hired executives or special awards to enhance retention.<sup>58</sup>

As discussed in detail below, many commenters expressed concern that the amount to be reported in the table for performance awards would be calculated without regard to the likelihood of achieving the relevant performance objectives, which could discourage companies from granting these awards.<sup>59</sup> Others, however, suggested that the design of equity awards is driven by numerous considerations, and companies would continue to make equity awards subject to performance conditions.<sup>60</sup>

<sup>54</sup> See, e.g., letters from AARP, Business Roundtable, State of Wisconsin Investment Board ("SWIB"), Pfizer, SCSGP, S&C, United Brotherhood of Carpenters and Joiners of America ("United Brotherhood of Carpenters"), United States Proxy Exchange ("USPX").

<sup>55</sup> See, e.g., letters from Business Roundtable ("Generally, we support the Proposed Rules, as they likely will produce disclosure that, in most situations, is more in line with how compensation committees view annual equity compensation—that is, disclosure of the equity compensation that a company grants in a particular year."); and SCSGP ("We support this change. The aggregate grant date fair value is generally used by compensation committees in determining the amount of stock and options to award, whereas the current disclosure requirement confusingly focuses on accounting considerations that may have no bearing on compensation decisions.").

<sup>56</sup> See, e.g., letter of United Brotherhood of Carpenters ("The proposed SCT reporting of equity awards will help inform investment decisions, as well as important investor voting decisions regarding executive compensation and director performance.").

<sup>57</sup> See, e.g., letter of Mercer ("Because the value included in the SCT determines the identification of at least three of the named executive officers (other than the principal executive officer and the principal financial officer), disclosure of the full grant-date fair value would also better align the identification of these officers with company compensation decisions.").

<sup>58</sup> See, e.g., letter of Protective Life Corporation.

<sup>59</sup> See, e.g., letters from ABA, Business Roundtable, Center on Executive Compensation, Cleary Gottlieb, Compensia, Honeywell, Frederic W. Cook & Co., Inc., Pearl Meyer, Protective Life Corporation, Securities Industry and Financial Markets Association (SIFMA), SCSGP, and Towers Perrin.

<sup>60</sup> See, e.g., letter from Hewitt Associates LLC ("Hewitt").

With respect to the proposal to rescind the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table, the comments were mixed. While some commenters supported this proposal,<sup>61</sup> others stated that retaining disclosure of the grant date fair value of individual awards would continue to provide investors valuable information. Because different companies may vary in the assumptions they apply to compute grant date fair value, some commenters noted that retaining this disclosure makes it easier for investors to assess how companies determined fair value for individual grants.<sup>62</sup> Further, different types of equity awards can have different incentive effects, making it important that shareholders understand the value associated with each type of award granted and the mix of values among various award types.<sup>63</sup> Commenters pointed out that reporting the separate value of multiple individual awards provides investors more information regarding the specific decisions of the compensation committee, so that investors can better evaluate those decisions and understand pay for performance.<sup>64</sup>

We also received a wide range of comments on our proposal to amend Instruction 2 to the salary and bonus columns of the Summary Compensation Table. Some commenters favored this amendment because, as stated in the Proposing Release, it would report compensation in the form actually received.<sup>65</sup> Other commenters, however, said it is important to report the form of compensation that the compensation committee originally awarded, so that investors can understand the overall compensation strategy and the intended distribution of risk among different types of compensation.<sup>66</sup>

### c. Final Rule

After considering the comments received, we are adopting the proposed amendments to revise Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant date

fair value of awards computed in accordance with FASB ASC Topic 718, with a special instruction for awards subject to performance conditions as described below. We agree with commenters that aggregate grant date fair value disclosure better reflects the compensation committee's decision with regard to stock and option awards. We remain of the view that it is more meaningful to shareholders if company compensation decisions—including decisions to grant large “one time” multi-year awards—cause the named executive officers to change. In circumstances where such a large “new hire” or “retention” grant results in the omission from the Summary Compensation Table of another executive officer whose compensation otherwise would have been subject to reporting, the company can consider including compensation disclosure for that executive officer to supplement the required disclosures.

Based on comments received, we are clarifying how performance awards<sup>67</sup> are disclosed. Most commenters stated that reporting the aggregate grant date fair value of performance awards based on maximum performance could discourage companies from granting these awards.<sup>68</sup> Noting that compensation committees take performance-contingent conditions into account when granting such awards, commenters said that the grant date fair value reported for awards with a performance condition should instead be based on the probable outcome of the performance conditions, consistent with the recognition criteria in the accounting literature.<sup>69</sup> As commenters stated, because performance awards generally are designed to incentivize attainment of target performance and set a higher maximum performance level as a “cap” on attainable compensation, requiring disclosure of an award's value to always be based on maximum performance would overstate the intended level of compensation and result in investor misinterpretation of compensation decisions. This could also discourage the grant of awards with difficult—or any—performance conditions, and lead to inflated benchmarking values used to set equity

award or total compensation levels at other companies.

We are persuaded that the value of performance awards reported in the Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table should be computed based upon the probable outcome of the performance condition(s) as of the grant date because that value better reflects how compensation committees take performance-contingent vesting conditions into account in granting such awards. We are adopting new Instructions to these tables to clarify that this amount will be consistent with the grant date estimate of compensation cost to be recognized over the service period, excluding the effect of forfeitures.<sup>70</sup> To provide investors additional information about an award's potential maximum value subject to changes in performance outcome, we will also require in the Summary Compensation Table and Director Compensation Table footnote disclosure of the maximum value assuming the highest level of performance conditions is probable.<sup>71</sup> Such footnote disclosure will permit investors to understand an award's maximum value without raising the concerns associated with requiring its tabular disclosure.<sup>72</sup>

We are requiring disclosure of awards granted during the year, as proposed. A number of commenters responded to our request for comment by indicating that they would prefer disclosure of the aggregate grant date fair value of equity awards granted *for* services in the relevant fiscal year, even if granted after fiscal year end, rather than awards granted *during* the relevant fiscal year, as proposed.<sup>73</sup> Other commenters expressed concern that revising the proposal in this way would result in a lack of uniformity that would confuse investors, would be inconsistent with the FASB ASC Topic 718 grant date, and could invite manipulated

<sup>70</sup> See Instruction 3 to Item 402(c)(2)(v) and (vi), Instruction 8 to Item 402(d), and Instruction 3 to Item 402(n)(2)(v) and (vi).

<sup>71</sup> See Instruction 3 to Item 402(c)(2)(v) and (vi), and Instruction 3 to Item 402(n)(2)(v) and (vi).

<sup>72</sup> See, e.g., letter from ABA.

<sup>73</sup> See, e.g., letters from ACC, Ameriprise Financial, Inc., BorgWarner, Business Roundtable, Cleary Gottlieb, Committee on Securities Law of the Business Law Section of the Maryland State Bar Association, Frederic W. Cook & Co., Inc., Graef Crystal, Davis Polk, General Mills, Inc., Glass Lewis, Grahall Partners, LLC., Honeywell, JP Morgan Chase & Co., RiskMetrics, SCSGP, SIFMA, and S&C. These commenters suggested this approach would better align the amounts reported in the Summary Compensation Table with the compensation decisions discussed in CD&A, and clarify the relationship between pay and performance.

<sup>61</sup> See letters from Buck Consultants, Chadbourne Park, Mercer, Pfizer, Protective Life Corporation, and S&C.

<sup>62</sup> See letters from AFL-CIO, Compensia and Graef Crystal.

<sup>63</sup> See letters from Compensia, Frederic W. Cook & Co., Inc., and Risk Metrics.

<sup>64</sup> See letters from Center on Executive Compensation, Hewitt, Pearl Meyer, Towers Perrin, and Universities Superannuation Scheme, *et al.*

<sup>65</sup> See, e.g., letters from Pfizer and RiskMetrics.

<sup>66</sup> See letters from Center on Executive Compensation, and Pearl Meyer.

<sup>67</sup> Performance awards include only those awards that are subject to performance conditions as defined in the Glossary to FASB ASC Topic 718.

<sup>68</sup> See, e.g., letters from ABA, Business Roundtable, Center on Executive Compensation, Cleary Gottlieb, Compensia, Honeywell, Frederic W. Cook & Co., Inc., Pearl Meyer, Protective Life Corporation, SIFMA, SCSGP, and Towers Perrin.

<sup>69</sup> FASB ASC Topic 718.

reporting.<sup>74</sup> We recognize that a “performance year” standard for reporting equity awards in securities in the relevant fiscal year may sometimes better align compensation disclosure with compensation decision making, and may be more consistent with Summary Compensation Table salary and bonus disclosure.<sup>75</sup> However, because it appears that multiple subjective factors, which could vary significantly from company to company, influence equity awards granted after fiscal year end, we are concerned that changing the approach to reporting could result in inconsistencies that would erode comparability. One commenter noted that many companies make equity awards after the end of the fiscal year based on executive performance during the last completed fiscal year, but determining whether an equity award was granted primarily for services performed during the last completed fiscal year can be a highly subjective determination and the factors that influence the decision of when to report an equity award may vary significantly from company to company.<sup>76</sup> Companies should continue to analyze in CD&A their decisions to grant post-fiscal year end equity awards where those decisions could affect a fair understanding of named executive officers’ compensation for the last fiscal year,<sup>77</sup> and consider including supplemental tabular disclosure where it facilitates understanding the CD&A.

Although we proposed to revise Instruction 2 to the salary and bonus column of the Summary Compensation Table so that companies would not be required to report in those columns the amount of salary or bonus forgone at a named executive officer’s election and the non-cash awards received instead of salary or bonus would be reported in the column applicable to the form of award elected, we have decided not to adopt this amendment. We agree with commenters that disclosing the amounts of salary and bonus that the compensation committee awarded better enables investors to understand the relative weights the company applied to

annual incentives and salary.<sup>78</sup> This information provides investors more insight into the extent to which a company’s compensation strategy pays for performance, may be heavily weighted in salary, or may be heavily weighted in annual incentives. Consistent with our decision to amend our rules to require disclosure enabling investors to better understand the risks involved in compensation programs, we are retaining the current version of this instruction, so that investors can understand overall compensation strategy and the intended distribution of risk among different types of compensation. Companies will continue to report the forgone amounts in the salary or bonus column, with footnote disclosure of the receipt of non-cash compensation that refers to the Grants of Plan-Based Awards Table where the stock, option or non-equity incentive plan awarded the named executive officer elected is reported.<sup>79</sup>

Finally, based on the comments received, we have decided not to rescind, as was proposed, the requirement to report the full grant date fair value of each equity award in the Grants of Plan-Based Awards Table and the Director Compensation Table. We agree with commenters that, because this disclosure reveals the value associated with each type of equity award granted and the mix of values among various awards with different incentive effects, retaining it will help investors better evaluate the decisions of the compensation committee.<sup>80</sup>

#### d. Transition

To facilitate year-to-year comparisons, consistent with our proposal, we will implement the Summary Compensation Table amendments by requiring companies providing Item 402 disclosure for a fiscal year ending on or after December 20, 2009 to present recomputed disclosure for each preceding fiscal year required to be included in the table, so that the stock awards and option awards columns present the applicable full grant date fair values, and the total compensation column is correspondingly recomputed.<sup>81</sup> The stock awards and option awards columns amounts should be computed based on the individual award grant date fair values reported in

the applicable year’s Grants of Plan-Based Awards Table, except that awards with performance conditions should be recomputed to report grant date fair value based on the probable outcome as of the grant date, consistent with FASB ASC Topic 718. In addition, if a person who would be a named executive officer for the most recent fiscal year (2009) also was disclosed as a named executive officer for 2007, but not for 2008, the named executive officer’s compensation for each of those three fiscal years must be reported pursuant to the amendments.<sup>82</sup> However, companies are not required to include different named executive officers for any preceding fiscal year based on recomputing total compensation for those years pursuant to the amendments, or to amend prior years’ Item 402 disclosure in previously filed Forms 10-K or other filings.

#### e. Comment Responses Regarding Rulemaking Petition and Other Requests for Comment

We requested comment regarding a rulemaking petition recommending Summary Compensation Table disclosure of stock and option awards based on the annual change in value of awards.<sup>83</sup> We also requested comment on whether any potential amendments to the Grants of Plan-Based Awards Table or the Outstanding Equity Awards at Fiscal Year-End Table should be considered to better illustrate the relationship between pay and company performance. Most commenters did not support the petition’s recommendation because they believed it would not report the board’s compensation decisions, on which investors focus in making voting and investment decisions, and could result in disclosure of negative numbers.<sup>84</sup> However, several commenters recommended other tabular revisions to highlight how compensation may be related to the company’s performance.<sup>85</sup> Most of these suggestions were in anticipation that legislation establishing an annual “say-on-pay” shareholder advisory vote may be enacted.<sup>86</sup> Commenters most

<sup>74</sup> See letters from Buck Consultants, Compensia, Pearl Meyer, Protective Life Corporation, and United Brotherhood of Carpenters.

<sup>75</sup> Instruction 1 to Item 402(c)(2)(iii) and (iv) provides that if the amount of salary or bonus earned for the fiscal year cannot be calculated as of the most recent practicable date, footnote disclosure of this fact and the date the amount is expected to be determined is required. When determined, the omitted amount and a recalculated total compensation figure must be reported in a filing under Item 5.02(f) of Form 8-K [17 CFR 249.308].

<sup>76</sup> See letter from Compensia.

<sup>77</sup> Instruction 2 to Item 402(b).

<sup>78</sup> See, e.g., letters from Center on Executive Compensation and Pearl Meyer.

<sup>79</sup> Instruction 2 to Item 402(c)(2)(iii) and (iv).

<sup>80</sup> See letters from Center on Executive Compensation and Pearl Meyer.

<sup>81</sup> Commenters generally favored this approach as a means of ensuring year-to-year comparability, and said it would not be difficult to comply. See, e.g., letters from Glass Lewis, Mercer, and Pfizer.

<sup>82</sup> However, a smaller reporting company, which is required to provide disclosure only for the two most recent fiscal years, could provide Summary Compensation Table disclosure only for 2009 if the person was a named executive officer for 2009 but not for 2008.

<sup>83</sup> See May 26, 2009, rulemaking petition submitted by Ira T. Kay and Steven Seelig, Watson Wyatt Worldwide, File No. 4-585, at <http://www.sec.gov/rules/petitions/2009/petn4-585.pdf>.

<sup>84</sup> See, e.g., letters from Protective Life Corporation, RiskMetrics.

<sup>85</sup> See, e.g., letters from Center on Executive Compensation, Graef Crystal, Paul Hodgson, Don Meiers and Dan Gode.

<sup>86</sup> The United States House of Representatives has passed H.R. 3269, the Corporate and Financial

frequently recommended adding a column to the Outstanding Equity Awards at Fiscal Year-End Table to report the fiscal year end intrinsic value of outstanding options and stock appreciation rights ("SARs").<sup>87</sup>

In addition, we solicited comment on whether there are other initiatives we should consider proposing to improve executive compensation disclosure, such as including disclosure of each executive officer's compensation, not just the named executive officers; eliminating the instruction providing that performance targets can be excluded based on the potential adverse competitive effect on the company of their disclosure; making the CD&A part of the Compensation Committee Report, and requiring the report to be "filed;" additional disclosure regarding "hold to retirement" and/or claw back provisions; and internal pay ratios.<sup>88</sup> Commenters who addressed these topics expressed mixed views.<sup>89</sup>

Institution Compensation Fairness Act of 2009, which would provide shareholders an advisory vote to approve the compensation of executives in any proxy, consent, or authorization for an annual meeting.

<sup>87</sup> See, e.g., letters from Cleary Gottlieb, Compensia, Grant Thornton, Hewitt, Pearl Meyer, and Towers Perrin. We would not object if companies voluntarily add a column captioned "Value of unexercised in-the-money options/SARs at fiscal year end (\$)" to the Outstanding Awards at Fiscal Year-End Table to report these fiscal year end intrinsic values.

<sup>88</sup> See Proposing Release at Section II.H.

<sup>89</sup> Commenters who addressed these topics generally opposed expanding executive compensation disclosure beyond the named executive officers, stating that it would not add meaningful information. See, e.g., letters from BorgWarner, Business Roundtable, Hewitt, Pearl Meyer, SCSSCP and SIFMA. Some commenters opposed eliminating the ability to omit disclosure of performance targets based on competitive harm to the company, stating that disclosure would discourage use of performance targets or that adverse consequences to the company would outweigh the targets' informative value to investors. See, e.g., letters from BorgWarner, Business Roundtable, SCSSCP, and Pearl Meyer (supporting disclosure of the percentage of target awards actually earned). Other commenters supported requiring retrospective disclosure of performance targets for awards in completed periods. See letters from RiskMetrics, SEIU, State Board of Administration of Florida, and Towers Perrin (supporting the competitive harm exclusion for performance cycles in effect when the proxy statement is distributed). Some commenters supported making CD&A part of the Compensation Committee Report as a means to improve CD&A disclosure quality, often recommending that the combined document be "filed." See letters from AFL-CIO, Jesse M. Brill, United Brotherhood of Carpenters, Hodak Value Advisors, RiskMetrics, and SEIU. Others supported retaining the current disclosure roles and status of the CD&A and Compensation Committee Report, finding no compelling reasons to change them. See, e.g., letters from Ameriprise Financial, Pearl Meyer, and SIFMA. Some commenters favored requiring enhanced disclosure of hold-to-retirement and clawback policies to demonstrate whether compensation practices foster a long-term value

Our goal at this stage is to adopt discrete amendments to improve compensation disclosure in proxy statements, such as the changes to option reporting in the Summary Compensation Table and Director Compensation Table, that can be implemented for the 2010 proxy season. Therefore, we are not adopting any other changes to executive compensation disclosure at this time. However, we will consider the comments received in connection with future rulemaking initiatives on compensation disclosure.

#### *B. Enhanced Director and Nominee Disclosure*

We proposed to amend Item 401 of Regulation S-K to expand the disclosure requirements regarding the qualifications of directors and nominees, past directorships held by directors and nominees, and the time period for disclosure of legal proceedings involving directors, nominees and executive officers. We are adopting the changes generally as proposed, but have made revisions in response to comments.

#### 1. Proposed Amendments

Under the proposed amendments, a company would be required to disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that qualified that person to serve as a director of the company, and as a member of any committee that the person serves on or is chosen to serve on, in light of the company's business. In addition to the expanded narrative disclosure regarding director and nominee qualifications, the proposed amendments would require disclosure of any directorships held by each director and nominee at any time during the past five years at public companies and registered investment companies, and would lengthen the time during which disclosure of legal proceedings involving directors, director nominees and executive officers is required from five to ten years. As proposed, this expanded disclosure would apply to

approach. See letters from Jesse M. Brill, SEIU, and State Board of Administration of Florida. Others opposed adding specific requirements, often noting that if such policies are material to compensation decisions, principles-based CD&A currently subjects them to disclosure. See, e.g., letters from Buck Consultants, Business Roundtable, Pearl Meyer, and Towers Perrin. Commenters similarly divided about requiring disclosure of internal pay ratios. See letters from Jesse M. Brill, Pearl Meyer, SCSSCP and SIFMA. One commenter opposed all of the potential initiatives on which we solicited comment, stating that they "would generate extensive disclosures of questionable relevance." See letter from Pfizer.

incumbent directors, to nominees for director who are selected by a company's nominating committee, and to any nominees put forward by another proponent in its proxy materials.

We proposed that the disclosures under the Item 401 amendments would appear in proxy and information statements on Schedules 14A and 14C, annual reports on Form 10-K and registration statements on Form 10 under the Exchange Act, as well as in registration statements under the Securities Act.

We also proposed to apply the expanded disclosure requirements regarding director and nominee qualifications, past directorships held by directors and nominees, and the time frame for disclosure of legal proceedings involving directors, nominees, and executive officers to funds. Specifically, we proposed to amend Schedules 14A and 14C to apply these expanded requirements to fund proxy and information statements, where action is to be taken with respect to the election of directors, and to amend Forms N-1A, N-2, and N-3 to require that funds include the expanded disclosures regarding director qualifications and past directorships in their statements of additional information.<sup>90</sup>

#### 2. Comments on the Proposed Amendments

Comments on the proposal were mixed. Individual investors, trade unions, institutional investors and pension funds supported the proposals. Several of these commenters noted that the amendments would be a helpful step forward in providing investors and shareholders with additional information they need to make more informed investment and voting decisions relating to corporate governance and the election of directors.<sup>91</sup> Most companies, law firms and bar groups opposed the proposal. Many of the commenters opposed to the proposed amendments expressed concern about requiring companies to disclose the qualifications, attributes and skills of directors and nominees on a person-by-person basis.<sup>92</sup> Some of

<sup>90</sup> Form N-1A is used by open-end management investment companies. Form N-2 is used by closed-end management investment companies. Form N-3 is used by separate accounts, organized as management investment companies, which offer variable annuity contracts.

<sup>91</sup> See, e.g., letters from Board of Directors Network, Forum of Executive Women, Integrated Governance Solutions, Norges Bank Investment Management ("Norges Bank"), and Ralph Saul.

<sup>92</sup> See, e.g., letters from ABA, Ameriprise, Business Roundtable, BorgWarner, Davis Polk, Honeywell, JPMorgan, Southern Company ("Southern"), and Wisconsin Energy.

these commenters believed that requiring disclosure of the qualifications, attributes and skills of directors and nominees on a person-by-person basis would not elicit meaningful disclosure. They asserted that well-assembled boards usually consist of a diverse collection of individuals who bring a variety of complementary skills that nominating committees and boards generally consider in the broader context of the board's overall composition, with a view toward constituting a board that, as a body, possesses the appropriate skills and experience to oversee the company's business. Another concern expressed by commenters opposed to the proposed amendments was that the disclosure of specialized knowledge or background of particular directors could lead to heightened liability.<sup>93</sup>

Commenters also objected to the use of term "qualify" in the proposed amendment. They noted that the term "qualify" would only be relevant to the extent that a company's governing instruments create minimum qualifications for directors, such as a requirement to own a certain amount of shares in the company.<sup>94</sup> Other commenters believed that "risk assessment skills" should not be singled out for specific discussion, but rather should be considered as part of the discussion of the board's aggregate skills and attributes.<sup>95</sup> These commenters stated that a better alternative may be to address risk as separate disclosure topic to elicit more detailed disclosure about risk.

Several commenters believed that it would be inappropriate to require disclosure of the specific experience, qualifications or skills that qualify a person to serve as a member of a particular board committee.<sup>96</sup> According to these commenters, other than having at least one member of the board with "financial expertise" satisfying the requirements for the audit committee, companies generally do not select individuals to serve on the board based on what committee they will serve on. These commenters noted that in many instances, companies will rotate directors among several committee positions during their tenure on the board.<sup>97</sup>

On the question of how frequently the disclosure should be required, many commenters supported having the

disclosure provided on an annual basis for all continuing directors and new nominees.<sup>98</sup> These commenters noted that the overall composition of the board changes when new nominees are introduced and annual disclosure would facilitate shareholders' assessments of the quality of the board as a whole, which must be analyzed in relation to any changes in the company's strategy, relevant risks, operations and organization. However, several other commenters stated that if the requirements are adopted, they should only be required when a director is first nominated.<sup>99</sup>

A broad spectrum of commenters supported the proposed amendments to require disclosure of any directorships at public companies held by each director and nominee at any time during the past five years instead of only currently held directorships, and to lengthen the time during which disclosure of legal proceedings is required from five to ten years.<sup>100</sup> However, other commenters asserted that additional disclosure of past directorships would become voluminous and tend to obfuscate a nominee's most relevant credentials.<sup>101</sup>

We requested comment on whether we should retain Item 407(c)(2)(v) of Regulation S-K in light of the proposed amendments to Item 401 of Regulation S-K. This item, among other things, requires disclosure of any minimum qualifications that a nominating committee believes must be met by someone nominated by a committee for a position on the board. Several commenters believed we should retain the disclosure currently required by Item 407(c)(2)(v) because this information allows shareholders to gain an understanding of the overall quality of the board and the board's priorities, and would improve the ability of shareholders to compare a nominee's background to the standards set by the board itself and to further evaluate board and committee composition.<sup>102</sup>

We also requested comment on whether there were additional legal proceeding disclosures that reflect on a

director's, executive officer's, or nominee's character and fitness to serve as a public company official that should be required to be disclosed, and we listed several possible additions to the current list. Several commenters agreed that the disclosure about the additional legal proceedings noted was important information that reflected on an individual's competence and integrity and as such, should be disclosed.<sup>103</sup> Other commenters believed the current disclosure requirements were adequate.<sup>104</sup>

### 3. Final Rule

After considering the comments, we are adopting the amendments to Item 401, but with several revisions. We believe the amendments will provide investors with more meaningful disclosure that will help them in their voting decisions by better enabling them to determine whether and why a director or nominee is an appropriate choice for a particular company.

The final rules require companies to disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director for the company as of the time that a filing containing this disclosure is made with the Commission.<sup>105</sup> The same disclosure, with respect to any nominee for director put forward by another proponent, would be required in the proxy soliciting materials of that proponent. This new disclosure will be required for all nominees and for all directors, including those not up for reelection in a particular year. The final rule requires this disclosure to be made annually because the composition of the entire board is important information for voting decisions. Although we are adopting the amendments to Item 401, we are not eliminating the disclosure requirements in Item 407(c)(2)(v) of Regulation S-K regarding the specific minimum qualifications and specific qualities or skills used by the nominating committee. We agree with commenters that this requirement should be retained because it will allow investors to compare and evaluate the skills and qualifications of each director

<sup>93</sup> See, e.g., letters from ABA, Ameriprise and Business Roundtable.

<sup>94</sup> See letter from ABA.

<sup>95</sup> See, e.g., letters from Honeywell and Protective Life Corporation.

<sup>96</sup> See letters from SCSGP, S&C and Southern.

<sup>97</sup> See, e.g., letters from SCSGP and S&C.

<sup>98</sup> See, e.g., letters from IIA, Norges Bank, Pax World Management Corporation, and RiskMetrics.

<sup>99</sup> See letters from BorgWarner, Business Roundtable, Cleary Gottlieb, SCSGP and S&C.

<sup>100</sup> See, e.g., letters from AARP, AFL-CIO, CII, Evolution Petroleum, Pfizer, RILA, SCSGP, TIAA-CREF, United Brotherhood of Carpenters, and Universities Superannuation Scheme, et al. Cf. letters from AFSCME and Florida State Board of Administration (supporting the proposed amendment and also suggesting that the disclosure of legal proceedings involving fraud should not be subject to a time limit).

<sup>101</sup> See, e.g., letter from S&C.

<sup>102</sup> See, e.g., letters from ABA and CII.

<sup>103</sup> See, e.g., letters from AARP, Colorado Public Employees' Retirement Association ("COPERA"), and Interfaith Center on Corporate Responsibility.

<sup>104</sup> See, e.g., letters from American Electric Power and S&C.

<sup>105</sup> Consistent with the comments, we are revising the requirement to delete the term "qualify," and instead we are focusing on the reasons for the decision that the person should serve as a director.

and nominee against the standards established by the board.<sup>106</sup>

The final rules do not require disclosure of the specific experience, qualifications or skills that qualify a person to serve as a committee member. In making this change from the proposal, we were persuaded by commenters who noted that many companies rotate directors among different committee positions to allow directors to gain different perspectives of the company.<sup>107</sup> However, if an individual is chosen to be a director or a nominee to the board because of a particular qualification, attribute or experience related to service on a specific committee, such as the audit committee, then this should be disclosed under the new requirements as part of the individual's qualifications to serve on the board.

The final amendments do not specify the particular information that should be disclosed. We believe companies and other proponents should be afforded flexibility in determining the information about a director's or nominee's skills, qualifications or particular area of expertise that would benefit the company and should be disclosed to shareholders. Accordingly, we have deleted the reference to "risk assessment skills" that was included in the proposed amendments.<sup>108</sup> However, we note that if particular skills, such as risk assessment or financial reporting expertise, were part of the specific experience, qualifications, attributes or skills that led the board or proponent to conclude that the person should serve as a director, this should be disclosed.

We are adopting substantially as proposed the amendments to require disclosure of any directorships at public companies and registered investment companies held by each director and nominee at any time during the past five years. Item 401 presently requires disclosure of any current director positions held by each director and nominee in any company with a class of securities registered pursuant to Section 12 of the Exchange Act,<sup>109</sup> or subject to the requirements of Section 15(d) of that Act,<sup>110</sup> or any company registered as an investment company under the Investment Company Act. We believe that expanding this disclosure to include service on boards of those companies for the past five years (even if the director or nominee no longer

serves on that board) will allow investors to better evaluate the relevance of a director's or nominee's past board experience, as well as professional or financial relationships that might pose potential conflicts of interest (such as past membership on boards of major suppliers, customers, or competitors).

In addition to these amendments, we are adopting amendments as proposed to lengthen the time during which disclosure of legal proceedings involving directors, director nominees and executive officers is required from five to ten years. We believe it is appropriate to extend the required reporting period from five to ten years as a means of providing investors with more extensive information regarding an individual's competence and character. We were persuaded by commenters who believed that disclosures of legal proceedings during the ten-year period would provide investors with additional important information.<sup>111</sup> We are also adopting amendments to expand the list of legal proceedings involving directors, executive officers, and nominees covered under Item 401(f) of Regulation S-K. Some commenters agreed that certain legal proceedings can reflect on an individual's competence and integrity to serve as a director, and that the additional disclosure noted in the proposing release would provide investors with valuable information for assessing the competence, character and overall suitability of a director, nominee or executive officer.<sup>112</sup>

In addition, consistent with our request for comment and comments received,<sup>113</sup> we are amending Item 401(f) to require disclosure of additional legal proceedings. These new legal proceedings include:

- Any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity;
- Any judicial or administrative proceedings based on violations of Federal or State securities, commodities, banking or insurance laws and regulations, or any settlement<sup>114</sup> to such actions; and
- Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization.

<sup>111</sup> See, e.g., letters from ABA, AARP and COPERA.

<sup>112</sup> See, e.g., letters from AARP, CII, COPERA, SEIU, and USPX.

<sup>113</sup> See note 103 above and accompanying text.

<sup>114</sup> This does not include disclosure of a settlement of a civil proceeding among private parties. We are including an instruction as part of the amendments to clarify this.

We believe this amendment will provide investors with information that is important to an evaluation of an individual's competence and character to serve as a public company official.<sup>115</sup>

In the Proposing Release, we also requested comment on whether we should amend our rules to require disclosure of additional factors considered by a nominating committee when selecting someone for a board position, such as board diversity. A significant number of commenters responded that disclosure about board diversity was important information to investors.<sup>116</sup> Many of these commenters believed that requiring this disclosure would provide investors with information on corporate culture and governance practices that would enable investors to make more informed voting and investment decisions.<sup>117</sup> Commenters also noted that there appears to be a meaningful relationship between diverse boards and improved corporate financial performance, and that diverse boards can help companies more effectively recruit talent and retain staff.<sup>118</sup> We agree that it is useful for investors to understand how the board considers and addresses diversity, as well as the board's assessment of the implementation of its diversity policy, if any. Consequently, we are adopting amendments to Item 407(c) of Regulation S-K to require disclosure of whether, and if so how, a nominating committee considers diversity in identifying nominees for director.<sup>119</sup> In addition, if the nominating committee (or the board) has a policy with regard to the consideration of diversity in

<sup>115</sup> Consistent with the current disclosure requirement regarding legal proceedings, the additional legal proceedings included in the new requirements will not need to be disclosed if they are not material to an evaluation of the ability or integrity of the director or director nominee. See 17 CFR 229.401(f).

<sup>116</sup> See, e.g., letters from Board of Directors Network, Boston Common Asset Management, CalPERS, CalSTRS, Calvert, Council of Urban Professionals, Ernst & Young LLP ("E&Y"), Greenlining Institute, Hispanic Association on Corporate Responsibility, Interfaith Center on Corporate Responsibility, InterOrganization Network, Latino Business Chamber of Greater Los Angeles, Pax World Management Corporation, Prout Group, Inc., RiskMetrics, Sisters of Charity BVM, Sisters of St. Joseph Carondelet, and Trillium Asset Management Corporation.

<sup>117</sup> See, e.g., letters from the Boston Club, Boston Common Asset Management, CalPERS, Pax World Management Corporation, Trillium Asset Management Corporation, and Social Investment Forum.

<sup>118</sup> See, e.g., letters from Catalyst and the Social Investment Forum.

<sup>119</sup> See Item 407(c)(2)(vi) of Regulation S-K. Funds will be subject to the diversity disclosure requirement of Item 407(c)(2)(vi) of Regulation S-K under Item 22(b)(15)(ii)(A) of Schedule 14A. See 17 CFR 240.14a-101, Item 22(b)(15)(ii)(A).

<sup>106</sup> See, e.g., letter from CII.

<sup>107</sup> See, e.g., letters from Davis Polk and Pfizer.

<sup>108</sup> See, e.g., letters from Honeywell and Protective Life Corporation.

<sup>109</sup> 15 U.S.C. 87l.

<sup>110</sup> 15 U.S.C. 78o(d).

identifying director nominees, disclosure would be required of how this policy is implemented, as well as how the nominating committee (or the board) assesses the effectiveness of its policy. We recognize that companies may define diversity in various ways, reflecting different perspectives. For instance, some companies may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and attributes that contribute to board heterogeneity, while others may focus on diversity concepts such as race, gender and national origin. We believe that for purposes of this disclosure requirement, companies should be allowed to define diversity in ways that they consider appropriate. As a result we have not defined diversity in the amendments.

### *C. New Disclosure About Board Leadership Structure and the Board's Role in Risk Oversight*

We proposed a new disclosure requirement to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A to require disclosure of the company's leadership structure and why the company believes it is the most appropriate structure for it at the time of the filing. The proposal also required disclosure about the board's role in the company's risk management process. We are adopting the proposals with some changes.

#### 1. Proposed Amendments

Under the proposed amendments, companies would be required to disclose their leadership structure and the reasons why they believe that it is an appropriate structure for the company. As part of this proposed disclosure, companies would be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. For these companies, the proposed amendments would require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. In proposing this requirement, we noted that different leadership structures may be suitable for different companies depending on factors such as the size of a company, the nature of a company's business, or

internal control considerations, among other things. Irrespective of the type of leadership structure selected by a company, the proposed requirements were intended to provide investors with insights about why the company has chosen that particular leadership structure.

We also proposed to require additional disclosure in proxy and information statements about the board's role in the company's risk management process. Disclosure about the board's approach to risk oversight might address questions such as whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and whether and how the board, or board committee, monitors risk.

We also proposed that funds provide the new Item 407 disclosure about leadership structure and the board's role in the risk management process in proxy and information statements and similar disclosure as part of registration statements on Forms N-1A, N-2 and N-3. The proposed amendments were tailored to require that a fund disclose whether the board chair is an "interested person" of the fund, as defined in Section 2(a)(19) of the Investment Company Act. We proposed that if the board chair is an interested person, a fund would be required to disclose whether it has a lead independent director and what specific role the lead independent director plays in the leadership of the fund.

#### 2. Comments on the Proposed Amendments

Comments were mostly supportive of the proposals.<sup>120</sup> Commenters believed the disclosure regarding a company's leadership structure and the board's role in risk management process would provide useful information to investors and improve investor understanding of the role of the board in a company's risk management practices.<sup>121</sup> Some commenters opposed the disclosures. Many of these commenters believed that the proposed amendments were too vague and would likely elicit boilerplate descriptions of a company's management hierarchy and risk management that would not provide

<sup>120</sup> See, e.g., letters from AFL-CIO, Chairmen's Forum, Calvert, CII, CalSTRS, the General Board of Pension and Health Benefits of the United Methodist Church, Hermes, Norges Bank, Pfizer, RiskMetrics, and SEIU.

<sup>121</sup> See, e.g., letters from CII, the General Board of Pension and Health Benefits of the United Methodist Church, IGS, and RIMS.

significant insight or meaning to investors.<sup>122</sup>

Many commenters suggested revisions to the proposed disclosure requirements. For instance, several commenters recommended that we use the phrase "board leadership structure" rather than "company leadership structure" and noted that the discussion of the board leadership structure and the board's role in risk management are two separate disclosure items.<sup>123</sup> These commenters believed that the use of the phrase "company leadership structure" could be misinterpreted to require a discussion of a company's management leadership structures. Other commenters suggested that we replace the phrase "risk management" with "risk oversight" because the board's role is to oversee management, which is responsible for the day-to-day issues of risk management.<sup>124</sup>

Several commenters believed disclosure of the board's role in risk management would be more effective as part of a comprehensive discussion of a company's risk management processes, rather than as stand-alone disclosure.<sup>125</sup> They suggested that companies be allowed to provide the required disclosure in the MD&A discussion included in the Form 10-K, and to incorporate by reference this information in the proxy statement rather than repeat the information.

With respect to funds, commenters addressing the issue generally supported the proposal that funds disclose whether the board chair is an "interested person" as defined under the Investment Company Act.<sup>126</sup> In addition, commenters noted the importance of fund board oversight of risk management,<sup>127</sup> but commenters were split regarding whether we should require disclosure about fund board oversight of risk management.<sup>128</sup>

#### 3. Final Rule

After consideration of the comments, we are adopting the proposals substantially as proposed with a few technical revisions in response to comments. We believe that, in making voting and investment decisions,

<sup>122</sup> See, e.g., letters from Cleary Gottlieb, S&C and Theragenics.

<sup>123</sup> See, e.g., letters from Business Roundtable and Honeywell.

<sup>124</sup> See, e.g., letters from GovernanceMetrics and PLC.

<sup>125</sup> See, e.g., letters from ABA and JPMorgan.

<sup>126</sup> See, e.g., letters from Independent Directors Council ("IDC") and Mutual Fund Directors Forum ("MFDF").

<sup>127</sup> See, e.g., letters from IDC and MFDF.

<sup>128</sup> See letters from Calvert and MFDF (supporting disclosure). *But see* letters from the Investment Company Institute and IDC (opposing disclosure).

investors should be provided with meaningful information about the corporate governance practices of companies.<sup>129</sup> As we noted in the Proposing Release, one important aspect of a company's corporate governance practices is its board's leadership structure. Disclosure of a company's board leadership structure and the reasons the company believes that its board leadership structure is appropriate will increase the transparency for investors as to how the board functions.

As stated above, the amendments were designed to provide shareholders with disclosure of, and the reasons for, the leadership structure of a company's board concerning the principal executive officer, the board chairman position and, where applicable, the lead independent director position. We agree with commenters that the phrase "board leadership structure" instead of "company leadership structure" would avoid potential misunderstanding that the amendments require a discussion of the structure of a company's management leadership.<sup>130</sup> We also agree with commenters that the phrase "risk oversight" instead of "risk management" would be more appropriate in describing the board's responsibilities in this area.<sup>131</sup>

Under the amendments, a company is required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. In these circumstances, the amendments will require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not

intended to influence a company's decision regarding its board leadership structure.

The final rules also require companies to describe the board's role in the oversight of risk. We were persuaded by commenters who noted that risk oversight is a key competence of the board, and that additional disclosures would improve investor and shareholder understanding of the role of the board in the organization's risk management practices.<sup>132</sup> Companies face a variety of risks, including credit risk, liquidity risk, and operational risk. As we noted in the Proposing Release, similar to disclosure about the leadership structure of a board, disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company. This disclosure requirement gives companies the flexibility to describe how the board administers its risk oversight function, such as through the whole board, or through a separate risk committee or the audit committee, for example. Where relevant, companies may want to address whether the individuals who supervise the day-to-day risk management responsibilities report directly to the board as a whole or to a board committee or how the board or committee otherwise receives information from such individuals.

The final rules also require funds to provide disclosure about the board's role in risk oversight. Funds face a number of risks, including investment risk, compliance, and valuation; and we agree with commenters who favored disclosure of board risk oversight by funds.<sup>133</sup> As with corporate issuers, we believe that additional disclosures would improve investor understanding of the role of the board in the fund's risk management practices. Furthermore, the disclosure should provide important information to investors about how a fund perceives the role of its board and the relationship between the board and its advisor in managing material risks facing the fund.

#### *D. New Disclosure Regarding Compensation Consultants*

We proposed amendments to Item 407 of Regulation S-K to require, for the first time, disclosure about the fees paid to compensation consultants and their

affiliates when they played a role in determining or recommending the amount or form of executive and director compensation, and they also provided additional services to the company. The proposed amendments also would have required a description of the additional services provided to the company by the compensation consultants and any affiliates of the consultants. We are adopting the amendments with changes in response to comments.

#### *1. Proposed Amendments*

Under the proposed amendments to Item 407, if a compensation consultant or its affiliates played a role in determining or recommending the amount or form of executive and director compensation, and also provided additional services, then the company would be required to disclose the following:

- The nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant and any affiliates of the consultant;
- The aggregate fees paid for all additional services, and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation;
- Whether the decision to engage the compensation consultant or its affiliates for non-executive compensation services was made, recommended, subject to screening or reviewed by management; and
- Whether the board of directors or the compensation committee has approved the other services provided by the compensation consultant in addition to executive compensation services.

The proposed disclosure requirements would have applied to all services provided by a compensation consultant and its affiliates if the compensation consultant played any role in determining or recommending the amount or form of executive and director compensation. The proposed amendments did not distinguish between consultants engaged by the board and consultants engaged by management. We provided an exception from the proposed disclosure requirements for those situations in which the compensation consultant's role in recommending the amount or form of executive and director compensation was limited to consulting on broad-based plans that did not discriminate in favor of executive officers or directors of the company, such as 401(k) plans or health insurance

<sup>129</sup> See, e.g., National Association of Corporate Directors, *Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies*, (Mar. 2009) ("Every board should explain, in proxy materials and other communications with shareholders, why the governance structures and practices it has developed are best suited to the company.").

<sup>130</sup> See letter from Honeywell.

<sup>131</sup> See, e.g., letters from Ameriprise Financial and Protective Life Corporation.

<sup>132</sup> See, e.g., letters from Norges Bank and RIMS.

<sup>133</sup> See letters from Calvert and MFDF.

plans. We believed that when a compensation consultant's services were limited to consulting on broad-based, non-discriminatory plans, these services did not give rise to the type of potential conflict of interest intended to be addressed by our proposed amendments.<sup>134</sup>

## 2. Comments on the Proposed Amendments

A significant number of commenters generally supported the proposed amendments to Item 407 of Regulation S-K to require disclosure of the fees paid to compensation consultants as well as a description of other services provided by compensation consultants.<sup>135</sup> Many of these commenters believed investors would benefit from disclosure regarding the potential conflicts of interests of compensation consultants when they advise on the amount or form of executive and director compensation and also provide additional services to the company.<sup>136</sup> These commenters believed that disclosure of the fees paid to compensation consultants would go a long way towards minimizing potential conflicts of interests and would allow shareholders to assess the potential conflicts of interest in regard to the compensation advice given to companies.

However, several commenters, primarily multi-service compensation consulting firms, opposed the proposed amendments.<sup>137</sup> These commenters believed the proposed amendments were too narrowly focused on fees paid to multi-service consulting firms and ignored important considerations relating to the consultant's qualifications, selection, and role.<sup>138</sup> They also asserted that the proposed disclosure could give investors a

distorted view of how companies use and select compensation consultants. Because the role of consultants is not uniform and varies considerably from company to company, these commenters asserted that investors should be given an understanding not only of the role consultants serve for each company, but also of the board's or compensation committee's selection process. This would include how it assessed the consultant's qualifications and how any potential conflicts of interest that may have been identified are mitigated by formal processes, or by the internal controls and processes maintained by the consulting firm.<sup>139</sup>

Several commenters opposed to the proposed amendments asserted that the amendments would decrease the compensation consulting resources available to companies.<sup>140</sup> Other commenters asserted that the proposed amendments would cause competitive harm to multi-service consulting firms who provide services other than executive compensation consulting, as companies would be discouraged from using multi-service compensation consulting firms in more than one capacity.<sup>141</sup> These commenters also claimed that the proposed amendments would cause competitive harm because disclosure of the nature and extent of all additional services provided by the consultant would reveal confidential and competitively sensitive pricing information that could allow competitors to determine the fee structure for these additional services.<sup>142</sup>

These commenters also expressed concern that the proposed amendments did not address potential conflicts of interest that may occur when a compensation consultant that only provides executive-compensation related services to the board is overly reliant on the fees it receives from a particular client. They suggested an alternative rule that would require disclosure of fees paid to a compensation consultant when a significant portion of the annual revenues of the compensation consultant were generated from any one client.<sup>143</sup>

Several commenters expressed concern that the scope of the proposed amendments was too broad. These commenters believed that when a compensation committee engages its

own compensation consultant, it mitigates any concerns about potential conflicts of interest involving consultants engaged by management.<sup>144</sup> According to these commenters, from that perspective, a compensation consulting firm that provides executive compensation consulting services to the company, and also provides other services to the company, would not present a conflict of interest issue when the compensation committee retains a different consultant.<sup>145</sup> Noting that management should have broad access to compensation experts and other third parties when developing executive pay proposals for board consideration, and that it is the board's responsibility to evaluate management's compensation proposals when determining whether or not to approve them, some commenters expressed concerns about the potential effect of the proposed disclosure on the board's discharge of its oversight responsibility.<sup>146</sup>

In the Proposing Release, we requested comment on whether there were other consulting services that do not give rise to potential conflicts of interest that should be excluded from the proposed disclosure requirements similar to the proposed exemption for consulting services that are limited to broad-based, non-discriminatory plans. Several commenters responded by suggesting that we exclude consulting services where the compensation consultant only provides the board with peer surveys that provide general information regarding the forms and amounts of compensation typically paid to executive officers and directors within a particular industry.<sup>147</sup> Another commenter suggested that surveys that are either not customized for a particular company, or that are customized based on parameters that are not developed by the compensation consultant, should be excluded from the amendments.<sup>148</sup> These commenters believed that in situations where the compensation consultant's services provided to a company were limited to providing those types of surveys, such services did not raise the potential conflicts of interest that the proposed amendments were intended to address.<sup>149</sup>

We also requested comment on whether we should establish a disclosure threshold based on the

<sup>134</sup> We also proposed to amend Item 407 along the same lines to clarify that the current disclosure requirements under the item were not triggered for a compensation consultant whose only services with regard to executive or director compensation were limited to these types of broad-based, non-discriminatory plans. Many commenters supported this amendment and we are adopting it as proposed.

<sup>135</sup> See, e.g., letters from AFL-CIO, AFSCME, Business Roundtable, CalSTRS, CII, COPERA, Evolution Petroleum, Glass Lewis, Grahall, Hermes Equity Ownership Services, NACD, Oppenheimer Funds, Pax World Management Corporation, State of Connecticut Treasurer's Office, TIAA-CREF, Trillium Asset Management Corporation, and Walden Asset Management.

<sup>136</sup> See, e.g., letters from AFL-CIO, Frank Inman, Hermes Equity Ownership Services Ltd., TIAA-CREF, and Trillium Asset Management.

<sup>137</sup> See letters from ABA, Hewitt, Mercer, Pfizer, Protective Life Corporation, Radford, Towers Perrin, Value Alliance, and Watson Wyatt.

<sup>138</sup> See, e.g., letters from Hewitt, Mercer and Towers Perrin.

<sup>139</sup> See, e.g., letter from Hewitt.

<sup>140</sup> See, e.g., letters from Hewitt and Mercer.

<sup>141</sup> See, e.g., letters from Mercer, Towers Perrin and Watson Wyatt.

<sup>142</sup> See, e.g., letter from Mercer.

<sup>143</sup> See, e.g., letters from Hewitt, Mercer, Towers Perrin and Watson Wyatt.

<sup>144</sup> See, e.g., letters from E&Y and Deloitte.

<sup>145</sup> *Id.*

<sup>146</sup> See letters from Hewitt and E&Y.

<sup>147</sup> See, e.g., letters from BorgWarner, Davis Polk, Honeywell, JPMorgan and Wisconsin Energy.

<sup>148</sup> See letter from ABA.

<sup>149</sup> See, e.g., letters from BorgWarner, Davis Polk and Honeywell.

amount of the fees for the non-executive compensation related services, such as above a certain dollar amount or a percentage of income or revenues. Several commenters recommended that the proposed amendments should include a disclosure threshold, including many who suggested that we should require disclosure only if the aggregate fees for all additional services provided by the consultant and its affiliates exceeded \$120,000.<sup>150</sup>

### 3. Final Rule

After considering the comments received, we are adopting a modified version of the proposed amendments. We believe the new disclosure requirements will provide investors with information that will enable them to better assess the potential conflicts a compensation consultant may have in recommending executive compensation, and the compensation decisions made by the board. As we noted in the Proposing Release, many companies engage compensation consultants to make recommendations on appropriate executive and director compensation levels, to design and implement incentive plans, and to provide information on industry and peer group pay practices. The services offered by compensation consultants, however, are often not limited to recommending executive and director compensation plans or policies. Many compensation consultants, or their affiliates, are retained by management to provide a broad range of additional services, such as benefits administration, human resources consulting and actuarial services. The fees generated by these additional services may be more significant than the fees earned by the consultants for their executive and director compensation services. The extent of the fees and provision of additional services by a compensation consultant or its affiliate may create the risk of a conflict of interest that may call into question the objectivity of the consultant's advice and recommendations on executive compensation.

At the same time, we are persuaded that there are circumstances where this

<sup>150</sup> See, e.g., letters from ACC, Business Roundtable, Davis Polk, and SCSGP. Some commenters also suggested a disclosure threshold based on tests in effect under rules with a similar focus in self-regulatory organizations, such as the 2% (for New York Stock Exchange-listed companies) or 5% (for NASDAQ-listed companies) of gross revenues test for disclosure of business relationships between a company and a director-affiliated entity. See, e.g., letter from Cleary Gottlieb. See also, letter from ABA (suggesting a percentage threshold set at a level where the effect of such fees diminishes the possible appearance of a conflict of interest).

disclosure should not be required either because of the limited nature of the additional services or because of other factors that mitigate the concern that the board may be receiving advice potentially influenced by a conflict of interest.

#### a. Summary of the Final Rule

As more fully described below, under our final rule, in addition to the requirement under the current rule to describe the role of the compensation consultant in determining or recommending the amount or form of executive and director compensation, fee disclosure related to the retention of a compensation consultant will be required in certain circumstances. The final rules can be summarized generally as follows:

- If the board, compensation committee or other persons performing the equivalent functions (collectively, "board") has engaged its own consultant to provide advice or recommendations on the amount or form of executive and director compensation and the board's consultant or its affiliates provide other non-executive compensation consulting services to the company, fee and related disclosure is required, provided the fees for the non-executive compensation consulting services exceed \$120,000 during the company's fiscal year. Disclosure is also required of whether the decision to engage the compensation consultant or its affiliates for non-executive compensation consulting services was made or recommended by management, and whether the board has approved these non-executive compensation consulting services provided by the compensation consultant or its affiliate;

- If the board has not engaged its own consultant, fee disclosures are required if there is a consultant (including its affiliates) providing executive compensation consulting services and non-executive compensation consulting services to the company, provided the fees for the non-executive compensation consulting services exceed \$120,000 during the company's fiscal year;

- Fee and related disclosure for consultants that work with management (whether for only executive compensation consulting services, or for both executive compensation consulting and other non-executive compensation consulting services) is not required if the board has its own consultant; and

- Services involving only broad-based non-discriminatory plans or the provision of information, such as surveys, that are not customized for the company, or are customized based on parameters that are not developed by

the consultant, are not treated as executive compensation consulting services for purposes of the compensation consultant disclosure rules.

#### b. Disclosure Required if the Board's Compensation Consultant Provides Additional Services to the Company

If the board has engaged a compensation consultant to advise the board as to executive and director compensation, and such consultant or its affiliates provides other non-executive compensation consulting services to the company, the disclosures specified by the new rules are required. We believe that in that situation, the receipt of fees for non-executive compensation consulting services by the board's consultant presents the potential conflict of interest intended to be highlighted for investors by our new rules. Subject to the disclosure threshold discussed below, the final rule requires disclosure of the aggregate fees paid for services provided to either the board or the company with regard to determining or recommending the amount or form of executive and director compensation, and the aggregate fees paid for any non-executive compensation consulting services provided by the compensation consultant or its affiliates.

In addition, the new rules require disclosure of whether the decision to engage the compensation consultant or its affiliates for the non-executive compensation consulting services was made, or recommended by, management, and whether the board approved such other services.<sup>151</sup>

#### c. Disclosure Required if the Board Does Not Have a Compensation Consultant, but the Company Receives Executive Compensation and Non-Executive Compensation Services From Its Consultant

The new rule also requires disclosure of fees in situations where the board has not engaged a compensation consultant, but management or the company received executive compensation consulting services and other non-executive compensation consulting services from a consultant or its affiliates, and the fees from the non-executive compensation consulting services provided by that consultant or its affiliates exceed \$120,000 for the company's fiscal year.<sup>152</sup> We recognize that in that situation the board, which generally is primarily responsible for determining the compensation paid to

<sup>151</sup> Item 407(e)(3)(iii)(A) of Regulation S-K.

<sup>152</sup> Item 407(e)(3)(iii)(B).

senior executives, may not be relying on the consultant used by management, and, therefore, conflicts of interest may be less of a concern. However, we believe that when management has a compensation consultant and the board does not have its own compensation consultant to help filter any advice provided by management's compensation consultant, the concerns about board reliance on consultants that may have a conflict are sufficiently present to require this approach. Consequently, the final rule provides that in this fact pattern, fee disclosure is required if the fees from the non-executive compensation consulting services provided by the compensation consultant exceed the disclosure threshold described below.

**d. Disclosure Not Required if the Board and Management Have Different Compensation Consultants, Even if Management's Consultant Provides Additional Services to the Company**

In some instances, the board may engage a compensation consultant to advise it on executive or director compensation, and management may engage a separate consultant to provide executive compensation consulting services and one or more additional non-executive compensation consulting services. We believe there is less potential for a conflict of interest to arise when the board has retained its own compensation consultant, and the company or management has a different consultant to provide executive compensation consulting and other non-executive compensation consulting services.<sup>153</sup> When the board engages its own compensation consultant, it mitigates concerns about potential conflicts of interest involving compensation consultants engaged by management.<sup>154</sup> Accordingly, the final rules provide a limited exception to the disclosure requirements for fees paid to other compensation consultants retained by the company if the board has retained its own consultant that reports to the board. In addition to limiting disclosure to circumstances that are more likely to present potential conflicts of interests, we believe this approach should address some concerns about competitive harm that were raised by commenters. The exception would be available without regard to whether management's consultant participates in board meetings. Where the board's compensation consultant provides additional non-executive compensation consulting services to the company, the

rule would, as described above, require fee and other related disclosures, which should address concerns about conflicts of interest by that consultant. Fee disclosure for services provided by management's compensation consultant would be less relevant in this situation because the board is able to rely on its own compensation consultant's advice, rather than the advice provided by management's compensation consultant, when making its executive compensation decisions.

**e. Disclosure Required Only if Fees for Additional Services Exceed \$120,000 During the Company's Last Completed Fiscal Year**

As noted previously, we agree with commenters that the final rule should have a disclosure threshold.<sup>155</sup> We believe that when aggregate fees paid for the non-executive compensation consulting services are limited, the potential conflict of interest is likely to be commensurately reduced. A disclosure threshold would also reduce the compliance burdens on companies when the potential conflict of interest is minimal. Under the rule as adopted, if the board has engaged a compensation consultant to provide executive and director compensation consulting services to the board or if the board has not retained a consultant but there is a firm providing executive compensation consulting services, fee disclosure is required if the consultant or its affiliates also provides other non-executive compensation consulting services to the company, and the fees paid for the other services exceed \$120,000 for the company's fiscal year. We believe fees for other non-executive compensation consulting services below that threshold are less likely to raise potential conflicts of interest concerns, and note this disclosure threshold should reduce the recordkeeping burden on companies. This threshold is similar to the disclosure threshold for transactions with related persons in Item 404 of Regulation S-K, which also deals with potential conflicts of interest on the part of related persons who have financial transactions or arrangements with the company, and therefore provides some regulatory consistency.<sup>156</sup>

**f. Disclosure of Nature and Extent of Additional Services Not Required**

The rule, as adopted, does not require disclosure of the nature and extent of

additional services provided by the compensation consultant and its affiliates to the company, as we proposed. We made this change from the proposal because we are persuaded by commenters who noted that requiring this disclosure could cause competitive harm by revealing confidential and sensitive pricing information, and we believe that the critical information about the potential conflict is adequately conveyed through the fee disclosure requirement. Although we are not adopting this requirement, companies may at their discretion include a description of any additional non-executive compensation consulting services provided by the compensation consultant and its affiliates where such information would facilitate investor understanding of the existence or nature of any potential conflict of interest.

**g. Exceptions to the Disclosure Requirement for Consulting on Broad-Based Plans and Provision of Survey Information**

We are adopting substantially as proposed the exception from the disclosure requirements for situations in which the compensation consultant's only role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors of the company. In addition, in response to comments received, we are expanding the exception to include situations where the compensation consultant's services are limited to providing information, such as surveys, that either is not customized for a particular company, or that is customized based on parameters that are not developed by the compensation consultant.<sup>157</sup> We are persuaded by commenters who noted that surveys that provide general information regarding the form and amount of compensation typically paid to executive officers and directors within a particular industry generally do not raise the potential conflicts of interest that the amendments are intended to address.<sup>158</sup> However, the exception would not be available if the compensation consultant provides advice or recommendations in connection with the information provided in the survey.

<sup>155</sup> See, e.g., letters from ACC, Davis Polk and SCSSP. This threshold requirement should also help address some of the competitive concerns expressed by some commenters. See, e.g., note 150 above and accompanying text.

<sup>156</sup> See 17 CFR 229.404.

<sup>157</sup> See, e.g., letters from ABA, Mercer and Towers Perrin.

<sup>158</sup> See letters from Davis Polk and Mercer.

<sup>153</sup> See, e.g., letters from Hewitt and E&Y.

<sup>154</sup> See letter from E&Y.

#### h. Other Concerns

We did not propose, and do not at this time adopt, disclosure of consulting fees based on a percentage of revenues received from a company. We have considered the concern expressed by some commenters that compensation consultants, even if they are only retained by the board for executive compensation related services and do not provide any additional services to the company, may become overly reliant on a single client for revenues, which could affect the advice the consultant provides to the board.<sup>159</sup> However, we are not currently persuaded that such reliance would cause a consultant to provide advice to the board that inappropriately reflects *management's* influence as a result of fees for additional services, which is the primary concern addressed by the final rule.

We also considered the suggestion provided by these commenters that companies be required to disclose various matters about the consideration of potential conflicts of interest.<sup>160</sup> We are not persuaded that we need to address this issue at this time and believe our final rule addresses our concerns without adding significant length to the disclosure or burdens on companies.

Our amendments as adopted are intended to facilitate investors' consideration of whether, in providing advice, a compensation consultant may have been influenced by a desire to retain other engagements from the company. This does not reflect a conclusion that we believe that a conflict of interest is present when disclosure is required under our new rule, or that a compensation committee or a company could not reasonably conclude that it is appropriate to engage a consultant that provides other services to the company requiring disclosure under our new rule. It also does not mean that we have concluded that there are no other circumstances that might present a conflict of interest for a

<sup>159</sup> See letters from Hewitt, Mercer, Pearl Meyer, and Towers Perrin.

<sup>160</sup> In their comment letters, several multi-service compensation consulting firms proposed an alternative disclosure requirement. Under their proposal, if the total fees paid to the consultant for all services provided to the company and its affiliates during the preceding fiscal year exceeded one-half of one percent of the total revenues of the consultant for that fiscal year, the company would be required to disclose, among other things, the protocols established by the compensation committee to ensure that the consultant is able to provide unbiased advice and is not inappropriately influenced by the company's management. See letters from Hewitt, Mercer, Watson Wyatt, and Towers Perrin.

compensation consultant retained by a compensation committee or company. Rather, the amendments are designed to provide context to investors in considering the compensation disclosures required to be provided under our rules, and, as explained above, are based on our understanding of the situations that are more likely to raise potential conflicts of interest concerns.

#### E. Reporting of Voting Results on Form 8-K

We proposed to transfer the requirement to disclose shareholder vote results from Forms 10-Q and 10-K to Form 8-K, and to have that information filed within four business days after the end of the meeting at which the vote was held. We are adopting the proposal with some modifications in response to comments.

##### 1. Proposed Amendments

Currently, Item 4 in Part II of Form 10-Q and Item 4 in Form 10-K require the disclosure of the results of any matter that was submitted to a vote of shareholders during the fiscal quarter covered by either the Form 10-Q or Form 10-K with respect to the fourth fiscal quarter. The proposed amendments would delete this requirement from Forms 10-Q and 10-K and move it to Form 8-K. As a result, voting results would be required to be filed on Form 8-K within four business days after the end of the meeting at which the vote was held. To accommodate timing difficulties in contested elections, we proposed a new instruction to the form that stated that if the matter voted upon at the shareholders' meeting related to a contested election of directors and the voting results were not definitively determined at the end of the meeting, companies would be required to file the preliminary voting results within four business days after the preliminary voting results were determined, and then file an amended report on Form 8-K within four business days after the final voting results were certified.

##### 2. Comments on the Proposed Amendments

The majority of comments we received on the proposed amendments supported requiring the filing of voting results on Form 8-K. Many commenters believed that more timely disclosure of the voting result would benefit shareholders and investors.<sup>161</sup> Some

<sup>161</sup> See, e.g., letters from CalSTRS, CII, Hermes, IIA, Norges Bank, United Brotherhood of Carpenters and Walden.

noted that matters submitted for shareholder vote involve issues that directly impact shareholder interests—for example investment or divestments, changes in shareholder rights and capital changes—and that timely disclosure of voting results can be crucial.<sup>162</sup> One commenter believed that majority vote requirements for director elections have introduced greater accountability and uncertainty into uncontested director elections, making it increasingly important that these election outcomes be reported in a timely manner to shareholders.<sup>163</sup>

Several commenters recommended modifications to the proposed amendments. Specifically, some commenters expressed concern that preliminary voting results should not be required to be disclosed because disclosure of preliminary results could mislead investors if the definitive results reflect a different outcome than what was disclosed initially.<sup>164</sup> Concerns were also expressed that the reporting of preliminary voting results could inadvertently influence voting if the disclosure is made at a time when the opportunity remains open for additional votes to be cast.<sup>165</sup> Commenters also believed that the four business day reporting requirement should not be tied to the end of the shareholders' meeting, but rather to the issuance of a certified report of an inspector of election.<sup>166</sup> In addition, commenters suggested that the proposed instruction excepting the filing of voting results in contested elections of directors within four business days after the end of the shareholders' meeting should be expanded to cover any matter for which final voting results are not available or "too close to call" within four business days following the end of the shareholders' meeting.<sup>167</sup>

A few commenters opposed the proposed amendments.<sup>168</sup> Commenters opposed to amendments expressed concern that it would be very difficult to meet the four business day filing requirement. One of these commenters noted that problems that stem from share lending and other practices can

<sup>162</sup> See, e.g., letters from CalSTRS and Norges Bank.

<sup>163</sup> See letter from United Brotherhood of Carpenters.

<sup>164</sup> See e.g., letter from Chadbourne.

<sup>165</sup> See letter from ABA.

<sup>166</sup> See letter from Allen Goolsby, et al.

<sup>167</sup> See, e.g., letters from BorgWarner, Business Roundtable, SCSC, S&C and Southern.

<sup>168</sup> See, e.g., letters from Keith Bishop, NACD, RILA and SCC.

significantly delay the time that votes can be tabulated.<sup>169</sup>

Several commenters believed that the disclosure of the results of shareholder votes should be added to the list of items on Form 8-K that are currently excluded from liability under Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5, and that do not result in a loss of Form S-3 eligibility under General Instruction I.A.3(b).<sup>170</sup> One commenter, however, believed that an amendment to General Instruction I.A.3(b) of Form S-3 to add an exception to the Form S-3 eligibility requirements for the reporting of voting results would not be necessary if we allowed preliminary voting results for contested elections and on proposals that are “too close to call” to be reported within four business days of the meeting and final voting results within four business days after the voting results become final.<sup>171</sup>

### 3. Final Rule

After evaluating the comments received, we are adopting the proposed amendments to Form 8-K, and are eliminating the requirement to disclose shareholder voting results on Forms 10-Q and 10-K. Accordingly, new Item 5.07 to Form 8-K requires companies to disclose on the form the results of a shareholder vote and to have that information filed within four business days after the end of the meeting at which the vote was held. Tying the filing requirement to the end of the meeting will provide shareholders, investors and other users of this information with a readily identifiable and certain date upon which a company would be required to disclose information on the results of the vote. We believe more timely disclosure of the voting results from an annual or special meeting would benefit investors and the markets. Under our prior disclosure requirements, it could be a few months before voting results are disclosed in a Form 10-Q or 10-K. Often, matters submitted for a shareholder vote at an annual or special meeting involve issues that directly impact shareholder interests, such as the election of directors, changes in shareholder rights, investments or divestments, and capital changes. The delay between the end of an annual or special meeting of shareholders and when the voting results of the meeting are disclosed in a Form 10-Q or 10-K can make the information less useful to investors and the markets. We also

understand that technological advances in shareholder communications and the growing use of third-party proxy services have increased the ability of companies to tabulate vote results and disseminate this information on a more expedited basis.

We agree with the suggestions of commenters that there may be situations other than contested elections where it may take a longer period of time to determine definitive voting results.<sup>172</sup> As a result, we are expanding the instruction to Form 8-K as adopted to state that companies are required to file the preliminary voting results within four business days after the end of the shareholders’ meeting, and then file an amended report on Form 8-K within four business days after the final voting results are known.<sup>173</sup> However, if a company obtains the definitive voting results before the preliminary voting results must be reported and decides to report its definitive results on Form 8-K, it will not be required to file the preliminary voting results. For example, if a company obtains the definitive voting results two days after the end of the shareholders’ meeting, it could report its definitive voting results on Form 8-K within four business days after the meeting and would not be required to file its preliminary voting results. To the extent that companies are concerned that the disclosure of preliminary voting results could be confusing to investors, they may include additional disclosure that helps to put the preliminary voting disclosure in a proper context.

In the Proposing Release, we requested comment on whether we should consider additional revisions to the requirement to report voting results, such as eliminating a portion of prior Instruction 4 to the disclosure item. One commenter responded by suggesting that we could consolidate and simplify some of the disclosure requirements and instructions to the item.<sup>174</sup> We agree with the suggestions that were submitted, and believe that certain requirements and instructions to the Item can be simplified, without changing the substance of what is required to be reported. Accordingly, we

are adopting the following revisions to new Item 5.07:

- Adding to paragraph (a) of the item a statement that the information required by the item need be provided only when a meeting of shareholders is involved;<sup>175</sup>
- Combining paragraphs (b) and (c) to the item into a single paragraph that requires disclosure of the quantitative results of each matter voted on at the meeting, and a brief description of each matter; and
- Eliminating Instruction 3, Instruction 5 and Instruction 7 to the item, as well as deleting the first sentence of Instruction 4.

## III. Paperwork Reduction Act

### A. Background

Certain provisions of the final amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>176</sup> We published a notice requesting comment on the collection of information requirements in the proposing release for the rule amendments, and we submitted these requirements to the Office of Management and Budget (“OMB”) for review in accordance with the PRA.<sup>177</sup> The titles for the collection of information are:

- (1) “Regulation 14A and Schedule 14A” (OMB Control No. 3235-0059);
- (2) “Regulation 14C and Schedule 14C” (OMB Control No. 3235-0057);
- (3) “Form 10-K” (OMB Control No. 3235-0063);
- (4) “Form 10-Q” (OMB Control No. 3235-0070);
- (5) “Form 10” (OMB Control No. 3235-0064);
- (6) “Form S-1” (OMB Control No. 3235-0065);
- (7) “Form S-4” (OMB Control No. 3235-0324);
- (8) “Form S-11” (OMB Control No. 3235-0067);
- (9) “Form 8-K” (OMB Control No. 3235-0060);
- (10) “Rule 20a-1 under the Investment Company Act of 1940, Solicitations of Proxies, Consents, and Authorizations” (OMB Control No. 3235-0158);
- (11) “Form N-1A” (OMB Control No. 3235-0307);
- (12) “Form N-2” (OMB Control No. 3235-0026);

<sup>172</sup> See, e.g., letters from Business Roundtable, S&C and Southern.

<sup>173</sup> See Instruction 1 to Item 5.07 of Form 8-K. We note that our amendments to Form 8-K are not intended to preclude a company from announcing preliminary voting results during the meeting of shareholders at which the vote was taken and before filing the Form 8-K, without regard to whether the company webcast the meeting.

<sup>174</sup> See letter of ABA.

<sup>175</sup> But see current Instruction 1 to Item 4 of Form 10-Q with respect to matters that have been submitted to a vote otherwise than at a meeting of shareholders, which we are not amending and which will be retained as Instruction 2 to new Item 5.07 of Form 8-K.

<sup>176</sup> 44 U.S.C. 3501 et seq.

<sup>177</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>169</sup> See letter from NACD.

<sup>170</sup> See letters from ABA, Business Roundtable, Honeywell and S&C.

<sup>171</sup> See letter from SCSGP.

(13) “Form N-3” (OMB Control No. 3235-0316); and

(14) “Regulation S-K” (OMB Control No. 3235-0071).

The regulations, schedules and forms were adopted under the Securities Act and the Exchange Act, except for Forms N-1A, N-2, and N-3, which we adopted pursuant to the Securities Act and the Investment Company Act, and Rule 20a-1, which we adopted pursuant to the Investment Company Act. The regulations, forms and schedules set forth the disclosure requirements for periodic reports, registration statements, and proxy and information statements filed by companies to help investors make informed investment and voting decisions. The hours and costs associated with preparing, filing and sending the form or schedule constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. Compliance with the amendments is mandatory. Responses to the information collections will not be kept confidential and there is no mandatory retention period for the information disclosed.

#### *B. Summary of the Final Rules*

As discussed in more detail above, the amendments that we are adopting will require:

- To the extent that risks arising from a company’s compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company, discussion of the company’s compensation policies or practices as they relate to risk management and risk-taking incentives that can affect the company’s risk and management of that risk;

- Reporting of the aggregate grant date fair value of stock awards and option awards granted in the fiscal year in the Summary Compensation Table and Director Compensation Table, computed in accordance with FASB ASC Topic 718, rather than the dollar amount recognized for financial statement purposes for the fiscal year, with a special instruction for awards subject to performance conditions;

- New disclosure of the qualifications of directors and nominees for director, and the reasons why that person should serve as a director of the company at the time at which the relevant filing is made with the Commission;

- Additional disclosure of any directorships held by each director and nominee at any time during the past five years at any public company or

registered management investment company;

- Additional disclosure of other legal actions involving a company’s executive officers, directors, and nominees for director, and lengthening the time during which such disclosure is required from five to ten years;

- New disclosure regarding the consideration of diversity in the process by which candidates for director are considered for nomination by a company’s nominating committee;

- New disclosure about a company’s board leadership structure and the board’s role in the oversight of risk;

- New disclosure about the fees paid to compensation consultants and their affiliates under certain circumstances; and

- Disclosure of the vote results from a meeting of shareholders on Form 8-K generally within four business days of the meeting.

The disclosure enhancements we are adopting will significantly improve the information companies provide to investors with regard to risk, governance and director qualifications and compensation. We believe that providing a more transparent view of these matters will help investors make more informed voting and investment decisions.

#### *C. Summary of Comment Letters and Revisions to Proposals*

In the Proposing Release, we requested comment on the PRA analysis. We received a response from one commenter that addressed our overall burden estimates for the proposed amendments. This commenter asserted that our PRA estimates underestimated the time and costs that companies would need to expend in complying with the proposed amendments.<sup>178</sup> This commenter asserted that companies would need to expend many additional hours to update their director and officer questionnaires to obtain more detailed information; director nominees would need to spend additional time responding to these questionnaires and providing companies with information about their backgrounds and qualifications; and companies would need to spend time analyzing the responses, deciding what information to disclose, and preparing the disclosures. This commenter, however, did not provide alternative cost estimates or cost estimates that could be applied generally to all companies. In response to comments and modifications to the amendments as proposed, we have

revised our estimates as discussed more fully in Section D.

We have made several substantive modifications to the proposed amendments. First, new Item 402(s) of Regulation S-K requires a company to discuss its compensation policies and practices for employees if such policies and practices are reasonably likely to have a material adverse effect on the company. This change from the “may have a material effect” disclosure standard that was proposed should substantially mitigate some of the costs and burdens associated with the proposed amendments. By focusing on risks that are “reasonably likely to have a material adverse effect” on the company, the amendments are designed to elicit disclosure on the company’s compensation policies and practices that would be most relevant to investors. Second, we have adopted amendments to expand the list of legal proceedings involving directors, executive officers, and nominees covered under Item 401(f) of Regulation S-K. Third, disclosure will be required of whether (and if so, how) the nominating committee considers diversity in identifying nominees for director. Fourth, we have adopted a disclosure threshold under the compensation consultant disclosure amendments that excludes fee and related disclosure where the fees for non-executive compensation consulting services do not exceed \$120,000 for a company’s fiscal year. In addition, disclosure of fees for consultants engaged by management would not be required if the compensation committee or board has its own compensation consultant.

#### *D. Revisions to PRA Reporting and Cost Burden Estimates*

For purposes of the PRA, in the Proposing Release we estimated that the total annual increase in the paperwork burden for all companies (other than registered management investment companies) to prepare the disclosure that would be required under the proposed amendments would be approximately 247,773 hours of company personnel time and a cost of approximately \$47,413,161 for the services of outside professionals. We further estimated the total annual increase in paperwork burden for registered management investment companies under the proposed amendments to be approximately 14,041 hours of company personnel time and a cost of approximately \$7,048,900 for the services of outside professionals. As discussed above, we are revising the PRA burden and cost estimates that we

<sup>178</sup> See letter from Business Roundtable.

originally submitted to the OMB in connection with the proposed amendments.

We derived our new burden hour and cost estimates by estimating the total amount of time it would take a company to prepare and review the disclosure requirements contained in the final rules. This estimate represents the average burden for all companies, both large and small. Our estimates have been adjusted to reflect the fact that some of the amendments would be required in some but not all of the documents listed above in Section A, and would not apply to all companies. In deriving our estimates, we recognize that the burdens will likely vary among individual companies based on a number of factors, including the size and complexity of their organizations, and the nature of their operations. We believe that some companies will experience costs in excess of this average in the first year of compliance with the amendments and some companies may experience less than the average costs. We estimate the annual incremental paperwork burden for all companies (other than registered management investment companies) to be approximately 223,426 hours of company personnel time and a cost of approximately \$49,964,730 for the services of outside professionals. For registered management investment companies, we estimate the annual paperwork burden to be approximately 19,334 hours of company personnel time and a cost of approximately \$9,480,200 for the services of outside professionals. These estimates include the time and the cost of preparing and reviewing disclosure, filing documents and retaining records.

With respect to reporting companies (other than registered management investment companies), the new rules and amendments will increase the existing disclosure burdens associated with proxy and information statements, Forms 10, 10-K, 8-K, S-1, S-4 and S-11. However, the disclosure requirements under new Item 402(s) of Regulation S-K are not applicable to smaller reporting companies.<sup>179</sup> With respect to registered management investment companies, the revisions will be reflected in certain Regulation S-K items, Schedule 14A, and Forms N-1A, N-2 and N-3.

In the Proposing Release, we assumed that the burden hours of the amendments would be comparable to

the burden hours related to similar disclosure requirements under existing reporting requirements, such as the disclosure of audit fees and non-audit services,<sup>180</sup> CD&A and executive compensation reporting,<sup>181</sup> and the disclosure of the activities of nominating committees.<sup>182</sup> We have made several adjustments to these estimates to reflect the revisions we made to the amendments and the responses of commenters. We increased the burden estimate for the enhanced director and nominee disclosure by four hours to reflect the additional disclosures that will be required, such as the new legal proceedings and diversity policy, and to address concerns that our initial estimate may have been understated. At the same time, we have decreased the burden estimate related to new Item 402(s) of Regulation S-K from sixteen to eight hours, as well as the burden estimate related to the new compensation consultant disclosure from four to three hours to reflect the revisions to the proposed amendments. However, we made no change in our assumption that substantially all of the burdens associated with the amendments to Items 401 and 402 of Regulation S-K would be associated with Schedules 14A and 14C, as these would be the primary disclosure documents where the new disclosures would be prepared and presented.<sup>183</sup>

We made no change in our estimate that there would be no annual incremental increase in the paperwork burden for companies to comply with the amendments to the Summary Compensation Table, Director Compensation Table, and Grants of Plan-Based Awards Table. We believe that the amendments to the Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table will simplify executive compensation disclosure because companies no longer will need to report two separate measures of equity compensation in their

compensation disclosure. For purposes of Item 402 disclosure, companies no longer will need to explain or analyze a second, separate measure of equity compensation that is based on financial statement recognition rather than compensation decisions. In addition, we believe it is likely that these amendments will make companies' identification of named executive officers more consistent from year-to-year, providing investors more meaningful disclosure and reducing executive compensation tracking burdens in determining which executive officers are the most highly compensated.

We have added a special instruction for equity awards subject to performance conditions calling for tabular disclosure of the value computed based upon the probable outcome of the performance conditions as of the grant date. Because this value is already required to be computed under the accounting literature,<sup>184</sup> it will not impose an incremental increase in paperwork burden. This instruction also requires footnote disclosure of the maximum value assuming the highest level of performance conditions is probable. We believe that any incremental burden associated with providing this footnote disclosure would be minimal.

For each reporting company (other than registered management investment companies), we estimate that the amendments would impose on average the following incremental burden hours:

- Eight hours related to the amendments to discuss compensation policies and practices as they relate to risk management;
- Eight hours for the enhanced director and nominee disclosure;
- Six hours for the disclosures about board leadership structure and the board's role in risk oversight;
- Three hours for the disclosures regarding compensation consultants; and
- One hour for the reporting of voting results on Form 8-K rather than on Forms 10-Q and 10-K.

With respect to registered management investment companies, the amendments to Forms N-1A, N-2, and N-3 will increase existing disclosure burdens for such forms by requiring:

- New disclosure of the qualifications of directors and nominees for director, and the reasons why that person should serve as a director of the company at the time at which the relevant filing is made with the Commission;

<sup>179</sup> Based on the number of proxy filings we received in the 2008 fiscal year, we estimate that approximately 3,922 domestic companies are smaller reporting companies that have a public float of less than \$75 million.

<sup>180</sup> Release No. 33-8183 (Jan. 28, 2003) [68 FR 6006] (which we estimated to be two hours).

<sup>181</sup> Release No. 33-8732A (Aug. 29, 2006) [71 FR 53518] (which we estimated to be 95 hours).

<sup>182</sup> Release No. 33-8340 (Nov. 24, 2003) [68 FR 69204] (which we estimated to be three hours).

<sup>183</sup> The burden estimates for Form 10-K assume that the amendments to Items 401 and 402 of Regulation S-K would be satisfied by either including the information directly in an annual report or incorporating the information by reference from the proxy statement or information statement on Schedule 14A or Schedule 14C. Our PRA estimates include an estimated 1 hour burden in the Form 10-K and schedules to account for the incorporation of the information that would be required under proposed amendments to Items 401 and 402 of Regulation S-K.

<sup>184</sup> FASB ASC Topic 718.

- Additional disclosure of any directorships held by each director and nominee at any time during the past five years at public companies or registered management investment companies; and

- New disclosure about a fund's board leadership structure and the board's role in the oversight of risk.

We estimate that the amendments would impose on average the following incremental burden hours with respect to registered management investment companies:

- Eight hours for the enhanced director and nominee disclosure in proxy statements and six hours for such disclosure in registration statements;<sup>185</sup> and

- Six hours for the disclosures about company leadership structure and the board's role in risk management.

### 1. Proxy and Information Statements

For purposes of the PRA, in the case of reporting companies (other than registered management investment companies) we estimate the annual incremental paperwork burden for proxy and information statements under the amendments would be approximately seventeen hours per form for companies that are smaller reporting companies, and twenty-five hours per form for companies that are either accelerated or large accelerated filers. In the case of registered management investment companies, we estimate the annual incremental paperwork burden for proxy and information statements under the amendments would be approximately fourteen hours per form.

These estimates include the time and the cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel, and members of the board of directors.

### 2. Exchange Act Periodic Reports

For purposes of the PRA, we estimate the annual incremental paperwork burden for Form 10-K under the amendments would be approximately one hour per form. This estimate includes the time and the cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel, and members of the board of directors.

### 3. Securities Act Registration Statements and Exchange Act Registration Statements

For purposes of the PRA, in the case of reporting companies (other than registered management investment companies) we estimate the annual incremental paperwork burden for Securities Act registration statements under the amendments would be approximately sixteen hours per form.<sup>186</sup> For registered management investment companies, we estimate that the annual incremental paperwork burden under the amendments to Forms N-1A, N-2, and N-3 would be approximately twelve hours per form. These estimates include the time and the cost of preparing disclosure that has been appropriately reviewed by management, in-house counsel, outside counsel, and members of the board of directors.

The tables below illustrate the total annual compliance burden of the collection of information in hours and in cost under the amendments for annual reports; quarterly reports; current reports; proxy and information statements; Form 10; Forms S-1, S-4, S-11, N-1A, N-2, and N-3; and Regulation S-K.<sup>187</sup> The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take a company to prepare and review the disclosure requirements. For the Exchange Act reports on Forms 10-K, 10-Q, and 8-K, and the proxy and information statements we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of \$400 per hour. For the registration statements on Forms 10, S-1, S-4, S-11, N-1A, N-2, and N-3, we estimate that 25% of the burden of preparation is carried by the company internally and that 75% of the burden of preparation is carried by outside professionals retained by the company at an average cost of \$400 per hour. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours. There is no change to the estimated burden of the collections of information under Regulation S-K because the burdens that this regulation imposes are reflected in our revised estimates for the forms.

**TABLE 1—INCREMENTAL PAPERWORK BURDEN UNDER THE AMENDMENTS FOR ANNUAL REPORTS; QUARTERLY REPORTS; PROXY AND INFORMATION STATEMENTS**

	Number of responses <sup>188</sup> (A)	Incremental burden hours/ form (B)	Total Incremental burden hours (C)=(A)*(B)	75% Company (D)=(C)*0.75	25% professional (E)=(C)*0.25	Professional costs (F)=(E)*\$400
10-K .....	13,545	1	13,545	10,159	3,386	\$1,354,500
10-Q <sup>189</sup> .....	32,462	(1)	(7,300)	(5,475)	(1,825)	(730,000)
8-K <sup>190</sup> .....	117,255	1	117,255	87,941	29,314	11,725,500
Sch. 14A <sup>191</sup> .....	7,300	.....	.....	.....	.....	.....
Accel. Filers .....	3,378	25	84,450	63,338	21,113	8,445,000
SRC Filers .....	3,922	17	66,674	50,006	16,669	6,667,400
Sch. 14C .....	680	.....	.....	.....	.....	.....
Accel. Filers .....	315	25	7,867	5,900	1,967	786,658
SRC Filers .....	365	17	6,211	4,658	1,553	621,073
Rule 20a-1 .....	1,225	14	17,150	12,863	4,288	1,715,000
Reg. S-K .....	N/A	N/A	N/A	N/A	N/A	N/A
<b>Total .....</b>	.....	.....	<b>305,851</b>	.....	.....	<b>30,585,130</b>

<sup>185</sup> We estimate that the disclosure burden for registration statements on Forms N-1A, N-2, and N-3 is less than for proxy statements because the disclosures relating to involvement in legal

proceedings for the past ten years applies only to proxy statements and not to registration statements.

<sup>186</sup> We calculated the sixteen hours by adding eight hours for the requirements under Item 402(s)

of Regulation S-K to eight hours for the enhanced director and nominee disclosure.

<sup>187</sup> Figures in both tables have been rounded to the nearest whole number.

TABLE 2—INCREMENTAL PAPERWORK BURDEN UNDER THE AMENDMENTS FOR REGISTRATION STATEMENTS

	Number of responses <sup>192</sup> (A)	Incremental burden hours/ form (B)	Total incremental burden hours (C)=(A)*(B)	25% company (D)=(C)*0.25	75% professional (E)=(C)*0.75	Professional costs (F)=(E)*\$400
Form 10 .....	238	16	3,809	952	2,856	\$1,142,500
Form S-1 .....	768	16	12,288	3,072	9,216	11,579,500
Form S-4 .....	619	16	9,904	2,476	7,428	3,686,400
Form S-11 .....	100	16	1,600	400	1,200	2,971,200
Form N-1A .....	1,935	12	23,220	5,805	17,415	6,966,000
Form N-2 .....	205	12	2,460	615	1,845	738,000
Form N-3 .....	17	12	204	51	153	61,200
Reg. S-K .....	N/A	N/A	N/A	N/A	N/A	N/A
<b>Total .....</b>			<b>53,485</b>			<b>27,144,800</b>

**IV. Cost-Benefit Analysis**

*A. Introduction*

We are adopting amendments to enhance the disclosures with respect to a company’s overall compensation policy and its impact on risk taking, director and nominee qualifications and legal proceedings, board leadership structure and the board’s role in risk oversight, and the interests of compensation consultants. In addition, we are adopting amendments to transfer the requirement to disclose voting results from Forms 10–Q and 10–K to Form 8–K.

We also are adopting amendments to the disclosure requirements for executive and director compensation to require stock awards and option awards

reporting based on a measure that will represent the aggregate grant date fair value of the compensation decision in the grant year, rather than the current rule, which allocates the grant date fair value over time commensurate with financial statement recognition of compensation costs.

*B. Benefits*

The amendments are intended to enhance transparency of a company’s compensation policies and its impact on risk taking; director and nominee qualifications; board leadership structure and the role of the board in risk oversight; potential conflicts of interest of compensation consultants; and voting results at annual and special meetings.

**1. Benefits Related to the New Narrative Disclosure of the Company’s Compensation Policies and Practices as They Relate to the Company’s Risk Management**

Incentive arrangements and other compensation for employees may affect risk-taking behavior in the company’s operations. To the extent that the risks arising from a company’s compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company, investors will benefit through an enhanced ability to monitor it. They would also potentially benefit from the ability to use this additional information in allocating capital across companies, toward companies where employee

incentives appear better aligned with operational success and investors’ appetite for risk. The new disclosure may also encourage the board and senior management to examine and improve incentive structures for management and employees of the company. These benefits may also lead to increased value to investors.

**2. Benefits Related to Revisions to Summary Compensation Table Disclosure**

As a result of the Summary Compensation Table and Director Compensation Table amendments, companies will no longer need to prepare and report the allocation of equity awards’ grant date fair value over time commensurate with financial statement recognition of compensation costs for executive and director compensation tabular reporting. Further, in preparing stock awards and option awards disclosure in the Summary Compensation Table and Director Compensation Table, companies no longer will need to incur additional costs to exclude the estimate for forfeitures related to service-based vesting used for financial statement reporting purposes. The elimination of costs of preparing and reporting this information is a benefit of the amendments.

The effects of the amendments in making information more readily available to investors may be useful to their voting and investment decisions. Reporting stock awards and option awards in the Summary Compensation Table based on aggregate grant date fair value is designed to make it easier for investors to assess compensation decisions and evaluate the decisions of the compensation committee. For example, under the amendments the Summary Compensation Table values will correspond to awards granted in the fiscal year, potentially allowing companies to better explain in CD&A

<sup>188</sup> The number of responses reflected in the table equals the actual number of forms and schedules filed with the Commission during the 2008 fiscal year, except for Form 8–K. The number of responses for Form 8–K reflects the number of Form 8–Ks filed during the 2008 fiscal year plus an additional 8,831 filings. See footnote 190 below.

<sup>189</sup> We calculated the reduction in the burden hours for Form 10–Q based on the number of proxy statements filed with the Commission during the 2008 fiscal year. We assumed that there would be, at a minimum, an equal number of Form 10–Qs filed to report the voting results from a meeting of shareholders. The reduction reflects the deletion of the disclosure of voting results from the form.

<sup>190</sup> We have included an additional 7,300 responses to Form 8–K to reflect the additional Form 8–Ks that would be filed to report final voting results. As explained in footnote 188 above, this number is based on the actual number of proxy statements filed in 2008. We adjusted this number upward by 20% to reflect our estimate of the additional Form 8–Ks that may be filed to report preliminary votes, and we have also included an additional 71 Form 8–Ks to reflect the number of Form 8–Ks that would be filed to report preliminary voting results because of a contested election, which we based on the actual number of proxy statements involving contested elections that were filed with the Commission during the 2008 fiscal year.

<sup>191</sup> The estimates for Schedule 14A and Schedule 14C are separated to reflect our estimate of the burden hours and costs related to new Item 402(s) of Regulation S–K which is applicable to companies that are either accelerated or large accelerated filers, but not applicable to companies that are non-

accelerated filers, including smaller reporting companies. We estimate that 3,378 Schedule 14A responses were filed by accelerated or large accelerated filers, and 315 Schedule 14C responses were filed by accelerated or large accelerated filers.

<sup>192</sup> The number of responses reflected in the table equals the actual number of forms filed with the Commission during the 2008 fiscal year, except for Forms N–1A and N–3. The number of responses for Forms N–1A and N–3 reflect the number of open-ended management investment companies registered with the Commission as of the end of the 2008 fiscal year.

how decisions with respect to awards granted for the year relate to other compensation decisions in the context of total compensation for the year. For awards subject to performance conditions, tabular disclosure will be based upon the probable outcome of the performance conditions as of the grant date. A special instruction for awards subject to performance conditions that requires footnote disclosure of the grant date fair value, assuming that the highest level of performance conditions will be achieved, will provide investors with further information as to the maximum potential payout of a particular grant. Further, the effect on total compensation of decisions to reprice options will be more evident because aggregate grant date fair value will be a component of total compensation reported in the Summary Compensation Table.

Under the amendments, the identification of named executive officers based on total compensation for the last completed fiscal year will reflect the aggregate grant date fair value of equity awards granted in that year. As a result, the named executive officers other than the principal executive officer and principal financial officer may change. Investors may benefit from receiving compensation disclosure with respect to executives who would not have been named executive officers under the former rules. To the extent that this change better aligns the identification of named executive officers with compensation decisions for the year, it should make it easier for companies to track executive compensation for reporting purposes.

Although the amendments are not intended to steer behavior, changes in the way that executive compensation is represented in the Summary Compensation Table and other new, compensation-related disclosures may indirectly lead boards to reconsider pay structure, potentially changing the amount of pay in some cases.

Smaller reporting companies are not required to provide a Grants of Plan-Based Awards Table or a CD&A, but are required to provide a Summary Compensation Table and Director Compensation Table. Investors in these companies should benefit from reporting stock awards and option awards based on aggregate grant date fair value in the grant year, as opposed to the current reporting approach based on financial statement recognition of the awards.

### 3. Benefits Related to Enhanced Director and Nominee Disclosure

The amendments to Item 401 of Regulation S-K, Schedule 14A and Forms N-1A, N-2 and N-3 will potentially benefit investors by increasing the amount and quality of information that they receive concerning the background and skills of directors and nominees for director, enabling investors to make better-informed voting and investment decisions. Disclosure of board's or other proponents' rationale for their nominees' membership on the board may benefit investors by enabling them to better assess whether and why a particular nominee is an appropriate choice for a particular company. Investors would be able to make more informed voting decisions in electing directors. Investors would also be able to adjust their holdings, allocating more capital to companies in which they believe board members are most likely to be able to effectively fulfill their duties to shareholders. In particular, in cases that do not meet investors' expectations, investors may respond by attempting to exert more influence on management or the board than would occur otherwise, thereby enhancing shareholder value.

Required disclosure of whether, and if so, how, a nominating committee (or the board) considers diversity in connection with identifying and evaluating persons for consideration as nominees for a position on the board of directors may also benefit investors. Board diversity policy is an important factor in the voting decisions of some investors.<sup>193</sup> Such investors will directly benefit from diversity policy disclosure to the extent the policy and the manner in which it is implemented is not otherwise clear from observing past and current board selections. Although the amendments are not intended to steer behavior, diversity policy disclosure may also induce beneficial changes in board composition. A board may determine, in connection with preparing its disclosure, that it is beneficial to disclose and follow a policy of seeking diversity. Such a policy may encourage boards to conduct broader director searches, evaluating a wider range of candidates and potentially improving board quality. To the extent that boards branch out from the set of candidates they would ordinarily consider, they may nominate directors who have fewer

existing ties to the board or management and are, consequently, more independent. To the extent that a more independent board is desirable at a particular company, the resulting increase in board independence could potentially improve governance. In addition, in some companies a policy of increasing board diversity may also improve the board's decision-making process by encouraging consideration of a broader range of views.

Expanded disclosure of membership on previous corporate boards may also benefit investors by making it easier for them to evaluate whether nominees' past board memberships present potential conflicts of interest (such as membership on boards of major suppliers, customers, or competitors). Investors may also be able to more easily evaluate the performance, in both operations and governance, of the other companies on whose boards the nominees serve or have served. The public may also benefit from better understanding any potential positive or negative effects on corporate performance resulting from directors serving on other boards.

The expanded list of legal proceedings involving directors, nominees and executive officers that must be disclosed, as well as the expanded disclosure of these legal proceedings from the current five-year requirement to ten years, would benefit investors by providing more information by which they could determine the suitability of a director or nominee.

### 4. Benefits Related to New Disclosure About Board Leadership Structure and the Board's Role in Risk Oversight

Investors may benefit from new disclosure about board leadership structure. In particular, they may benefit from understanding management's explanation regarding whether or not the principal executive officer serves as chairman of the board and, in the case of a registered management investment company, whether the chairman is an "interested person" of the fund. In deciding whether to separate principal executive officer and chairman positions, companies may consider several factors, including the effectiveness of communication with the board and the degree to which the board can exercise independent judgment about management performance, and shareholders may, in different cases, be best served by different decisions. Although the amendments are not intended to drive behavior, there may be possible benefits if a company re-evaluates its leadership structure or the

<sup>193</sup> See, e.g., letters from Calvert, Trillium, Boston Common Asset Management, CII, Florida State Board of Administration, and Sisters of Charity BVM. See also letter from Lissa Lamkin Broome and Thomas Lee Hazen.

board's role in risk oversight and decides to make changes as a result.

Disclosures of the board's role in risk oversight may also benefit investors. Expanded disclosure of the board's role in risk oversight may enable investors to better evaluate whether the board is exercising appropriate oversight of risk. Investors would be able to adjust their holdings, allocating more capital to companies in which they believe the board is adequately focused on risks. Improved capital allocation will also benefit the financial markets by increasing market efficiency.

#### 5. Benefits Related to New Disclosure Regarding Compensation Consultants

New disclosure regarding compensation consultants may benefit investors by illuminating potential conflicts of interest. Providing better, more complete information in cases where the value of non-executive compensation services is over \$120,000 for the last fiscal year will allow investors to determine for themselves whether there are concerns related to the compensation consultants' financial interests and objectivity. Compensation consultants may earn fees from other services to the company, including benefits administration, human resources consulting, and actuarial services. With an incentive to retain these significant additional revenue streams, they may face incentives to cater, to some degree, to management preferences in recommending executive compensation packages.<sup>194</sup> The House Committee on Oversight and Government Reform's Study on Executive Pay documented that 113 of 250 of the largest publicly traded companies hired compensation consultants that earned fees from other services, and that this practice was positively correlated with higher CEO pay.<sup>195</sup> However, Cadman, Carter and Hillgeist (2009) studied a larger set of companies, but did not find statistically significant relations between certain factors thought to indicate conflicts of

interest and the level of CEO pay.<sup>196</sup> To the degree that these potential conflicts may be more transparent under the amendments, investors benefit through their ability to better monitor the process of setting executive pay. This potential conflict is substantially reduced when the compensation committee hires a compensation consultant that does not provide other services to the company. Benefits of the amendment may be limited to the degree that compensation consultants have other potential conflicts of interest not specifically enumerated in the amendments.

Disclosures about compensation consultants may have effects on competition in the compensation consulting industry, introducing potential relative costs and benefits to both multi-service consulting firms and consulting firms exclusively specializing in executive compensation. Specific potential effects on competition are discussed in Section V below. Broadly, the disclosures may affect the level of competition in the compensation consulting industry. Any increase in competition could reduce prices of consulting services, benefiting client companies. Changes in competition may also affect the content of advice provided to companies. As discussed more fully in Section C below, it is possible that, if the level of competition in the industry decreases, compensation consultants may be less inclined to make recommendations favorable to management. This could potentially benefit shareholders.

#### 6. Benefits Related to Reporting of Voting Results on Form 8-K

The amendments to Form 8-K will facilitate security holder access to faster disclosure of the vote results of a company's annual or special meeting. To find this information, investors no longer would need to wait for this information to be disclosed in a Form 10-Q or 10-K, which could be filed months after the end of the meeting.

#### C. Costs

The amendments will impose new disclosure requirements on companies. Some of the disclosures are designed to build upon existing requirements to elicit a more detailed discussion of director and nominee qualifications, legal proceedings, and the interests of compensation consultants. To the degree that the amendments require

collecting information currently available, costs related to information collection will be limited.

#### 1. Costs Related to the New Narrative Disclosure of the Company's Compensation Policies and Practices as They Relate to the Company's Risk Management

We believe that there may be information gathering costs associated with the new disclosure of the company's compensation policies and practices as they relate to the company's risk management, even though the information required may be readily available, because this information may need to be reported up from business units and analyzed. Some commenters noted that the amendments would require companies to incur additional costs, such as costs related to conducting a risk analysis of compensation policies for all employees.<sup>197</sup> This could also include the cost of hiring additional advisors to assist in the analysis, as well as additional costs in drafting the new disclosure. Using our PRA burden estimates, we estimate the aggregate annual cost of the amendments to be approximately \$12,215,326.<sup>198</sup> As previously discussed, the proposed amendments would have required discussion and analysis of compensation policies if risks arising from those compensation policies "may have a material effect on the company." We have revised the amendment to require a company to discuss its compensation policies and practices for employees if such policies and practices are "reasonably likely to have a material adverse effect" on the company. By focusing on risks that are "reasonably likely to have a material adverse effect" on the company, we believe the amendments will result in a smaller number of companies making this risk disclosure. This change from the "may have a material effect" disclosure should mitigate some of the costs and burdens associated with the amendments.

Companies may also face costs related to the disclosure of the company's compensation policies to the extent that

<sup>194</sup> See letter from Mary Ellen Carter.

<sup>195</sup> In December 2007, the U.S. House of Representatives Committee on Oversight and Government Reform issued a report on the role played by compensation consultants at large, publicly traded companies (the "Waxman Report"). The Waxman Report found that the fees earned by compensation consultants for providing other services often far exceed those earned for advising on executive compensation, and that on average companies paid compensation consultants over \$2.3 million for other services and less than \$220,000 for executive compensation advice. See Staff of House Comm. on Oversight and Government Reform, 110th Cong., Report on Executive Pay: Conflicts of Interest Among Compensation Consultants (Comm. Print 2007).

<sup>196</sup> Cadman, Carter and Hillgeist, 2009, The Incentives of Compensation Consultants and CEO Pay, Journal of Accounting and Economics (forthcoming) and provided with the letter submitted by Mary Ellen Carter.

<sup>197</sup> See, e.g., letters from Business Roundtable and Robert Ahrenholz.

<sup>198</sup> This estimate is based on the estimated total burden hours of the amendments associated with the schedules and forms that would include the new disclosure, an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy and information statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

it provides management with incentives to adopt risk-averse strategies that result in the abandonment of risky projects whose returns otherwise would compensate for the amount of additional risk. This could discourage beneficial risk-taking behavior.

## 2. Costs Related to Revisions to Summary Compensation Table Disclosure

Investors may face some costs related to revisions in executive compensation reporting. Under the amendments to the Summary Compensation Table and as noted in the Benefits section, the identification of named executive officers based on total compensation for the last completed fiscal year will reflect the aggregate grant date fair value of equity awards granted in that year, so that some executives subject to executive compensation disclosure may be different.

Smaller reporting companies, which are not required to provide the Grants of Plan-Based Awards Table, may incur some costs on a transitional basis in switching from the previously required measure of stock awards and option awards to aggregate grant date fair value reporting. We expect that any such additional costs will be limited by the fact that grant date fair value information required under the amendments is also collected to comply with financial reporting purposes. Because companies other than smaller reporting companies previously were required to report the grant date fair value of individual equity awards in the Grants of Plan-Based Awards Table, we expect that they will incur only negligible costs in switching to the amended Summary Compensation Table and Director Compensation Table disclosure requirements.

Moreover, grant date fair value guidelines under FASB ASC Topic 718 call for management to exercise judgment in valuing stock options. For financial statement recognition purposes, the grant date fair value measure of compensation cost is expensed over the expected term of the option. Compensation cost for awards containing a performance-based vesting condition is recognized only if it is probable that the performance condition will be achieved. To the extent that an investor believes that Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards should be measured based on financial statement recognition principles to take into account potential adjustments, the amendments may entail a cost. The special instruction for awards subject to

performance conditions mitigates this potential cost to some extent by providing that such awards are reported in the Summary Compensation Table and Director Compensation Table based upon the probable outcome of the performance condition(s) as of the grant date. This instruction also requires footnote disclosure of the maximum value assuming the highest level of performance conditions is probable. We believe that any incremental cost associated with providing this footnote disclosure would be minimal.

## 3. Costs Related to Enhanced Director and Nominee Disclosure

Companies may face some information gathering and reporting costs related to enhanced director and nominee disclosure. One commenter noted that companies may face costs related to the amendments to the extent that companies will need to update their director and officer questionnaires to obtain more detailed information, and will need to spend additional time analyzing the information as well as preparing the disclosures.<sup>199</sup> Companies may also experience increased costs as it may be more difficult to find candidates willing to serve on boards if they do not want this information disclosed in a Commission filing. To the extent that information is available and verifiable through other sources, however, we expect the potential costs of the additional disclosure will be limited. Using our PRA burden estimates, we estimate the aggregate annual cost to operating companies to be approximately \$20,790,000.<sup>200</sup> With respect to our PRA burden estimates for registered management investment companies, we estimate the aggregate annual cost to be approximately \$6,979,700.<sup>201</sup>

In addition, although the amendments are not intended to steer behavior, a company may adopt a diversity policy in connection with preparing its

disclosure regarding whether and, if so, how diversity is considered in connection with identifying and evaluating persons for consideration as nominees for a position on the board of directors. If this policy turns out to be difficult to implement, companies could incur economic costs as a result in the form of recruiting costs or otherwise.

## 4. Costs Related to New Disclosure About Board Leadership Structure and the Board's Role in Risk Oversight

Companies may face some costs related to new disclosure about board leadership structure. Disclosure of the board's role in risk oversight may have some similar costs. The information gathering costs are likely to be less significant than the costs to prepare the disclosure. Using our PRA burden estimates, we estimate the aggregate annual cost to operating companies to be approximately \$11,970,000.<sup>202</sup> With respect to our PRA burden estimates for registered management investment companies, we estimate the aggregate annual cost to be approximately \$6,367,200.<sup>203</sup> Although the amendments are not intended to drive behavior, there may be possible costs if a company re-evaluates its leadership structure or the board's role in risk oversight and decides to make changes as a result.

## 5. Costs Related to New Disclosure Regarding Compensation Consultants

Companies may face some costs related to new disclosure about fees for compensation consulting and for other services provided by compensation consultants. Using our PRA burden estimates, we estimate the aggregate annual cost to be approximately \$5,985,000.<sup>204</sup> In addition, the costs to a company in contracting with compensation consultants could be increased under these amendments, and compensation consultants also may alter

<sup>199</sup> See letter from Business Roundtable.

<sup>200</sup> This estimate is based on the estimated total burden hours of the amendments associated with the schedules and forms that would include the new disclosures, an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy and information statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>201</sup> This estimate is based on the estimated total burden hours of 22,742, an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>202</sup> This estimate is based on the estimated total burden hours of the amendments associated with the schedules and forms that would include the new disclosures, an assumed 75%/25% split of the burden hours, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>203</sup> This estimate is based on the estimated total burden hours of 20,292, an assumed 75%/25% split of the burden hours between internal staff and external professionals with respect to proxy statements, an assumed 25%/75% split of the burden hours between internal staff and external professionals with respect to registration statements, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>204</sup> This estimate is based on the estimated total burden hours related to the amendments in connection to Schedules 14A and 14C, an assumed 75%/25% split of the burden hours, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

their mix of services. For instance, costs may increase if companies decide to contract with multiple compensation consultants for services that had previously been provided by only one compensation consultant. Several commenters asserted that the amendments could discourage companies from using a single compensation consulting firm to provide executive compensation services and services other than executive compensation consulting.<sup>205</sup> Possible increased costs might include the costs associated with the time each new compensation consultant will need to learn about the company and the decline in any economies of scale the compensation consultant may have factored into fees charged to the company. To the extent that compensation consulting firms exit compensation consulting to eliminate potential conflicts and mandatory fee disclosure, fewer experienced consultants may be available for hire. To the extent that the remaining consultants cannot scale operations sufficiently quickly to meet demand, then this could result in less qualified opinions from remaining consultants, with potential costs to shareholders. In the long run, however, industry capacity may increase, which would mitigate this effect.

Disclosures on compensation consultants may have effects on competition in the compensation consulting industry, introducing potential relative costs and benefits to multi-service consulting firms and consulting firms specializing in executive compensation. Specific potential effects on competition are discussed in the Section V below. As discussed in more detail in Section V, competition could conceivably decrease if some multi-service firms exit the executive compensation consulting industry. Any decrease in competition could increase prices of consulting services, potentially creating higher costs for client companies, while benefiting the compensation consulting industry as a whole. However, competition could increase, for example, to the extent that the amendments make smaller boutique firms more attractive to companies. If the amendments increase competitiveness of the industry, compensation consultants may charge lower fees. They may also, however, feel pressure to generate recommendations favorable to management in order to increase the likelihood of being retained

<sup>205</sup> See, e.g., letters from Mercer, Towers Perrin and Watson Wyatt.

in the future. Any decline in the objectivity of advice from compensation consultants would potentially be costly to shareholders.

#### 6. Costs Related to Reporting of Voting Results on Form 8-K

Shareholders who are used to receiving this information in a Form 10-Q filing may incur costs of adapting their research practices to find this information in Form 8-K filings, which may involve searching through a number of filings. This adjustment may involve costs, in particular, to those investors who process this information using automated systems. A separate filing to report the information and potentially report both preliminary and final voting results may also increase direct costs to companies for filing fees, filing creation, and report dissemination because it may require two Form 8-K filings. However, the cost for preparing a quarterly report on Form 10-Q would be less because this disclosure would not appear in that Form. Companies that report preliminary voting results may face some additional information gathering and reporting costs because they would need to file a Form 8-K to disclose preliminary voting results and to file an amended Form 8-K to disclose final vote results. Using our PRA burden estimates, we estimate the aggregate annual cost to be approximately \$2,207,750.<sup>206</sup>

#### V. Consideration of Impact on the Economy, Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act requires us,<sup>207</sup> when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Section 2(b) of the Securities Act,<sup>208</sup> Section 3(f) of the Exchange Act,<sup>209</sup> and Section 2(c) of the Investment Company Act require us,<sup>210</sup> when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public

<sup>206</sup> This estimate is based on the estimated 8,831 additional Form 8-K filings, an assumed 75%/25% split of one burden hour between internal staff and external professionals, and an hourly rate of \$200 for internal staff time and \$400 for external professionals.

<sup>207</sup> 15 U.S.C. 78w(a)(2).

<sup>208</sup> 15 U.S.C. 77b(b).

<sup>209</sup> 15 U.S.C. 78c(f).

<sup>210</sup> 15 U.S.C. 80a-2(c).

interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

The amendments that we are adopting are designed to enhance the information companies provide to investors with regard to the following:

- *Risk:* By requiring disclosure about the board's role in oversight of risk and, to the extent that risks arising from a company's compensation policies and practices are reasonably likely to have a material adverse effect on the company, disclosure about such policies and practices as they relate to risk management;

- *Governance and Director Qualifications:* By requiring expanded disclosure of the background and qualifications of directors and director nominees and new disclosure about a company's board leadership structure, and accelerating the reporting of information regarding shareholder voting results; and

- *Compensation:* By revising the reporting of stock and option awards received by named executive officers, and requiring disclosure of potential conflicts of interest of compensation consultants in certain circumstances.

The amendments are designed to enable investors to make better informed voting and investment decisions. For example, several commenters noted that investors will be able to use the new risk disclosures to make more informed investment decisions.<sup>211</sup> Improved investment decisions could lead to increased efficiency and competitiveness of the U.S. capital markets. Investors could allocate capital across companies, toward companies where the risk incentives are more aligned with an investor's risk preference. In this regard, the amendments may affect the relative ability of some companies to raise capital depending on how investors react to the disclosures they provide in response to the amendments. In addition, the amendments may improve the efficiency of information gathering by investors to the extent that disclosure provided in response to the amendments is easier to access through filings made with the Commission.

The amendments may affect competition, such as encouraging competition among companies to demonstrate superior risk oversight and improved incentive structures for management and the employees of the company. Several commenters indicated

<sup>211</sup> See, e.g., letters from CalSTRS, CII, the General Board of Pension and Health Benefits of the United Methodist Church, and Hermes.

that the amendments requiring fee and other disclosures related to compensation consultants might have some effects on competition among firms in this industry. Some of these commenters believed the amendments could negatively impact competition among large multi-service compensation consulting firms.<sup>212</sup> Companies will face new disclosure requirements with respect to their use of compensation consulting firms in certain circumstances, but not with respect to compensation consulting firms who provide only executive compensation consulting services. To the extent that companies receiving compensation for consulting services are reluctant to disclose the fees paid for advice on executive compensation, this may put some larger multi-service compensation consulting firms at a competitive disadvantage relative to smaller firms who focus on executive compensation consulting. In such cases, multi-service firms may be excluded from competing for compensation consulting services at companies where they already provide other non-executive compensation consulting services. However, this potential anti-competitive impact may be diminished to the extent that the potential opportunities lost to some multi-service firms would otherwise be available to other multi-service firms who do not provide non-executive compensation consulting services to the company. To the extent that this occurs, competition between multi-service firms could increase. In addition, the amendments provide a limited exception to the disclosure requirements for fees paid to other compensation consultants retained by the company if the board has retained its own consultant that reports to the board. This exception limits disclosure to circumstances that are more likely to present conflicts of interest, which should also address concerns about the competitive disadvantage faced by multi-service firms.

In some instances, the amendments may result in disclosure of pricing information that certain compensation consulting firms would prefer to remain private, which could affect some consulting firms' marginal cost of providing executive compensation and non-executive compensation services. Competition in the compensation consulting industry also may be affected if, for example, some compensation consulting firms choose not to provide executive compensation consulting services to avoid having to disclose fees

on other, more critical aspects of their businesses. If multi-service compensation consulting firms currently use cross-selling synergies to subsidize their compensation consulting services for the purpose of soliciting other business, then their departure may result in an increase in fees, which may better approximate the stand-alone value of the services and promote competition from new market participants who could not otherwise subsidize compensation consulting services.

Conversely, the amendments may increase competition in the executive compensation consulting industry. If certain larger compensation consulting firms currently enjoy an advantage related to their ability to cross sell services, for example, where management is more likely to recommend to the board a compensation consultant with whom management has prior experience, the marginal cost of providing services may be lower, currently, than it is for smaller compensation consulting firms. In this circumstance, any additional marginal costs related to disclosure by multi-service firms may have the effect of making marginal costs faced by multi-service firms and boutique firms more equal, allowing boutique firms to compete more effectively. This may encourage entry into compensation consulting services by more firms, or at least make the threat of their entry more credible. If the number of multi-service compensation consulting firms is limited, relative to potential entrants, the level of effective competition in the industry may increase. The industry may also become more competitive for other reasons. For example, more public availability of aggregate fee disclosure, in general, may provide an informational advantage to companies as they negotiate with potential compensation consulting firms, effectively lowering the price of consulting services. Additionally, pricing disclosed, either publicly or in private negotiation, may more accurately reflect each particular service provided. If multi-service compensation consulting firms currently use cross-selling synergies to subsidize their compensation consulting services for the purpose of soliciting other business, then an increase in fees resulting from their departure may better approximate the stand-alone value of the services and promote competition from new market participants who could not otherwise subsidize compensation consulting services.

The size of the market for compensation consulting services is

large; depending on the assumptions, we estimate that the total fee revenues of the compensation consulting market could be in the range of \$480 million to \$3.7 billion. The lower approximate bound is calculated using the \$200,000 average per firm fee for executive compensation advice paid by the 250 large companies studied in the Waxman Report, and an estimated 2,190 companies from the Russell 3000 index that report using an executive compensation consultant.<sup>213</sup> The lower estimate could be higher to the extent that non-Russell 3000 companies also hire compensation consultants, or lower to the extent that smaller companies pay less than \$200,000 for compensation consulting advice. The upper approximate bound is calculated from the periodic reports of the four largest multi-service compensation consulting firms: Towers Perrin, Mercer, Hewitt, and Watson Wyatt. These four firms reported 2008 fiscal year-end total revenues of \$9.9 billion, of which \$2.16 billion was disclosed as generated from compensation consulting activities, but which could include non-executive compensation consulting services.<sup>214</sup> Considering that these four firms represent approximately 58% of the compensation consulting market,<sup>215</sup> this indicates the total compensation consulting market could be \$3.7 billion.

## VI. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act.<sup>216</sup> This FRFA relates to amendments to Regulation S-K, Schedule 14A and Forms 8-K, 10-Q, and 10-K under the Exchange Act, and Forms N-1A, N-2, and N-3, under the Investment Company Act. The amendments will require the following:

- To the extent that risks arising from a company's compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company, discussion of the company's compensation policies or practices as they relate to risk

<sup>213</sup> See letter from Mary Ellen Carter.

<sup>214</sup> Hewitt reported 33% of total revenues (\$990 million) from Talent and Organizational Consulting; Mercer reported \$550 million in consulting revenue from management and rewarding of employees, the design of remuneration programs, and improvement of human resource effectiveness; Watson Wyatt reported 10% of total revenues (\$167 million) from its Human Capital Group, which included providing advice on compensation plans and other long-term incentive programs; Towers Perrin reported 26.6% of total revenues (\$450 million) from Talent and Rewards Consulting.

<sup>215</sup> See letter from Mary Ellen Carter.

<sup>216</sup> 5 U.S.C. 601.

<sup>212</sup> See, e.g., letters from Hewitt, Mercer and Towers Perrin.

management and risk-taking incentives that can affect the company's risk and management of that risk;

- Reporting of the aggregate grant date fair value of stock awards and option awards granted in the fiscal year in the Summary Compensation Table and Director Compensation Table to be computed in accordance with FASB ASC Topic 718, with a special instruction for awards subject to performance conditions;

- New disclosure of the qualifications of directors and nominees for director, and the reasons why that person should serve as a director of the company at the time at which the relevant filing is made with the Commission; the same information would be required with respect to directors nominated by others;

- Additional disclosure of any directorships held by each director and nominee at any time during the past five years at any public company or registered investment company;

- Additional disclosure of other legal actions involving a company's executive officers, directors, and nominees for director, and lengthening the time during which such disclosure is required from five to ten years;

- New disclosure about a company's board leadership structure and the board's role in the oversight of risk;

- New disclosure regarding the consideration of diversity in the process by which candidates for director are considered for nomination by a company's nominating committee;

- New disclosure about the fees paid to compensation consultants and their affiliates under certain circumstances; and

- Reporting of the vote results from a meeting of shareholders on Form 8-K generally within four business days of the meeting.

An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the Regulatory Flexibility Act and included in the Proposing Release.

#### A. Need for the Amendments

As described both in this release and the Proposing Release, during the past few years, investors have increasingly focused on corporate accountability, and have expressed the desire for additional information that would enhance their ability to make informed voting and investment decisions. The amendments are intended to improve the disclosure shareholders of public companies receive regarding compensation and corporate governance, and facilitate communications relating to voting

decisions. We believe the amendments will enhance the transparency of a company's compensation policies and practices, and the impact of such policies and practices on risk taking; director and nominee qualifications; board leadership structure; the potential conflicts of compensation consultants; and will provide investors with clearer and more meaningful executive compensation disclosure.

#### B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed amendments, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed amendments. We did not receive comments specifically addressing the IRFA. However, several commenters addressed aspects of the proposed rule amendments that could potentially affect small entities. In particular, some commenters believed that compliance with the proposed amendments would impose a significant burden on smaller companies.<sup>217</sup> Other commenters believed that smaller companies should be exempted from all or parts of the amendments.<sup>218</sup> Although we believe that a complete exemption from the amendments would not be appropriate because this would interfere with achieving the goal of enhancing the information provided to all investors, we have made revisions to the amendments that we believe will significantly reduce the impact of the amendments on reporting companies, including smaller companies. In addition, we did not propose, and we are not at this time adopting, a requirement that smaller companies discuss their compensation policies and practices for employees if such policies and practices are reasonably likely to have a material adverse effect.

#### C. Small Entities Subject to the Final Amendments

The amendments will affect some companies that are small entities. The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."<sup>219</sup> The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility

Act for each of the types of entities regulated by the Commission. Securities Act Rule 157<sup>220</sup> and Exchange Act Rule 0-10(a)<sup>221</sup> defines a company, other than an investment company, to be a "small business" or "small organization" if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,229 companies, other than registered investment companies, that may be considered small entities. The amendments to Regulation S-K, Schedule 14A and Forms 8-K, 10-Q, and 10-K will affect any small entity that is subject to Exchange Act periodic and proxy reporting requirements. In addition, the amendments also will affect small entities that file a registration statement under the Securities Act.

An investment company is considered to be a "small business" if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>222</sup> We believe that the amendments will affect small entities that are investment companies. We estimate that there are approximately 162 investment companies that may be considered small entities.

#### D. Reporting, Recordkeeping, and Other Compliance Requirements

The amendments are designed to enhance the transparency of boards of directors, provide investors with a better understanding of the functions and activities of boards, and to provide investors with clearer and more meaningful compensation disclosure. These amendments will require small entities that are operating companies to provide:

- Reporting stock awards and option awards in the Summary Compensation Table and Director Compensation Table based on aggregate grant date fair value;

- Disclosure of the qualifications of directors and nominees for director, and a brief discussion of the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director for the company at the time the disclosure is made, in light of the company's business and structure;

- Additional disclosure concerning certain legal proceedings involving a company's directors, nominees for director and executive officers;

- Disclosure regarding the consideration of diversity in the process

<sup>217</sup> See letters from Keith Bishop and Theragenics.

<sup>218</sup> See, e.g., letters from the Committee on Securities Law of the Business Law Section of the Maryland State Bar Association and Theragenics.

<sup>219</sup> 5 U.S.C. 601(6).

<sup>220</sup> 17 CFR 230.157.

<sup>221</sup> 17 CFR 240.0-10(a).

<sup>222</sup> 17 CFR 270.0-10(a).

by which candidates for director are considered for nomination by a company's nominating committee;

- Additional disclosure, in certain instances, about compensation consultants retained by the board of directors; and

- Disclosure of the results of shareholder votes on Form 8-K generally within four business days after the end of the meeting.

In addition, these amendments would require small entities that are registered management investment companies to provide:

- Disclosure of the qualifications of directors and nominees for director, and the reasons why that person should serve as a director of the company at the time at which the relevant filing is made with the Commission;

- Disclosure of any directorships held by each director and nominee at any time during the past five years at public companies or registered management investment companies; and

- Disclosure about a fund's board leadership structure and the board's role in the oversight of risk.

#### *E. Agency Action To Minimize Effect on Small Entities*

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the disclosure amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;

- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;

- Using performance rather than design standards; and

- Exempting small entities from all or part of the requirements.

In connection with the amendments, we considered alternatives, including establishing different compliance or reporting requirements that take into account the resources available to small entities, clarifying or simplifying compliance and reporting requirements under the amendments for small entities, using design rather than performance standards, and exempting small entities from all or part of the amendments.

Under our current rules, small entities are subject to some different compliance or reporting requirements under Regulation S-K, and the amendments do not alter these requirements. Under Regulation S-K, small entities are

required to provide abbreviated compensation disclosure with respect to the principal executive officer and two most highly compensated executive officers for the last two completed fiscal years. Specifically, small entities may provide the executive compensation disclosure specified in Items 402(l) through (r) of Regulation S-K, rather than the corresponding disclosure specified in Items 402(a) through (k) of Regulation S-K. Items 402(l) through (r) also do not require small entities to provide CD&A or the Grants of Plan-Based Awards Table. The amendments to the Summary Compensation Table and Director Compensation Table are unlikely to have a significant impact on small entities because their principal effect is to disclose stock and option awards based on grant date fair value, which small entities need to compute for financial reporting purposes. We did not propose, and we are not adopting, a requirement that smaller companies discuss their compensation policies and practices for employees if such policies and practices are reasonably likely to have a material adverse effect. In addition, the amendments to the Grants of Plan-Based Awards Table do not apply to small entities.

We considered, but did not establish additional different compliance requirements for small entities. We believe that investors in companies that are small entities may want and would benefit from the disclosures elicited by the amendments regarding director and nominee qualifications, as well as board leadership and risk oversight. For example, many commenters noted that our amendments to enhance director and nominee disclosure would provide investors with additional information that would allow them to make better informed investment and voting decisions.<sup>223</sup> Different compliance requirements or an exemption for small entities would interfere with achieving the goal of enhancing the information provided to all investors. We believe that uniform and comparable disclosures across all companies will help investors and the markets.

We also considered, but did not establish, different disclosure thresholds for small entities under our amendments regarding compensation consultant disclosure. Although the disclosure exclusion provided in the amendment where the fees for non-executive compensation consulting services do not exceed \$120,000 for a company's fiscal year will reduce the

compliance burdens for all companies, we believe this change will likely be more meaningful to companies that are small entities because these companies likely expend a lesser amount of their revenues on compensation consulting services.

The amendments clarify, consolidate and simplify the reporting requirements for all public companies including small entities. The amendments require clear and straightforward disclosure of director and nominee qualifications, board leadership structure and the potential conflicts of interest of compensation consultants. We have used a mix of design and performance standards in connection with the amendments. Based on our past experience, we believe the amendments will be more useful to investors if there are specific disclosure requirements, however, some of the new requirements provide companies flexibility in determining what information to disclose. The disclosures are intended to result in more comprehensive and clearer disclosure.

#### **VII. Statutory Authority and Text of the Amendments**

The amendments contained in this release are being adopted under the authority set forth in Sections 3(b), 6, 7, 10, and 19(a) of the Securities Act; Sections 12, 13, 14, 15(d) and 23(a) of the Exchange Act; and Sections 8, 20(a), 24(a), 30 and 38 of the Investment Company Act.

#### **List of Subjects**

17 CFR Parts 229, 239, 240, 249 and 274 Reporting and recordkeeping requirements, Securities.

#### **Text of the Amendments**

■ For the reasons set out in the preamble, the Commission amends title 17, chapter II, of the Code of Federal Regulations as follows:

#### **PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K**

■ 1. The authority citation for part 229 continues to read in part as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

<sup>223</sup> See, e.g., letters from Board of Directors Network, Forum of Executive Women, Integrated Governance Solutions, and Norges Bank.

- 2. Amend § 229.401 by:
  - a. Revising paragraph (e)(1);
  - b. In paragraph (e)(2) revising the phrase “Indicate any other directorships” to read “Indicate any other directorships held, including any other directorships held during the past five years.”;
  - c. In paragraph (f), introductory text, revising the phrase “during the past five years” to read “during the past ten years”;
  - d. Removing the word “or” following the semi-colon at the end of paragraph (f)(4);
  - e. Removing the period at the end of paragraphs (f)(5) and (f)(6) and adding in their place a semi-colon;
  - f. Adding paragraphs (f)(7) and (f)(8) before the Instructions to paragraph (f);
  - g. In the Instruction 1 to paragraph (f) revise the phrase “For purposes of computing the five year period” to read “For purposes of computing the ten-year period”; and
  - h. Adding Instruction 5 to the Instructions to paragraph (f).

The revisions and additions read as follows:

**§ 229.401 (Item 401) Directors, executive officers, promoters and control persons.**

\* \* \* \* \*

(e) *Business experience.* (1) *Background.* Briefly describe the business experience during the past five years of each director, executive officer, person nominated or chosen to become a director or executive officer, and each person named in answer to paragraph (c) of Item 401, including: each person’s principal occupations and employment during the past five years; the name and principal business of any corporation or other organization in which such occupations and employment were carried on; and whether such corporation or organization is a parent, subsidiary or other affiliate of the registrant. In addition, for each director or person nominated or chosen to become a director, briefly discuss the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director for the registrant at the time that the disclosure is made, in light of the registrant’s business and structure. If material, this disclosure should cover more than the past five years, including information about the person’s particular areas of expertise or other relevant qualifications. When an executive officer or person named in response to paragraph (c) of Item 401 has been employed by the registrant or a subsidiary of the registrant for less than five years, a brief explanation shall be included as to the nature of the

responsibility undertaken by the individual in prior positions to provide adequate disclosure of his or her prior business experience. What is required is information relating to the level of his or her professional competence, which may include, depending upon the circumstances, such specific information as the size of the operation supervised.

\* \* \* \* \*

(f) \* \* \*

(7) Such person was the subject of, or a party to, any Federal or State judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated, relating to an alleged violation of:

- (i) Any Federal or State securities or commodities law or regulation; or
  - (ii) Any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order; or
  - (iii) Any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or
- (8) Such person was the subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act (7 U.S.C. 1(a)(29))), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

*Instructions to Paragraph (f) of Item 401:*

\* \* \* \* \*

5. This paragraph (f)(7) shall not apply to any settlement of a civil proceeding among private litigants.

\* \* \* \* \*

- 3. Amend § 229.402 by:
  - a. Revising paragraphs (c)(2)(v) and (c)(2)(vi);
  - b. Removing the Instruction to Item (c)(2)(v) and (vi), and adding in its place Instructions 1, 2, and 3 to Item (c)(2)(v) and (vi) before paragraph (c)(2)(vii);
  - c. Revising paragraph (c)(2)(ix)(G);
  - d. Removing the period at the end of paragraphs (d)(2)(iii) and (d)(2)(iv) and adding a semi-colon in their place;
  - e. Adding Instruction 8 to Item 402(d);
  - f. Revising paragraphs (k)(2)(iii) and (k)(2)(iv);
  - g. Revising paragraph (k)(2)(vii)(I) and Instruction to Item 402(k);

- h. In paragraph (l) revising the phrase “paragraphs (a) through (k)” to read “paragraphs (a) through (k) and (s)”;
- i. Revising paragraphs (n)(2)(v) and (n)(2)(vi);
- j. Removing the Instruction to Item 402(n)(2)(v) and (vi), and adding in its place Instructions 1, 2, and 3 to Item 402(n)(2)(v) and (vi) before paragraph (n)(2)(vii);
- k. Revising paragraph (n)(2)(ix)(G);
- l. Revising paragraphs (r)(2)(iii), (r)(2)(iv) and (r)(2)(vii)(I), and Instruction to Item 402(r); and
- m. Adding paragraph (s) before the Instruction to Item 402.

The revisions and additions read as follows:

**§ 229.402 (Item 402) Executive compensation.**

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(v) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (e));

(vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (f));

*Instruction 1 to Item 402(c)(2)(v) and (vi).* For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the registrant’s financial statements, footnotes to the financial statements, or discussion in the Management’s Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

*Instruction 2 to Item 402(c)(2)(v) and (vi).* If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means (“repriced”), or otherwise has materially modified such awards, the registrant shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718, with respect to that repriced or modified award.

*Instruction 3 to Item 402(c)(2)(v) and (vi).* For any awards that are subject to performance conditions, report the value at the grant date based upon the probable outcome of such conditions. This amount should be consistent with the estimate of aggregate compensation

cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures. In a footnote to the table, disclose the value of the award at the grant date assuming that the highest level of performance conditions will be achieved if an amount less than the maximum was included in the table.

\* \* \* \* \*

(ix) \* \* \*

(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (e) or (f); and

\* \* \* \* \*

(d) \* \* \*

*Instructions to Item 402(d).*

\* \* \* \* \*

8. For any equity awards that are subject to performance conditions, report in column (l) the value at the grant date based upon the probable outcome of such conditions. This amount should be consistent with the estimate of aggregate compensation cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures.

\* \* \* \* \*

(k) \* \* \*

(2) \* \* \*

(iii) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (c));

(iv) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (d));

\* \* \* \* \*

(vii) \* \* \*

(I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d); and

\* \* \* \* \*

*Instruction to Item 402(k).* In addition to the Instruction to paragraphs (k)(2)(iii) and (iv) and the Instructions to paragraph (k)(2)(vii) of this Item, the following apply equally to paragraph (k) of this Item: Instructions 2 and 4 to paragraph (c) of this Item; Instructions to paragraphs (c)(2)(iii) and (iv) of this Item; Instructions to paragraphs (c)(2)(v) and (vi) of this Item; Instructions to

paragraph (c)(2)(vii) of this Item; Instructions to paragraph (c)(2)(viii) of this Item; and Instructions 1 and 5 to paragraph (c)(2)(ix) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (k) of this Item that correspond to analogous disclosures provided for in paragraph (c) of this Item to which they refer.

\* \* \* \* \*

(n) \* \* \*

(2) \* \* \*

(v) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (e));

(vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (f));

*Instruction 1 to Item 402(n)(2)(v) and (n)(2)(vi).* For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the smaller reporting company's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

*Instruction 2 to Item 402(n)(2)(v) and (n)(2)(vi).* If at any time during the last completed fiscal year, the smaller reporting company has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means ("repriced"), or otherwise has materially modified such awards, the smaller reporting company shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718, with respect to that repriced or modified award.

*Instruction 3 to Item 402(n)(2)(v) and (vi).* For any awards that are subject to performance conditions, report the value at the grant date based upon the probable outcome of such conditions. This amount should be consistent with the estimate of aggregate compensation cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures. In a

footnote to the table, disclose the value of the award at the grant date assuming that the highest level of performance conditions will be achieved if an amount less than the maximum was included in the table.

\* \* \* \* \*

(ix) \* \* \*

(G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (e) or (f); and

\* \* \* \* \*

(r) \* \* \*

(2) \* \* \*

(iii) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (c));

(iv) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (d));

\* \* \* \* \*

(vii) \* \* \*

(I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d); and

\* \* \* \* \*

*Instruction to Item 402(r).* In addition to the Instruction to paragraph (r)(2)(vii) of this Item, the following apply equally to paragraph (r) of this Item: Instructions 2 and 4 to paragraph (n) of this Item; the Instructions to paragraphs (n)(2)(iii) and (iv) of this Item; the Instructions to paragraphs (n)(2)(v) and (vi) of this Item; the Instructions to paragraph (n)(2)(vii) of this Item; the Instruction to paragraph (n)(2)(viii) of this Item; the Instructions to paragraph (n)(2)(ix) of this Item; and paragraph (o)(7) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (r) of this Item that correspond to analogous disclosures provided for in paragraph (n) of this Item to which they refer.

\* \* \* \* \*

(s) *Narrative disclosure of the registrant's compensation policies and practices as they relate to the registrant's risk management.* To the extent that risks arising from the registrant's compensation policies and practices for its employees are

reasonably likely to have a material adverse effect on the registrant, discuss the registrant's policies and practices of compensating its employees, including non-executive officers, as they relate to risk management practices and risk-taking incentives. While the situations requiring disclosure will vary depending on the particular registrant and compensation policies and practices, situations that may trigger disclosure include, among others, compensation policies and practices: at a business unit of the company that carries a significant portion of the registrant's risk profile; at a business unit with compensation structured significantly differently than other units within the registrant; at a business unit that is significantly more profitable than others within the registrant; at a business unit where compensation expense is a significant percentage of the unit's revenues; and that vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the registrant from the task extend over a significantly longer period of time. The purpose of this paragraph(s) is to provide investors material information concerning how the registrant compensates and incentivizes its employees that may create risks that are reasonably likely to have a material adverse effect on the registrant. While the information to be disclosed pursuant to this paragraph(s) will vary depending upon the nature of the registrant's business and the compensation approach, the following are examples of the issues that the registrant may need to address for the business units or employees discussed:

(1) The general design philosophy of the registrant's compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by employees on behalf of the registrant, and the manner of their implementation;

(2) The registrant's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation;

(3) How the registrant's compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;

(4) The registrant's policies regarding adjustments to its compensation

policies and practices to address changes in its risk profile;

(5) Material adjustments the registrant has made to its compensation policies and practices as a result of changes in its risk profile; and

(6) The extent to which the registrant monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.

\* \* \* \* \*

■ 4. Amend § 229.407 by:

- a. Revising paragraph (c)(2)(vi);
- b. Revising paragraph (e)(3)(iii); and
- c. Adding paragraph (h) before the Instructions to Item 407.

The revisions and additions read as follows:

**§ 229.407 (Item 407) Corporate governance.**

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(vi) Describe the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether the nominee is recommended by a security holder, and whether, and if so how, the nominating committee (or the board) considers diversity in identifying nominees for director. If the nominating committee (or the board) has a policy with regard to the consideration of diversity in identifying director nominees, describe how this policy is implemented, as well as how the nominating committee (or the board) assesses the effectiveness of its policy;

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(iii) Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation (other than any role *limited* to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice) during the registrant's last completed fiscal year, identifying

such consultants, stating whether such consultants were engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement:

(A) If such compensation consultant was engaged by the compensation committee (or persons performing the equivalent functions) to provide advice or recommendations on the amount or form of executive and director compensation (other than any role *limited* to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice) and the compensation consultant or its affiliates also provided additional services to the registrant or its affiliates in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for such additional services. Disclose whether the decision to engage the compensation consultant or its affiliates for these other services was made, or recommended, by management, and whether the compensation committee or the board approved such other services of the compensation consultant or its affiliates.

(B) If the compensation committee (or persons performing the equivalent functions) has not engaged a compensation consultant, but management has engaged a compensation consultant to provide advice or recommendations on the amount or form of executive and director compensation (other than any role *limited* to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant

does not provide advice) and such compensation consultant or its affiliates has provided additional services to the registrant in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for any additional services provided by the compensation consultant or its affiliates.

\* \* \* \* \*

(h) *Board leadership structure and role in risk oversight.* Briefly describe the leadership structure of the registrant's board, such as whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions, and, in the case of a registrant that is an investment company, whether the chairman of the board is an "interested person" of the registrant as defined in section 2(a)(19) of the Investment Company Act (15 U.S.C. 80a-2(a)(19)). If one person serves as both principal executive officer and chairman of the board, or if the chairman of the board of a registrant that is an investment company is an "interested person" of the registrant, disclose whether the registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the board. This disclosure should indicate why the registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the registrant. In addition, disclose the extent of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function, and the effect that this has on the board's leadership structure.

\* \* \* \* \*

**PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

■ 5. The authority citation for Part 239 continues to read in part as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

**PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

■ 6. The authority citation for Part 240 is revised to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350 and 12 U.S.C. 5221(e)(3) unless otherwise noted.

\* \* \* \* \*

- 7. Amend § 240.14a-101 by:
  - a. Revising paragraph (b) of Item 7;
  - b. In Item 22:
    - i. Redesignating paragraph (b)(3) as paragraph (b)(3)(ii);
    - ii. Adding new paragraph (b)(3)(i); and
    - iii. Redesignating *Instruction to paragraph (b)(3)* as *Instruction to paragraph (b)(3)(ii)*;
    - iv. Redesignating paragraph (b)(4), introductory text, and paragraph (b)(4)(i) through paragraph (b)(4)(iv) as new paragraph (b)(4)(i), introductory text, and paragraph (b)(4)(i)(A) through paragraph (b)(4)(i)(D);
    - v. Adding new paragraph (b)(4)(ii);
    - vi. Revising paragraph (b)(11) before the *Instruction*; and
    - vii. Revising *Instruction to paragraph (b)(11)*.

The revisions and additions read as follows:

**§ 240.14a-101 Schedule 14A. Information required in proxy statement.**

\* \* \* \* \*

*Item 7. Directors and executive officers.*

\* \* \* \* \*

(b) The information required by Items 401, 404(a) and (b), 405 and 407(d)(4), (d)(5) and (h) of Regulation S-K (§ 229.401, § 229.404(a) and (b), § 229.405 and § 229.407(d)(4), (d)(5) and (h) of this chapter).

\* \* \* \* \*

*Item 22. Information required in investment company proxy statement.*

\* \* \* \* \*

(b) *Election of Directors.* \* \* \*  
 (3)(i) For each director or nominee for election as director, briefly discuss the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director for the Fund at the time that the disclosure is made in light of the Fund's business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications.

\* \* \* \* \*

(4) \* \* \*  
 (ii) Unless disclosed in the table required by paragraph (b)(1) of this Item or in response to paragraph (b)(4)(i) of

this Item, indicate any directorships held during the past five years by each director or nominee for election as director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act of 1940 (15 U.S.C. 80a-1 *et seq.*), as amended, and name the companies in which the directorships were held.

\* \* \* \* \*

(11) Provide in tabular form, to the extent practicable, the information required by Items 401(f) and (g), 404(a), 405, and 407(h) of Regulation S-K (§§ 229.401(f) and (g), 229.404(a), 229.405, and 229.407(h) of this chapter).

*Instruction to paragraph (b)(11).* Information provided under paragraph (b)(8) of this Item 22 is deemed to satisfy the requirements of Item 404(a) of Regulation S-K for information about directors, nominees for election as directors, and Immediate Family Members of directors and nominees, and need not be provided under this paragraph (b)(11).

\* \* \* \* \*

**PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934**

■ 8. The authority citation for part 249 continues to read in part as follows:

**Authority:** 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

■ 9. Amend Form 8-K (referenced in § 249.308) by adding Item 5.07 under the caption "Information To Be Included in the Report" after the General Instructions read as follows:

**Note:** The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form 8-K**

\* \* \* \* \*

**General Instructions**

\* \* \* \* \*

**Information To Be Included in the Report**

\* \* \* \* \*

**Item 5.07 Submission of Matters to a Vote of Security Holders**

If any matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, provide the following information:

(a) The date of the meeting and whether it was an annual or special meeting.

(b) If the meeting involved the election of directors, the name of each director elected at the meeting, as well as a brief description of each other matter voted upon at the meeting; and state the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes as to each such matter, including a separate tabulation with respect to each nominee for office.

(c) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (17 CFR 240.14a-101)) terminating any solicitation subject to Rule 14a-12(c), including the cost or anticipated cost to the registrant.

*Instruction 1 to Item 5.07.* The four business day period for reporting the event under this Item 5.07 shall begin to run on the day on which the meeting ended. The registrant shall disclose on Form 8-K under this Item 5.07 the preliminary voting results. The registrant shall file an amended report on Form 8-K under this Item 5.07 to disclose the final voting results within four business days after the final voting results are known. *However*, no preliminary voting results need be disclosed under this Item 5.07 if the registrant has disclosed final voting results on Form 8-K under this Item.

*Instruction 2 to Item 5.07.* If any matter has been submitted to a vote of security holders otherwise than at a meeting of such security holders, corresponding information with respect to such submission shall be provided. The solicitation of any authorization or consent (other than a proxy to vote at a stockholders' meeting) with respect to any matter shall be deemed a submission of such matter to a vote of security holders within the meaning of this item.

*Instruction 3 to Item 5.07.* If the registrant did not solicit proxies and the board of directors as previously reported to the Commission was re-elected in its entirety, a statement to that effect in answer to paragraph (b) will suffice as an answer thereto.

*Instruction 4 to Item 5.07.* If the registrant has furnished to its security holders proxy soliciting material containing the information called for by paragraph (c), the paragraph may be answered by reference to the information contained in such material.

*Instruction 5 to Item 5.07.* If the registrant has published a report containing all the information called for by this item, the item may be answered

by a reference to the information contained in such report.

\* \* \* \* \*

■ 10. Amend Form 10-Q (referenced in § 249.308a) by removing Item 4 in Part II—Other Information, and redesignating Items 5 and 6 as Items 4 and 5.

■ 11. Amend Form 10-K (referenced in § 249.310) by removing Item 4 in Part I, and redesignating Items 5 through 15 as Items 4 through 14.

**Note:** The text of Forms 10-Q and 10-K do not, and these amendments will not, appear in the Code of Federal Regulations.

**PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

**PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940**

■ 12. The authority citation for Part 274 continues to read in part as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

\* \* \* \* \*

■ 13. Form N-1A (referenced in §§ 239.15A and 274.11A), Item 17 is amended by:

- a. Revising the heading to paragraph (b);
- b. Revising paragraph (b)(1);
- c. Redesignating paragraph (b)(3), introductory text, and paragraph (b)(3)(i) through paragraph (b)(3)(iv) as paragraph (b)(3)(i), introductory text, and paragraph (b)(3)(i)(A) through paragraph (b)(3)(i)(D);
- d. Adding new paragraph (b)(3)(ii); and
- e. Adding paragraph (b)(10).

The revisions and additions read as follows:

**Note:** The text of Form N-1A does not, and these amendments will not, appear in the Code of Federal Regulations.

**Form N-1A**

\* \* \* \* \*

**Item 17. Management of the Fund**

\* \* \* \* \*

(b) *Leadership Structure and Board of Directors.*

(1) Briefly describe the leadership structure of the Fund's board, including the responsibilities of the board of directors with respect to the Fund's management and whether the chairman of the board is an interested person of the Fund. If the chairman of the board is an interested person of the Fund, disclose whether the Fund has a lead independent director and what specific

role the lead independent director plays in the leadership of the Fund. This disclosure should indicate why the Fund has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Fund. In addition, disclose the extent of the board's role in the risk oversight of the Fund, such as how the board administers its oversight function and the effect that this has on the board's leadership structure.

\* \* \* \* \*

(3) \* \* \*

(ii) Unless disclosed in the table required by paragraph (a)(1) of this Item 17 or in response to paragraph (b)(3)(i) of this Item 17, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Securities Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Securities Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the Investment Company Act, and name the companies in which the directorships were held.

\* \* \* \* \*

(10) For each director, briefly discuss the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director for the Fund at the time that the disclosure is made, in light of the Fund's business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications.

\* \* \* \* \*

■ 14. Form N-2 (referenced in §§ 239.14 and 274.11a-1), Item 18 is amended by:

- a. Redesignating paragraph 5, introductory text, and paragraph 5(a) through paragraph 5(d) as paragraph 5(b), introductory text, and paragraph 5(b)(1) through paragraph 5(b)(4);
- b. Adding new paragraph 5(a);
- c. Redesignating paragraph 6, introductory text, and paragraph 6(a) through paragraph 6(d) as paragraph 6(a), introductory text, and paragraph 6(a)(1) through paragraph 6(a)(4);
- d. Adding new paragraph 6(b); and
- e. Adding paragraph 17 after the instructions.

The additions read as follows:

**Note:** The text of Form N-2 does not, and these amendments will not, appear in the Code of Federal Regulations.

**Form N-2**

\* \* \* \* \*

**Item 18. Management**

\* \* \* \* \*

5.(a) Briefly describe the leadership structure of the Registrant's board, including whether the chairman of the board is an interested person of the Registrant, as defined in section 2(a)(19) of the 1940 Act (15 U.S.C. 80a-2(a)(19)). If the chairman of the board is an interested person of the Registrant, disclose whether the Registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the Registrant. This disclosure should indicate why the Registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Registrant. In addition, disclose the extent of the board's role in the risk oversight of the Registrant, such as how the board administers its oversight function, and the effect that this has on the board's leadership structure.

\* \* \* \* \*

6. \* \* \*

(b) Unless disclosed in the table required by paragraph 1 of this Item 18 or in response to paragraph 6(a) of this Item 18, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or subject to the requirements of section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the 1940 Act, and name the companies in which the directorships were held.

\* \* \* \* \*

17. For each director, briefly discuss the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director for the Registrant at the

time that the disclosure is made, in light of the Registrant's business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications.

\* \* \* \* \*

■ 15. Form N-3 (referenced in §§ 239.17a and 274.11b), Item 20 is amended by:

- a. Redesignating paragraph (d), introductory text, and paragraph (d)(i) through paragraph (d)(iv) as paragraph (d)(ii), introductory text, and paragraph (d)(ii)(A) through paragraph (d)(ii)(D);
- b. Adding new paragraph (d)(i);
- c. Redesignating paragraph (e), introductory text, and paragraph (e)(i) through paragraph (e)(iv) as paragraph (e)(i), introductory text, and paragraph (e)(i)(A) through paragraph (e)(i)(D);
- d. Adding new paragraph (e)(ii); and
- e. Adding paragraph (o) after the instructions.

The additions read as follows:

**Note:** The text of Form N-3 does not, and these amendments will not, appear in the Code of Federal Regulations.

**Form N-3**

\* \* \* \* \*

**Item 20. Management**

\* \* \* \* \*

(d)(i) Briefly describe the leadership structure of the Registrant's board, including whether the chairman of the board is an interested person of the Registrant, as defined in Section 2(a)(19) of the 1940 Act (15 U.S.C. 80a-2(a)(19)) and the rules thereunder. If the chairman of the board is an interested person of the Registrant, disclose whether the Registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the Registrant. This

disclosure should indicate why the Registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the Registrant. In addition, disclose the extent of the board's role in the risk oversight of the Registrant, such as how the board administers its risk oversight function, and the effect that this has on the board's leadership structure.

(e) \* \* \*

(ii) Unless disclosed in the table required by paragraph (a) of this Item 20 or in response to paragraph (e)(i) of this Item 20, indicate any directorships held during the past five years by each director in any company with a class of securities registered pursuant to section 12 of the Exchange Act (15 U.S.C. 78l) or subject to the requirements of Section 15(d) of the Exchange Act (15 U.S.C. 78o(d)) or any company registered as an investment company under the 1940 Act, and name the companies in which the directorships were held.

\* \* \* \* \*

(o) For each director, briefly discuss the specific experience, qualifications, attributes, or skills that led to the conclusion that the person should serve as a director for the Registrant at the time that the disclosure is made, in light of the Registrant's business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications.

\* \* \* \* \*

Dated: December 16, 2009.

By the Commission.

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E9-30327 Filed 12-17-09; 4:15 pm]

**BILLING 8011-01-P**

**APPENDIX B-VI**

**John W. White, *Principles Matter*, Address at the Practicing  
Law Institute Conference (Sept. 6, 2006)**



## U.S. Securities and Exchange Commission

### **Speech by SEC Staff: Principles Matter**

*by*

**John W. White**

*Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

Practising Law Institute Conference  
New York, N.Y.  
September 6, 2006

Thank you, Scott. It is truly a pleasure to be here at PLI today, at what I believe is the first comprehensive program that's been put together to address the new executive compensation disclosure rules that the Commission approved a little over a month ago.

I realize that there will be many conferences, as well as countless training programs by executive compensation specialists, and by law firms, as the fall progresses. And there will be countless more presentations to boards of directors and officers of public companies about the new rules. Obviously, members of the SEC staff will not be able to be present at most of these.

But I do hope there is a theme that will permeate all of them — which is what I would like to talk about this morning. That theme is what I consider to be the most important thread that runs throughout this rulemaking — the meaning and significance of principles-based disclosure. Before I turn to that, however, I must first give the standard disclaimer that you have heard so many times before, that the views I'm going to express today are solely my own and do not necessarily reflect the views of the Securities and Exchange Commission or of any members of its staff other than myself.

I realize this may sound like a broken record to those of you who have heard me talk in the past, but I place an incredibly high premium on conferences such as this one and on continuing education programs in general. Simply put, none of us can know everything, and none of us can go it alone. And we really shouldn't try to. PLI should be commended on having assembled such an impressive cast for today's program, and I'm sure you're looking forward as much as I am to learning from our stellar faculty today. But please note — your participation today is no less important than theirs. I believe that disclosure counsel and advisors have a critical role to play as the new rules become the norm. And that's precisely because these rules are so principles-based — there are far fewer bright line rules than some may have wanted, there are no cookie cutters that can be used to produce good disclosure, there are no computer programs that can generate the right words on the page.

As the SEC Commissioners and various staff members (including myself)

have noted repeatedly, executive compensation has changed dramatically in the past decade — in its amount, in its form, in its complexity — while our related disclosure rules had remained stagnant. I believe that part of what motivated the Commission to update its rules was a recognition of this fact and that our rules need to reflect and respond to the changes in American business and our capital markets. But in the same vein as what I said a moment ago, the Commission cannot do it alone. We relied tremendously on the overwhelming, and very constructive, feedback we received from all quarters during the comment period on the rule proposal. And now that the rules have been finalized, we are relying on all of you to help make them work right in practice.

Companies will greatly benefit from the advice and counsel of intelligent people with sound judgment who understand the significance of principles-based disclosure — how to ask the right questions, how to get the right answers and how to translate those answers into disclosure that is clear, understandable and useful to investors. I sincerely hope and anticipate that each of you can be leaders in this considerable effort. I've learned over the years that a key early step in successfully rolling out an important new project — and executive compensation disclosure for the 2007 proxy season is such a project — is finding your partners and training the guides. If you'll accept the challenge of standing with the Commission on this one, I'd like you to start with a two-word message: *principles matter*.

### **The Principle of a Principles-Based System**

There are a wide variety of views on how to explain the term "principles-based" although everyone seems to have the same general idea. I personally like the description Robert Herz, chairman of the FASB, gave in 2002:

Under a principles-based approach, one starts with laying out the key objectives of good reporting in the subject area and then provides guidance explaining the objective and relating it to some common examples. While rules are sometimes unavoidable, the intent is not to try to provide specific guidance or rules for every possible situation. Rather, if in doubt, the reader is directed back to the principles.<sup>1</sup>

Bob was talking about accounting and financial reporting, of course, and that's often where we hear the phrase "principles-based." But it applies equally well to other types of disclosure, and the Commission has embraced it in the recent executive compensation disclosure rulemaking, among other places.

In their study on principles-based accounting a few years ago,<sup>2</sup> my predecessors on the SEC staff noted the difficulties of a pure principles-based — or "principles-only" — system and concluded that some structure is useful. Similarly, in the new rules, the Commission requires some level of tabular presentation both to provide comparability as well as to serve as a framework for an effective principles-based approach. There are a variety of new tables, and the often focused-on Summary Compensation Table has been modified to present all compensation components in dollar amounts and then to add across to a single, aggregate dollar amount for each named executive officer. But even for these tables to work, principles must be followed to determine, and describe, the right entries.

Principles-based disclosure is not a new concept at the Commission. And as

you help companies understand how to meet their new principles-based compensation disclosure obligations, you are not at a loss for past learning. Former Commissioner Cyndi Glassman noted in a speech last March (which I would commend to everyone), that "[o]f all of our disclosure rules, MD&A may be the most principles-based."<sup>3</sup> As such, companies have already been challenged, especially in the past several years, to tell a compelling story with their MD&A's, to make that story relevant, qualitative and contextual, and to avoid mere quantitative disclosure that just repeats the data that is already in the financial statements. Commissioner Glassman referred to an "elevator analysis" — that is, "x" went up and "y" went down — which is, as she said, "descriptive, but not very informative." If you've been doing your MD&A right, you have not ended your drafting when the elevator doors open and you already have a good idea what principles-based disclosure means and what it should look like. As the Commission noted in the Adopting Release, MD&A is an especially good starting point for the new, equally principles-based, Compensation Discussion & Analysis, or CD&A. I'll return to this important subject in just a moment.

I have referred to the principles-based theme as a thread that runs throughout the executive compensation disclosure rulemaking, and if you study the Release carefully, you will see that the phrase appears in multiple places. As a concept, I believe it runs even deeper than just the places that are expressly labeled as such. But calling something principles-based is only a start. For it to have the meaning and impact that it should requires that those who are making the necessary disclosures embrace the concept as much as the regulators who have promulgated the standards.

So what does it mean that key components of executive compensation disclosure are principles-based, and how does that intersect with the role of disclosure counsel and advisors who are charged with the important job of shepherding a company through these new requirements? Going back to Bob Herz's description, what are the key objectives of good reporting in these areas? And I would add to that: how does ascribing to a principles-based approach both help answer the hard disclosure questions and also produce a better end-product for investors?

I'd like to try to answer these questions by looking at a couple of specific examples in our new rules. And in each case, I hope you will see that the principles do matter.

### **Compensation Discussion & Analysis**

Descriptions of the new Compensation Discussion & Analysis section may be the current, favorite home of the term "principles-based". And I believe that is telling and appropriate. Just as CD&A is at the heart of the Commission's recent rulemaking, its principles-based foundation is at the heart of what quality disclosure in this area should be. CD&A is what gives context to the required tables and the numbers in them. As Chairman Cox explained at the Open Meeting at which the Commission adopted the new disclosure rules, CD&A "will give companies an opportunity to explain their compensation policies, and to share with investors how they arrived at the particular levels and forms of compensation for their highest paid executives."<sup>4</sup>

The Commission went on to explain in its Adopting Release:

The purpose of the Compensation Discussion and Analysis disclosure is to provide material information about the

compensation objectives and policies for named executive officers without resorting to boilerplate disclosure. The [CD&A] is intended to put into perspective for investors the numbers and narrative that follow it.<sup>5</sup>

The rules do provide six questions that CD&A *must* answer, and I'm sure we'll be hearing more about those in the panel that follows. The rules also provide 15 examples of topics a company *might* consider addressing in its CD&A. Those examples are neither exhaustive nor mandatory. It is the company, and those drafting its disclosure, that must determine what is material to the company and those making investment and voting decisions. They must then craft the appropriate disclosure that is responsive to those questions and is tailored to the company's particular facts and circumstances.

As I have said, CD&A is at the heart of principles-based compensation disclosure, and we could probably spend hours talking about how that might work, how it should work. But I'd like to look at CD&A from one specific, narrow (but important) vantage point and to think about how its principles-based design should make the right questions easier to identify and the answers easier to develop.

In the Release, the Commission describes the time period CD&A must cover — the last fiscal year. But then the Commission explains that

[CD&A] may also require discussion of post-termination compensation arrangements, on-going compensation arrangements, and policies that the company will apply on a going-forward basis. [CD&A] should also cover actions regarding executive compensation that were taken after the last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.<sup>6</sup>

What does that mean? Well, going back again to Bob Herz's description, we know that one disclosure objective with the CD&A is to provide perspective and context for investors in understanding the rest of the company's executive compensation disclosure. So what additional disclosure, talking about other years, might be necessary or helpful to give that perspective and context, given the general requirement to cover the last fiscal year? That's where *principles matter*.

We all know that the end of a year may be a fairly arbitrary date that is no different than any other day. Or it may not be. But the point is that I can't answer that for your company. Only you can. There's no bright line in CD&A that says if something happens on January 1, after year-end, then it doesn't matter. Same if it happens on February 1. Or if it happened two years ago.

Imagine a hypothetical where five years ago, a company was going through a particularly difficult time, and an executive agreed to work at minimum wage until the company turned itself around. That turn-around happened last year, and the company's Board rewarded her with a handsome

compensation package. The compensation might even seem disproportionate to what this executive did last year, or to the company's peers. I believe most companies in that situation would be happy, perhaps even eager, to explain in their CD&A the context for last year's apparently oversized compensation. The principle would be the same, though, if the numbers and the story went another way. Perhaps this executive endured her pay cut throughout all of last year, but the company turned around in February and the Board just awarded her a substantial bonus or pay raise. It happened after the year end, but it might be invaluable context to understanding the executive's compensation for the year in question. However the facts play out, the disclosure outcome, in principle, should be the same — tell investors the story, completely and fairly, in the context of understanding what was going on with your compensation programs. Let your investors know why the company did what it did, and what effect you expect that to have.

So applying this principle, if something that happened five years ago, or two years ago, is not material to an understanding of your compensation last year, then you do not need to talk about those prior years, or agonize over the excerpt I read a few minutes ago, that CD&A is not limited to the past fiscal year. On the other hand, if something that happened several years ago, or something that happened early this year, before your proxy is prepared, is relevant or necessary to a fair understanding of the year in question, then you do need to talk about it. The same could be true with regard to something that everyone expects to happen next year. The principle that must be applied demands this, and it should in turn guide your analysis and make the requisite disclosures more obvious.

### **Perquisites**

To move on to another example, how do the principles help us understand perquisites disclosure? After all, the phrase "principles-based" does not roll off the tongue quite as often with talk of perks as it does with CD&A, but I believe it should. In the recent Release, the Commission once again declined to provide any bright-line rules as to what constitutes a perquisite or personal benefit. As the Commission said,

"We continue to believe that it is not appropriate for Item 402 to define perquisites or personal benefits, given that different forms of these items continue to develop, and thus a definition would become outdated."<sup>7</sup>

The principle, however, will not become outdated.

Perquisites are an important piece of executive compensation. Subject to a de minimis exception provided in the rules, companies need to disclose to investors the perquisites they provide executives, and their value. For clarity, the Commission has retained its position that the value of a perquisite is its aggregate incremental cost to the company. But it's up to you to figure out what that is.

As to what is a perquisite, the Commission has provided interpretive guidance for analyzing and answering this question. In this regard, as I am sure you have read, a company should engage in a two-step analysis:

1. An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties.

2. Otherwise, an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.

Key phrases in this analysis include "integrally and directly related to the performance of the executive's duties", "direct or indirect benefit that has a personal aspect", and "generally available on a non-discriminatory basis to all employees." You may lament the fact that I cannot give you a hard and fast definition of any of those phrases, but if you let the principles guide you, you will not run astray.

One area of perks analysis that has received considerable attention in recent years is that of executives' personal usage of corporate aircraft. Within that area is a fairly narrow question of whether the costs of a "deadhead" flight leg must be included in the calculation of the perk's value. A deadhead flight leg is when a plane flies essentially empty — typically in order to return to its home base, such as the corporate headquarters.

So the corporate aircraft may take an executive and her family out to Colorado for a ski vacation and then return to corporate headquarters in Virginia. As far as I know, everyone would agree that the flight from Virginia to Colorado was a perquisite for the executive. And it should be valued and disclosed in keeping with the Commission's rules.

With regard to the deadhead leg, I assume that flight from Colorado to Virginia is not cost-free. Perhaps your pilot and flight crew are on salary and the cost of employing them does not change at all based on flight legs. Or alternatively, perhaps they're paid by the hour, or by the mile, and so the flight from Colorado to Virginia does cause the company to incur additional costs. Every company probably has added fuel costs to fly the plane back home, even empty. There might also be added landing fees, or weather report fees, and so on. Many of these incremental costs could easily vary from company to company, depending on the facts and circumstances.

And it could be more complicated. What if instead of flying back home empty, the plane flew on to Texas to pick up another executive from a business trip? Colorado is closer to Texas than Virginia is, so presumably that might change the company's calculation of its aggregate incremental costs. What if the plane had to fly empty to France to pick up another executive from a business meeting? It would have flown empty from Virginia to pick up the other executive in France in any event, but Virginia is closer to France than Colorado is. Again, the costs might change.

To my mind, most companies will typically need to engage in a facts and circumstances analysis to determine the aggregate, incremental cost of a corporate aircraft perk, including any deadhead legs. But countless well-educated and intelligent people have debated this one and come to different answers as to whether the cost of the deadhead leg even needs to be considered at all. I think that stops too short. In my view, if a deadhead flight leg causes a company to incur incremental costs, those must be included in the calculation of the perk's value.

Aside from aggregate incremental cost, there is no firm rule in the Commission Release, or from the staff, on valuing corporate aircraft usage,

let alone deadhead flight legs. There are, however, principles, and companies should not play games with these questions or their answers to them and the disclosures that go with them. I would encourage someone faced with this issue to think through the analysis above carefully, and remember the goals of a principles-based system. What is the disclosure objective? Provide your investors with the value of the perquisites your company accords its executives, based on their aggregate incremental costs. And provide your investors with the material information they need in order to understand that valuation, its context, and the particular facts and circumstances of those perquisites. Remember, *principles matter*.

I have tried to use a couple of different examples to illustrate the importance of principles-based disclosure. There are, of course, many other examples that arise from the recent rulemaking that we could look at—disclosure of option grant practices and disclosure of related party transactions are two that I particularly like and which I hope I will have the chance to address in future forums like this one. I would certainly encourage everyone to think about those two topics carefully in the context of principles-based disclosure.

But, as we all learn to be guides in this principles-based world, let's go back, for a moment, to the fundamentals of principles-based disclosure. Remember the Bob Herz quote. He explained that there is not a specific rule for every possible situation, but there is a principle. As we've seen with perks, there's no bright line rule about deadhead flight legs and what to do with them in calculating a perk's value. But there is a principle.

You may all recall a speech about executive compensation disclosure that my predecessor, Alan Beller, gave two years ago — often referred to as the "all means all" speech even though it never actually uses those words. In his remarks, Alan noted, and I quote, "in the area of executive compensation, management's retort to advice to make additional disclosure may too often be 'Where does it say we have to disclose that?'"<sup>8</sup> Well, depending on the item, there still may not be express words in the rules requiring specific disclosure. But now you will have something to point to, and something to say if asked Alan's question: you will explain that *it's the principles that matter*. To the extent that management is still looking for a flashing sign, the Commission has made it clear that, at least in some regards, they must now look to the principles. I hope that executives at America's public companies will heed and appreciate this, as you, as their advisors and counsel, help them craft the disclosure that their investors have long deserved, and which the Commission now demands.

### **Plain English**

I do have one final disclosure thought to leave with you. I believe it's equally useful (and important) to apply a basic principle of good disclosure to everything you draft. In any of these areas, the disclosure should be clear and concise and provide meaningful information to investors that is easy to understand. The substance and content of your disclosure need to be principles-based; the presentation does as well. It needs to be in Plain English.

Plain English is a phrase, like "principles-based", that may get thrown around a lot. It's important to remember what it really means though. It does not mean "dumbing down". It does not require stripping your disclosure of depth or context. It does mean presenting complex information in a clear and concise manner that is understandable to a broad

audience. It takes time to write well, to write disclosure that is understandable and useful to investors. Take that time. Use the active voice, and speak directly. Write for investors, not lawyers.

## Conclusion

I started my remarks today by talking about the new Compensation Discussion & Analysis section. Obviously, no one has drafted one of these before. There's no boilerplate out there, no precedents to mark up and reuse. If you're used to getting pressure to "match up" your disclosure to the disclosure of your company's peers or competitors, that won't exist this first year. You have a chance to start with a clean slate in that sense. Take it, and make a difference. And as you're working on those CD&A's for the first time, I hope you will remember my remarks this morning and what I've said about principles-based disclosure.

As we all look ahead to the upcoming proxy season, I am sincerely heartened and enthusiastic about the chances of witnessing a sea change in the quality, and usefulness, of executive compensation disclosure. I believe that the groundwork the Commission has laid in adopting its new principles-based disclosure standards has considerably advanced the interests of investors. That vision will not reach fruition, however, without the partnership of America's companies in stepping up and providing the public with their own principles-based disclosures. That's where we need your help, and I hope we have given you a standard, and examples, to cite to your skeptical clients. Remember the message that should be conveyed: *the principles matter.*

Thank you.

## Endnotes

<sup>1</sup> "Remarks before the Financial Executives International Current Financial Reporting Issues Conference," Robert H. Herz, November 4, 2002.

<sup>2</sup> "Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System," by the Office of the Chief Accountant and the Office of Economic Analysis, U.S. Securities and Exchange Commission, July 25, 2003, available at <http://www.sec.gov/news/studies/principlesbasedstand.htm>.

<sup>3</sup> "Remarks before the Tenth Annual Corporate Counsel Institute: Priorities and Concerns at the SEC," Cynthia A. Glassman, Commissioner, U.S. Securities and Exchange Commission, March 9, 2006, available at <http://www.sec.gov/news/speech/spch030906cag.htm>.

<sup>4</sup> "Introductory Remarks at the SEC Open Meeting," Christopher Cox, Chairman, U.S. Securities and Exchange Commission, July 26, 2006, available at <http://www.sec.gov/news/speech/2006/spch072606cc.htm>.

<sup>5</sup> SEC Release No. 33-8732A, "Executive Compensation and Related Party Disclosures," August 29, 2006, (the "Release"), at p. 29, available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.

<sup>6</sup> Release at pp 34-35.

<sup>7</sup> Release at p.73.

<sup>8</sup> "Remarks Before Conference of the NASPP, The Corporate Counsel and the Corporate Executive," Alan L. Beller, Director, Division of Corporation Finance, October 20, 2004, available at <http://www.sec.gov/news/speech/spch102004alb.htm>.

<http://www.sec.gov/news/speech/2006/spch090606jww.htm>

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Modified: 09/11/2006

**APPENDIX B-VII**

**June 2012** Release adopting Compensation Committee and Compensation Adviser Rules

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 229 and 240

[Release Nos. 33-9330; 34-67220; File No. S7-13-11]

RIN 3235-AK95

### Listing Standards for Compensation Committees

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** We are adopting a new rule and amendments to our proxy disclosure rules to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10C to the Securities Exchange Act of 1934. Section 10C requires the Commission to adopt rules directing the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that is not in compliance with Section 10C's compensation committee and compensation adviser requirements. In accordance with the statute, new Rule 10C-1 directs the national securities exchanges to establish listing standards that, among other things, require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent," as defined in the listing standards of the national securities exchanges adopted in accordance with the final rule. In addition, pursuant to Section 10C(c)(2), we are adopting amendments to our proxy disclosure rules concerning issuers' use of compensation consultants and related conflicts of interest.

**DATES:** *Effective Date:* July 27, 2012.

*Compliance Dates:* Each national securities exchange and national securities association must provide to the Commission, no later than September 25, 2012, proposed rule change submissions that comply with the requirements of Exchange Act Rule 10C-1. Further, each national securities exchange and national securities association must have final rules or rule amendments that comply with Rule 10C-1 approved by the Commission no later than June 27, 2012. Issuers must comply with the disclosure changes in Item 407 of Regulation S-K in any proxy or information statement for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors will be elected occurring on or after January 1, 2013.

**FOR FURTHER INFORMATION CONTACT:** N. Sean Harrison, Special Counsel, Office of Rulemaking, at (202) 551-3430, or Heather Maples, Senior Special Counsel, Office of Chief Counsel, at (202) 551-3520, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are adopting new Rule 10C-1 under the Securities Exchange Act of 1934<sup>1</sup> and amendments to Item 407<sup>2</sup> of Regulation S-K.<sup>3</sup>

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<sup>1</sup> 15 U.S.C. 78a *et seq.*

<sup>2</sup> 17 CFR 229.407.

<sup>3</sup> 17 CFR 229.10 through 229.1208.

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### I. Background And Summary

On March 30, 2011, we proposed a new rule and rule amendments<sup>4</sup> to implement Section 10C of the Securities Exchange Act of 1934 (the "Exchange Act"),<sup>5</sup> as added by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act").<sup>6</sup> Section 10C requires the Commission to direct the national securities exchanges<sup>7</sup> (the "exchanges") and national securities associations<sup>8</sup> to prohibit the listing of any equity

<sup>4</sup> See Release No. 33-9199 (Mar. 30, 2011) [76 FR 18966] (the "Proposing Release").

<sup>5</sup> 15 U.S.C. 78j-3.

<sup>6</sup> Public Law 111-203, 124 Stat. 1900 (2010).

<sup>7</sup> A "national securities exchange" is an exchange registered as such under Section 6 of the Exchange Act [15 U.S.C. 78f]. There are currently sixteen national securities exchanges registered under Section 6(a) of the Exchange Act: NYSE Amex (formerly the American Stock Exchange), BATS Exchange, BATS Y-Exchange, BOX Options Exchange, C2 Options Exchange, Chicago Board Options Exchange, Chicago Stock Exchange, EDGA Exchange, EDGX Exchange, International Securities Exchange, NASDAQ OMX BX (formerly the Boston Stock Exchange), The NASDAQ Stock Market, National Stock Exchange, New York Stock Exchange, NYSE Arca and NASDAQ OMX PHLX (formerly Philadelphia Stock Exchange). Certain exchanges are registered with the Commission through a notice filing under Section 6(g) of the Exchange Act for the purpose of trading security futures. See Section II.B.1, below, for a discussion of these types of exchanges.

<sup>8</sup> A "national securities association" is an association of brokers and dealers registered as such under Section 15A of the Exchange Act [15 U.S.C. 78o-3]. The Financial Industry Regulatory Authority ("FINRA") is the only national securities association registered with the Commission under Section 15A of the Exchange Act. FINRA does not list equity securities; therefore, we refer only to national securities exchanges in this release. In addition, Section 15A(k) of the Exchange Act [15 U.S.C. 78o-3(k)] provides that a futures association registered under Section 17 of the Commodity Exchange Act [7 U.S.C. 21] shall be registered as a national securities association for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products pursuant to Section 15(b)(11) of the Exchange Act [15 U.S.C. 78o(b)(11)]. See Section II.B.1, below, for a discussion regarding security futures products.

security of an issuer, with certain exceptions, that does not comply with Section 10C's compensation committee and compensation adviser requirements.<sup>9</sup>

Specifically, Section 10C(a)(1) of the Exchange Act requires the Commission to adopt rules directing the exchanges to establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors and to be "independent."<sup>10</sup> The term "independent" is not defined in Section 10C. Instead, Section 10C(a)(3) provides that "independence" is to be defined by the exchanges after taking into consideration "relevant factors," which are required to include (1) a director's source of compensation, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and (2) whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. Section 10C(a)(4) of the Exchange Act requires our rules to permit the exchanges to exempt particular relationships from the independence requirements, as each exchange determines is appropriate, taking into consideration the size of an issuer and any other relevant factors.

In addition to the independence requirements set forth in Section 10C(a), Section 10C(f) of the Exchange Act requires the Commission to adopt rules directing the exchanges to establish listing standards that provide for the following requirements relating to compensation committees and compensation consultants, independent legal counsel and other advisers (collectively, "compensation advisers"), as set forth in paragraphs (b)–(e) of Section 10C:

- Each compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of compensation advisers;<sup>11</sup>

- Before selecting any compensation adviser, the compensation committee must take into consideration specific factors identified by the Commission that affect the independence of compensation advisers;<sup>12</sup>

- The compensation committee must be directly responsible for the appointment, compensation and oversight of the work of compensation advisers;<sup>13</sup> and

- Each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.<sup>14</sup>

Finally, Section 10C(c)(2) requires each issuer to disclose in any proxy or consent solicitation material for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting), in accordance with Commission regulations, whether the issuer's compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed.

We proposed new Exchange Act Rule 10C–1 to implement the compensation committee listing requirements of Sections 10C(a)–(g)<sup>15</sup> of the Exchange Act. We proposed rule amendments to Item 407 of Regulation S–K to require the disclosures mandated by Section 10C(c)(2), which are to be provided in any proxy or information statement relating to an annual meeting of shareholders at which directors are to be elected (or special meeting in lieu of the annual meeting). In connection with these amendments, we also proposed to revise the current disclosure requirements with respect to the retention of compensation consultants.

The comment period for the Proposing Release closed on May 19, 2011.<sup>16</sup> We received 58 comment letters from 56 different commentators, including pension funds, corporations, compensation consulting firms, professional associations, trade unions, institutional investors, investment advisory firms, law firms, academics, individual investors and other interested parties. Commentators generally supported the proposed implementation of the new requirements. Some commentators urged us to adopt additional requirements not mandated by the Act. Other commentators opposed some aspects of the proposed rule and rule

amendments and suggested modifications to the proposals.

We have reviewed and considered all of the comments that we received on the proposals. The final rules reflect a number of changes made in response to these comments. We discuss our revisions with respect to the proposed rule and rule amendments in more detail throughout this release.

## II. Discussion of the Final Rules

### A. Exchange Listing Standards

#### 1. Applicability of Listing Standards

We proposed to direct the exchanges to adopt listing standards that would apply Section 10C's independence requirements to members of a listed issuer's compensation committee as well as any committee of the board that performs functions typically performed by a compensation committee. We are adopting this aspect of the rule substantially as proposed, but with one change reflecting comments we received.

##### a. Proposed Rule

In enacting Section 10C of the Exchange Act, Congress intended to require that "board committees that set compensation policy will consist only of directors who are independent."<sup>17</sup> In addition, Congress sought to provide "shareholders in a public company" with "additional disclosures involving compensation practices."<sup>18</sup> Although Section 10C includes numerous provisions applicable to the "compensation committees" of listed issuers, it does not require a listed issuer to have a compensation committee or a committee that performs functions typically assigned to a compensation committee. Moreover, Section 10C does not provide that, in the absence of a compensation committee, the entire board of directors will be considered to be the compensation committee, nor does it include provisions that have the effect of requiring a compensation committee as a practical matter.

Neither the Act nor the Exchange Act defines the term "compensation committee."<sup>19</sup> Our rules do not

<sup>17</sup> See H.R. Rep. No. 111–517, Joint Explanatory Statement of the Committee of Conference, Title IX, Subtitle E "Accountability and Executive Compensation," at 872–873 (Conf. Rep.) (June 29, 2010).

<sup>18</sup> *Id.*

<sup>19</sup> By contrast, Section 3(a)(58) of the Exchange Act defines an "audit committee" as "a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial

Continued

<sup>9</sup> See Exchange Act Sections 10C(a) and (f).

<sup>10</sup> Five categories of issuers are excluded from this requirement: controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act"), and foreign private issuers that disclose in their annual reports the reasons why they do not have an independent compensation committee.

<sup>11</sup> Exchange Act Sections 10C(c)(1)(A) and 10C(d)(1).

<sup>12</sup> Exchange Act Section 10C(b).

<sup>13</sup> Exchange Act Sections 10C(c)(1)(B) and 10C(d)(2).

<sup>14</sup> Exchange Act Section 10C(e).

<sup>15</sup> Section 10C(g) of the Exchange Act exempts controlled companies from the requirements of Section 10C.

<sup>16</sup> We extended the original comment period deadline from April 29, 2011 to May 19, 2011. See Listing Standards for Compensation Committees, Release No. 33–9203 (Apr. 29, 2011) [76 FR 25273].

currently require that a listed issuer establish a compensation committee. Current exchange listing standards, however, generally require listed issuers either to have a compensation committee or to have independent directors determine, recommend or oversee specified executive compensation matters.<sup>20</sup> For example, the New York Stock Exchange (“NYSE”) requires a listed issuer to have a compensation committee composed solely of independent directors and to assign various executive compensation-related tasks to that committee.<sup>21</sup> On the other hand, the NASDAQ Stock Market (“Nasdaq”) does not mandate that a listed issuer have a compensation committee, but requires that executive compensation be determined or recommended to the board for determination either by a compensation committee composed solely of independent directors or by a majority of the board’s independent directors in a vote in which only independent directors participate.<sup>22</sup> Some of the

statements of the issuer; and \* \* \* if no such committee exists with respect to an issuer, the entire board of directors of the issuer.”

<sup>20</sup> There are some exchanges registered under Section 6(a) of the Exchange Act that have not adopted listing standards that require executive compensation determinations for listed issuers to be made or recommended by an independent compensation committee or independent directors. However, these exchanges, which include the BOX Options Exchange, International Securities Exchange, EDGA Exchange, EDGX Exchange, BATS Y-Exchange, and C2 Options Exchange, currently either trade securities only pursuant to unlisted trading privileges or trade only standardized options. In addition, the listing standards of certain exchanges that are registered with the Commission for the purpose of trading security futures do not address executive compensation matters. See Section II.B.1, below, for a discussion of these types of exchanges.

<sup>21</sup> See NYSE Listed Company Manual Section 303A.05. Section 303A.05 permits a listed issuer’s board to allocate the responsibilities of the compensation committee to another committee, provided that the committee is composed entirely of independent directors and has a committee charter. The NYSE exempts certain issuers from this requirement, including controlled companies, limited partnerships, companies in bankruptcy, and closed-end and open-end management investment companies registered under the Investment Company Act. See NYSE Listed Company Manual Section 303A.00.

<sup>22</sup> See Nasdaq Rule 5605(d). Based on data supplied by Nasdaq, we understand that fewer than 2% of its listed issuers utilize the alternative of having independent board members, and not a committee, oversee compensation. See also Nasdaq IM 5605–6 (stating that the Nasdaq rule “is intended to provide flexibility for a [c]ompany to choose an appropriate board structure and to reduce resource burdens, while ensuring [i]ndependent [d]irector control of compensation decisions.”). Nasdaq exempts certain issuers from this requirement, including asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies registered under the Investment Company Act, and controlled companies. See Nasdaq Rules 5615(a) and 5615(c)(2).

other exchanges have standards comparable to the NYSE’s and require their listed issuers to have independent compensation committees.<sup>23</sup> Other exchanges have standards comparable to Nasdaq’s and, in the absence of a compensation committee, require executive compensation determinations to be made or recommended by a majority of independent directors on the listed issuer’s board.<sup>24</sup>

Proposed Rule 10C–1(b) would direct the exchanges to adopt listing standards that would apply to a listed issuer’s compensation committee or, in the absence of such a committee, any other board committee that performs functions typically performed by a compensation committee, including oversight of executive compensation. Proposed Rule 10C–1(b), however, would not require the independence listing requirements to apply to members of the board who oversee executive compensation in the absence of a board committee.<sup>25</sup>

#### b. Comments on the Proposed Rule

Comments on this proposal were generally favorable. Many commentators supported the functional approach of the proposed rule, which would require compensation committee independence listing standards to apply to any board committee charged with oversight of executive compensation, regardless of its formal title.<sup>26</sup> In response to our request for comment on whether we should direct the exchanges to apply the proposed rule’s requirements to directors who oversee executive compensation matters in the absence of a formal committee structure, several commentators recommended that we do so,<sup>27</sup> and two of these commentators suggested that such a requirement

<sup>23</sup> See NYSE Arca Rule 5.3(k)(4); National Stock Exchange Rule 15.5(d)(5); and NASDAQ OMX PHLX Rule 867.05.

<sup>24</sup> See NASDAQ OMX BX Rule 4350(c)(3); NYSE Amex Company Guide Section 805; Chicago Board Options Exchange Rule 31.10; Chicago Stock Exchange Article 22, Rules 19(d) and 21; and BATS Exchange Rule 14.10(c)(4).

<sup>25</sup> As noted, to the extent no board committee is authorized to oversee executive compensation, under applicable listing standards, board determinations with respect to executive compensation matters may be made by the full board with only independent directors participating. In such situations, under state corporate law, we understand that action by the independent directors would generally be considered action by the full board, not action by a committee.

<sup>26</sup> See, e.g., letters from Chris Barnard (“Barnard”), the Chartered Financial Analyst Institute (“CFA”) and Railpen Investments (“Railpen”).

<sup>27</sup> See, e.g., letters from Barnard, Better Markets Inc. (“Better Markets”), CFA, Georg Merkl (“Merkl”), National Association of Corporate Directors (“NACD”) and Railpen.

would help ensure that companies could not rely on technicalities or loopholes to avoid independent director oversight of executive compensation.<sup>28</sup> Another commentator, however, argued that the final rule should not apply to independent directors who determine, or recommend to the board, executive compensation matters in the absence of a formal committee structure.<sup>29</sup> This commentator believed that broadening the scope of the rule to apply to a group of directors who determine executive compensation in lieu of a formal committee is not clearly mandated by Section 10C and would burden listed issuers that do not have a board committee overseeing executive compensation, without necessarily improving their oversight of executive compensation.<sup>30</sup>

In the Proposing Release, we requested comment on whether the exchanges should be prohibited from listing issuers that do not have compensation committees. Several commentators supported the concept of mandatory compensation committees for listed issuers, on the basis that executive compensation deserves special, ongoing attention by a dedicated working group of the board; a committee structure may promote increased board expertise on compensation; and having a formal committee would help promote accountability to shareholders.<sup>31</sup> Several other commentators opposed such requirements, arguing that the exchanges should be allowed broad discretion on how listed issuers determine compensation matters.<sup>32</sup>

#### c. Final Rule

After considering the comments, we are adopting Rule 10C–1(b) substantially as proposed. Under the final rule, the exchanges will be directed to adopt listing standards that apply to any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not such committee also

<sup>28</sup> See letters from NACD and Railpen.

<sup>29</sup> See letter from the American Bar Association, Business Law Section (“ABA”).

<sup>30</sup> This commentator also noted that, “[a]s a practical matter, we understand that most listed companies that are accelerated filers under the Exchange Act, and many listed companies that are smaller reporting companies, already have compensation committees or committees performing the functions of compensation committees.” *Id.*

<sup>31</sup> See letters from the American Federation of Labor and Congress of Industrial Organizations (“AFL–CIO”), the Council of Institutional Investors (“CII”), Merkl and the Ohio Public Employees’ Retirement System (“OPERS”).

<sup>32</sup> See letters from ABA, CFA and NACD.

performs other functions or is formally designated as a compensation committee.<sup>33</sup> In addition, the listing standards adopted by the exchanges must also apply the director independence requirements of Rule 10C-1(b)(1), the requirements relating to consideration of a compensation adviser's independence in Rule 10C-1(b)(4), and the requirements relating to responsibility for the appointment, compensation and oversight of compensation advisers in Rules 10C-1(b)(2)(ii) and (iii) to the members of a listed issuer's board of directors who, in the absence of a board committee, oversee executive compensation matters on behalf of the board of directors. We believe this approach is an appropriate way to implement Section 10C. The listing standards are intended to benefit investors by requiring that the independent directors of a listed issuer oversee executive compensation matters, consider independence criteria before retaining compensation advisers and have responsibility for the appointment, compensation and oversight of these advisers. We believe it would benefit investors to implement Section 10C in a manner that does not allow listed issuers to avoid these listing standards by simply not having a compensation committee or another board committee oversee executive compensation matters.

We have determined not to require the exchanges to apply the listing standards relating to the compensation committee's authority to retain compensation advisers, Rule 10C-1(b)(2)(i), or required funding for payment of such advisers to directors who oversee executive compensation matters outside of the structure of a formal board committee, Rule 10C-1(b)(3). As noted above, we understand that action by independent directors acting outside of a formal committee structure would generally be considered action by the full board of directors. As a result, we believe it is unnecessary to apply these requirements to directors acting outside of a formal committee structure, as they retain all the powers of the board of directors in making executive compensation determinations.

We are implementing this change by defining the term "compensation committee" so that it includes, for all purposes other than the requirements relating to the authority to retain

<sup>33</sup> For example, if a listed issuer has a "corporate governance committee" or a "human resources committee," the responsibilities of which include, among other matters, oversight of executive compensation, such committee will be subject to the compensation committee listing requirements of the applicable exchange.

compensation advisers in Rule 10C-1(b)(2)(i) and required funding for payment of such advisers in Rule 10C-1(b)(3), the members of the board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a formal committee. For ease of reference throughout this release, in our discussion of the final rules we are adopting, references to an issuer's "compensation committee" include any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not formally designated as a "compensation committee," as well as, to the extent applicable, those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of such a committee.

The final rule will not require a listed issuer to have a compensation committee or a committee that performs functions typically assigned to a compensation committee. We believe this aspect of the final rule is consistent with the requirements of Section 10C, which does not direct us to require such a committee. Moreover, in light of our determination to apply the requirements for director independence, consideration of adviser independence, and responsibility for the appointment, compensation and oversight of compensation advisers to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a formal committee, there will be little difference between the requirements applicable to listed issuers that do not have compensation committees as compared to those applicable to issuers that do have compensation committees.

## 2. Independence Requirements

Proposed Rule 10C-1(b)(1) would require each member of a listed issuer's compensation committee to be a member of the board of directors and to be independent. We proposed to require that the exchanges develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, the two factors enumerated in Section 10C(a)(3). We are adopting these requirements as proposed, except that, as discussed above, this aspect of the final rule will also apply to those members of a listed issuer's board of directors who oversee executive compensation matters on

behalf of the board of directors in the absence of a board committee.

### a. Proposed Rule

Most exchanges that list equity securities already require directors on compensation committees or directors determining or recommending executive compensation matters to be "independent" under their general independence standards. Although independence requirements and standards vary somewhat among the different exchanges, listing standards generally prescribe certain bright-line independence tests (including restrictions on compensation, employment and familial or other relationships with the listed issuer or the executive officers of the listed issuer that could interfere with the exercise of independent judgment) that directors must meet in order to be considered independent.<sup>34</sup> For example, both NYSE and Nasdaq rules preclude a finding of independence if the director is or recently was employed by the listed issuer, the director's immediate family member is or recently was employed as an executive officer of the listed issuer, or the director or director's family member received compensation from the listed issuer in excess of specified limits.<sup>35</sup> In addition, under both NYSE and Nasdaq rules, directors may be disqualified based on their or their family members' relationships with a listed issuer's auditor, affiliation with entities that have material business relationships with the listed issuer, or employment at a company whose compensation committee includes any of the listed issuer's executive officers.<sup>36</sup> We note, however, that with the exception of audit committee membership requirements, stock ownership alone will not automatically preclude a director from being considered independent under either NYSE or Nasdaq listing standards.<sup>37</sup> The NYSE and Nasdaq also require their listed issuers' boards to affirmatively determine that each independent director either, in NYSE's case, has no material relationship with the issuer<sup>38</sup> or, in Nasdaq's case, has no relationship which, in the opinion of the issuer's board of directors, would interfere with the director's exercise of independent judgment in carrying out his or her

<sup>34</sup> See NYSE Listed Company Manual Section 303A.02(b); Nasdaq Rule 5605(a)(2).

<sup>35</sup> See *id.*

<sup>36</sup> See *id.*

<sup>37</sup> See Commentary to NYSE Listed Company Manual Section 303A.02(a); Nasdaq Rule 5605; Nasdaq IM-5605.

<sup>38</sup> See NYSE Rule 303A.02(a).

responsibilities.<sup>39</sup> The other exchanges have similar requirements.<sup>40</sup>

In addition to meeting exchange listing standards, there are other reasons for members of the compensation committee to be independent. For example, in order for a securities transaction between an issuer and one of its officers or directors to be exempt from short-swing profit liability under Section 16(b) of the Exchange Act, the transaction must be approved by the full board of directors or by a committee of the board that is composed solely of two or more “Non-Employee Directors,” as defined in Exchange Act Rule 16b-3(b)(3).<sup>41</sup> We understand that many issuers use their independent compensation committees to avail themselves of this exemption.<sup>42</sup> Similarly, if an issuer wishes to preserve the tax deductibility of the amounts of certain awards paid to executive officers, among other things, the performance goals of such awards must be determined by a compensation committee composed of two or more “outside directors,” as defined in Section 162(m) of the Internal Revenue Code.<sup>43</sup> The definitions of “Non-

Employee Director” and “outside director” are similar to the exchanges’ definitions of independent director.

The proposed rule would direct the exchanges to develop a definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to, a director’s source of compensation, including any consulting, advisory or other compensatory fee paid by the issuer to such director, and whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. We did not propose to specify any additional factors that the exchanges must consider in determining independence requirements for members of compensation committees.

In proposing Rule 10C-1(b)(1), we considered the similarities and differences between Section 952 of the Act and Section 301 of the Sarbanes-Oxley Act of 2002.<sup>44</sup> Section 301 of the Sarbanes-Oxley Act added Section 10A(m)(1) to the Exchange Act,<sup>45</sup> which required the Commission to direct the exchanges to prescribe independence requirements for audit committee members. Although the independence factors in Section 10C(a)(1) are similar to those in Section 10A(m)(1)—and indeed, Section 952 of the Act essentially provides the compensation committee counterpart to the audit committee requirements of Section 301 of the Sarbanes-Oxley Act—one significant difference is that Section 10C(a) requires only that the exchanges “consider relevant factors” (emphasis added), which include the source of compensation and any affiliate relationship, in developing independence standards for compensation committee members, whereas Section 10A(m) expressly states that certain relationships preclude independence: An audit committee member “*may not*, other than in his or her capacity as a member of the audit committee \* \* \* [a]ccept any consulting, advisory, or other compensatory fee from the issuer; or [b]e an affiliated person of the issuer or

any subsidiary thereof” (emphasis added).<sup>46</sup>

As a result, we interpret Section 10C as providing the exchanges more discretion to determine the standards of independence that compensation committee members are required to meet than they are provided under Section 10A with respect to audit committee members. Section 10A(m) prescribes minimum criteria for the independence of audit committee members. In contrast, Section 10C gives the exchanges the flexibility to establish their own minimum independence criteria for compensation committee members after considering relevant factors, including the two enumerated in Section 10C(a)(3). Accordingly, the proposed rule would allow each exchange to establish its own independence definition, subject to Commission review and approval pursuant to Section 19(b) of the Exchange Act, provided the exchange considers relevant factors in establishing its own standards, including those specified in Section 10C(a)(3).

#### b. Comments on the Proposed Rule

Comments on this proposal were generally favorable. Many commentators supported permitting the exchanges to establish their own independence criteria for compensation committee members, provided they consider the statutorily-required factors.<sup>47</sup> One commentator claimed that this approach would utilize the relative strengths and experiences of the exchanges by avoiding a “one size fits all” approach and could be more conducive to responding quickly to changes in corporate governance.<sup>48</sup> Another commentator noted that the proposal permitted each exchange to develop more finely tuned listing rules that

<sup>46</sup> See Section 10A(m) of the Exchange Act. Exchange Act Rule 10A-3 states that in order to be considered “independent,” an audit committee member “may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee \* \* \* [a]ccept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof \* \* \*.” For non-investment company issuers, the audit committee member also cannot be an affiliated person of the issuer or its subsidiaries. For investment company issuers, the audit committee member cannot be an “interested person” of the issuer as defined in Section 2(a)(19) of the Investment Company Act.

<sup>47</sup> See, e.g., letters from ABA, Barnard, Sanjai Bhagat, et al. (“Bhagat”), the Center on Executive Compensation (“CEC”), CFA, Davis Polk & Wardwell LLP (“Davis Polk”), MarkWest Energy Partners, L.P. (“MarkWest”), NYSE Euronext (“NYSE”), Pfizer Inc. (“Pfizer”) and Sullivan & Cromwell LLP (“S&C”).

<sup>48</sup> See letter from MarkWest.

<sup>39</sup> See Nasdaq Rule 4200(a)(15).

<sup>40</sup> See, e.g., NYSE Arca Rule 5.3(k)(1) and NYSE AMEX Company Guide Section 803.A.02.

<sup>41</sup> As defined in Exchange Act Rule 16b-3(b)(3)(i) [17 CFR 240.16b-3(b)(3)(i)], a “Non-Employee Director” is a director who is not currently an officer (as defined in Rule 16a-1(f)) of the issuer or a parent or subsidiary of the issuer, or otherwise currently employed by the issuer or a parent or subsidiary of the issuer; does not receive compensation, either directly or indirectly, from the issuer or a parent or subsidiary of the issuer for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed the dollar amount for which disclosure would be required pursuant to Item 404(a) of Regulation S-K; and does not possess an interest in any other transaction for which disclosure would be required pursuant to Item 404(a) of Regulation S-K. In addition, Rule 16b-3(b)(3)(ii) provides that a Non-Employee Director of a closed-end investment company is a director who is not an “interested person” of the issuer, as that term is defined in Section 2(a)(19) of the Investment Company Act [15 U.S.C. 80a-2(a)(19)].

<sup>42</sup> See letter from Sullivan & Cromwell LLP to Facilitating Shareholder Director Nominations, Release No. 34-60089, available at <http://www.sec.gov/comments/s7-10-09/s71009-430.pdf>. (“In our experience, many compensation committee charters require their members to meet the requirements of Rule 16b-3 and Section 162(m).”); Ira G. Bogner & Michael Krasnovsky, “Exchange Rules Impact Compensation Committee Composition,” The Metropolitan Corporate Counsel, Apr. 2004, at 17 (“Most compensation committees of public companies include at least two directors that are ‘outside directors’ under Section 162(m) of the Internal Revenue Code \* \* \* and ‘non-employee directors’ under Rule 16b-3 of the Securities Exchange Act \* \* \*”).

<sup>43</sup> A director is an “outside director” if the director (A) is not a current employee of the publicly held corporation; (B) is not a former employee of the publicly held corporation who receives compensation for prior services (other than

benefits under a tax-qualified retirement plan) during the taxable year; (C) has not been an officer of the publicly held corporation; and (D) does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services. Section 162(m) of the Internal Revenue Code of 1986, as amended. Treas. Reg. Section 1.162-27(e)(3).

<sup>44</sup> Public Law 107-204, 116 Stat. 745 (2002).

<sup>45</sup> 15 U.S.C. 78j-1(m)(1).

reflect the particular characteristics of each exchange's listed companies.<sup>49</sup>

Allowing the exchanges the latitude to establish their own independence criteria concerned some commentators, however.<sup>50</sup> These commentators cautioned against permitting the exchanges to establish their own independence criteria and argued in support of a uniform definition of independence across all exchanges.<sup>51</sup> One of these commentators claimed that uniform requirements would serve as a deterrent to engaging in a "race to the bottom."<sup>52</sup> Another commentator recommended that the exchanges' independence criteria should preclude a finding of independence if a director fails to meet the definitions of an "outside" director under Section 162(m) of the Internal Revenue Code or a "non-employee" director under Exchange Act Rule 16b-3(b)(3); is a party to a related party transaction that must be disclosed pursuant to Item 404 of Regulation S-K; or has an immediate family member who is employed by the company.<sup>53</sup>

Some commentators urged us to require the exchanges to consider additional factors in developing a definition of independence.<sup>54</sup> Several commentators advocated that we should require the exchanges to include business or personal relationships between a compensation committee member and executive officers of the issuer as factors for consideration,<sup>55</sup> as well as board interlocks.<sup>56</sup> Another commentator believed that mandatory factors for consideration should include linkages between a director's family members and the company or its affiliates and a director's relationships with other directors.<sup>57</sup> One commentator believed that, in setting

independence standards for compensation committee members, the exchanges should be required to consider all factors relevant to assessing the independence of a board member, including personal, family and business relationships, and all other factors that might compromise a board member's judgment on matters relating to executive compensation.<sup>58</sup>

Three commentators, including the NYSE, stated that we should not specify additional mandatory factors that the exchanges must consider in developing a definition of independence applicable to compensation committee members.<sup>59</sup> In particular, the NYSE expressed concern that if the final rule specifies additional mandatory factors for consideration, such factors would be understood by the exchanges and by many boards of directors as the Commission's determination that such relationships compromise director independence, which would thereby effectively preempt the review of compensation committee independence standards that the exchanges would be required to undertake under the rule.<sup>60</sup>

In the Proposing Release, we noted the concern of several commentators<sup>61</sup> that our rules implementing Section 10C not prohibit directors affiliated with significant investors (such as private equity funds and venture capital firms) from serving on compensation committees. We requested comment on whether a director affiliated with a shareholder with a significant ownership interest who is otherwise independent would be sufficiently independent for the purpose of serving on the compensation committee. Many commentators advocated that a significant shareholder's stock ownership alone should not preclude directors affiliated with the significant shareholder from serving on an issuer's compensation committee.<sup>62</sup> A number

of these commentators noted that equity ownership by directors serves to align the directors' interests with those of the shareholders with respect to compensation matters.<sup>63</sup> According to one commentator, private equity funds typically have a strong institutional belief in the importance of appropriately structured and reasonable compensation arrangements, and the directors elected by such funds are highly incentivized to rigorously oversee compensation arrangements because the funds' income, success and reputations are dependent on creating value for shareholders.<sup>64</sup> This commentator also noted that, while private equity funds may seek to create shareholder value by strengthening or replacing the management team of a portfolio company, such funds rarely appoint partners or employees of their affiliated private equity firms to serve as executives of portfolio companies.<sup>65</sup>

One commentator did not believe that directors affiliated with large shareholders should be permitted to serve on compensation committees, noting that situations could arise where the director's obligation to act in the best interest of all shareholders would conflict with the director's or large shareholder's own interest.<sup>66</sup> Two additional commentators noted that private equity and venture capital firms may engage in significant transactions with an issuer, and urged that all ties to the company be considered in evaluating the independence of directors affiliated with significant shareowners.<sup>67</sup>

Our proposed rule would require the exchanges to consider current relationships between the issuer and the compensation committee member, and we requested comment on whether relationships prior to a director's appointment to the compensation committee or, for directors already serving as compensation committee members when the new listing standards take effect, prior to the effective date of the new listing standards, should also be considered. Only two commentators expressed support for establishing any such "look-back" period.<sup>68</sup> One commentator, although not supporting a look-back period, believed that the decision of whether to require one should be determined not by the Commission but

("Jackson"), the Private Equity Growth Capital Council ("PEGCC") and SCSSGP.

<sup>49</sup> See, e.g., letters from CEC and Davis Polk.

<sup>50</sup> See letter from PEGCC.

<sup>51</sup> See *id.*

<sup>52</sup> See letter from Barnard.

<sup>53</sup> See letters from AFSCME and UAW.

<sup>54</sup> See letters from Better Markets and CFA.

<sup>49</sup> See letter from ABA (noting that "the average board size of an S&P 100 company (which are primarily listed on the NYSE) is approximately 50% larger than the average board size of a Silicon Valley 150 company (which are primarily listed on Nasdaq)" and that "[i]nvestors in these disparate categories of companies have meaningfully different expectations and interests in the governance context").

<sup>50</sup> See, e.g., letters from the American Federation of State, County and Municipal Employees ("AFSCME"), California Public Employees' Retirement System ("CalPERS"), the Colorado Public Employees' Retirement Association ("COPERA"), OPERS and USS.

<sup>51</sup> See letters from CalPERS, Railpen and USS.

<sup>52</sup> See letter from USS.

<sup>53</sup> See letter from AFL-CIO.

<sup>54</sup> See, e.g., letters from AFSCME, Better Markets, CFA, CII, the State Board of Administration of Florida ("FLSBA") and UAW Retiree Medical Benefits Trust ("UAW").

<sup>55</sup> See, e.g., letters from AFL-CIO, AFSCME, CFA, CII, FLSBA and UAW.

<sup>56</sup> See, e.g., letters from AFSCME, CII, FLSBA and UAW.

<sup>57</sup> See letter from CII.

<sup>58</sup> See letter from Better Markets.

<sup>59</sup> See letters from ABA, NYSE and the Society of Corporate Secretaries and Governance Professionals ("SCSSGP").

<sup>60</sup> See letter from NYSE.

<sup>61</sup> To facilitate public input on the Act, the Commission has provided a series of email links, organized by topic, on its Web site at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we received on Section 952 of the Act before we issued the Proposing Release are available on our Web site at <http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml>. Several of those commentators suggested that stock ownership alone should not automatically disqualify a board member from serving as an independent director on the compensation committee. See, e.g., letters from ABA, Brian Foley & Company, Inc., Compensia, Davis Polk and Frederic W. Cook & Co., Inc. ("Frederic Cook").

<sup>62</sup> See, e.g., letters from ABA, AFSCME, Bhagat, CEC, Davis Polk, Debevoise, Robert J. Jackson

by the exchanges.<sup>69</sup> Other commentators argued that a look-back period was not necessary because the two largest exchanges (NYSE and Nasdaq) currently impose look-back requirements on listed issuers in their standards regarding director independence.<sup>70</sup>

### c. Final Rule

After consideration of the comments, we are adopting the requirements as proposed, except that we are also extending them to apply to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. Under the final rule, the exchanges will be directed to establish listing standards requiring each member of a listed issuer's compensation committee to be a member of the board of directors and to be independent. The final rule does not require that exchanges establish a uniform definition of independence. We believe this approach is consistent with the mandate in Section 10C(a)(3). Further, given the wide variety of issuers that are listed on exchanges, we believe that the exchanges should be provided with flexibility to develop independence requirements appropriate for the issuers listed on each exchange and consistent with the requirements of Rule 10C-1(b)(1). Although this provides the exchanges with flexibility to develop the appropriate independence requirements, as discussed below, the independence requirements developed by the exchanges will be subject to review and final Commission approval pursuant to Section 19(b) of the Exchange Act.

In developing their own definitions of independence applicable to compensation committee members, the exchanges will be required to consider relevant factors, including, but not limited to:

- A director's source of compensation, including any consulting, advisory or compensatory fee paid by the issuer; and
- Whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

The final rule does not specify any additional factors that the exchanges must consider in determining independence requirements for compensation committee members, nor does the final rule prescribe any standards or relationships that will automatically preclude a finding of independence. Because the rule's

relevant factors cover the same matters as the prohibitions in Section 10A(m)'s definition of audit committee independence, we expect the exchanges to consider whether those prohibitions should also apply to compensation committee members. However, consistent with Section 10C, the exchanges are not required to adopt those prohibitions in their requirements and will have flexibility to consider other factors in developing their requirements.

As noted above and in the Proposing Release, Section 10C of the Exchange Act does not require that the exchanges prohibit all affiliates from serving on a compensation committee. In establishing their independence requirements, the exchanges may determine that, even though affiliated directors are not allowed to serve on audit committees, such a blanket prohibition would be inappropriate for compensation committees, and certain affiliates, such as representatives of significant shareholders, should be permitted to serve. However, in response to concerns noted by some commentators that significant shareholders may have other relationships with listed companies that would result in such shareholders' interests not being aligned with those of other shareholders, we emphasize that it is important for exchanges to consider other ties between a listed issuer and a director, in addition to share ownership, that might impair the director's judgment as a member of the compensation committee. For example, the exchanges might conclude that personal or business relationships between members of the compensation committee and the listed issuer's executive officers should be addressed in the definition of independence.<sup>71</sup>

Although each exchange must consider affiliate relationships in establishing a definition of compensation committee independence, there is no requirement to adopt listing standards precluding compensation committee membership based on any specific relationships. Accordingly, we do not believe it is necessary to separately define the term "affiliate" for purposes of Rule 10C-1. In addition, the final rule does not impose any required look-back periods that must be incorporated in exchange listing

standards relating to the independence of compensation committee members. We agree with commentators that the determination of whether to impose a look-back period in evaluating compensation committee member independence should be left to the exchanges and note that the exchanges already incorporate various look-back periods in their general criteria for director independence. In this respect, the final rule is similar to Exchange Act Rule 10A-3, which did not impose a mandatory look-back period for evaluating audit committee member independence in light of look-back periods already required by the exchanges for evaluating director independence generally.

Consistent with the proposal, the exchanges' definitions of independence for compensation committee members will be implemented through proposed rule changes that the exchanges will be required to file pursuant to Section 19(b) of the Exchange Act, which are subject to the Commission's review and approval.<sup>72</sup> Consistent with the proposal, Rule 10C-1(a)(4) will require that each proposed rule change submission include, in addition to any other information required under Section 19(b) of the Exchange Act and the rules thereunder: a review of whether and how the proposed listing standards satisfy the requirements of the final rule; a discussion of the exchange's consideration of factors relevant to compensation committee independence; and the definition of independence applicable to compensation committee members that the exchange proposes to adopt or retain in light of such review.<sup>73</sup> The Commission will then consider,

<sup>72</sup> The standard of review for approving proposed exchange listing standards is found in Section 19(b)(2)(C) of the Exchange Act, which provides that "[t]he Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations issued under this title that are applicable to such organization." Under Section 6(b) of the Exchange Act, the rules of an exchange must be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest."

<sup>73</sup> A submission would be required even if an exchange believes that its existing rules satisfy the requirements of Rule 10C-1. In such a circumstance, the exchange's rule submission would explain how the exchange's existing rules satisfy the requirements of Rule 10C-1, and the submission would be subject to the Commission's review and approval.

<sup>69</sup> See letter from Davis Polk.

<sup>70</sup> See letters from ABA and CEC.

<sup>71</sup> As the NYSE Listed Company Manual observes, "the concern is independence from management." See Commentary to NYSE Rule 303A.02(a). See also the Commentary to NYSE Rule 303A.02(a), which discusses the wide range of circumstances that could signal conflicts of interest or that might bear on the materiality of the relationship between the director and the issuer.

prior to final approval, whether the exchanges considered the relevant factors outlined in Section 10C(a) and whether the exchanges' proposed rule changes are consistent with the requirements of Section 6(b) and Section 10C of the Exchange Act.

### 3. Authority To Retain Compensation Advisers; Responsibilities; and Funding

Section 10C(c)(1) of the Exchange Act provides that the compensation committee of a listed issuer may, in its sole discretion, retain or obtain the advice of a "compensation consultant,"<sup>74</sup> and Section 10C(d) extends this authority to "independent legal counsel and other advisers."<sup>75</sup> Both sections also provide that the compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of compensation advisers. Sections 10C(c)(1)(C) and 10C(d)(3) provide that the compensation committee's authority to retain, and responsibility for overseeing the work of, compensation advisers may not be construed to require the compensation committee to implement or act consistently with the advice or recommendations of a compensation adviser or to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of its duties. To ensure that the listed issuer's compensation committee has the necessary funds to pay for such advisers, Section 10C(e) provides that a listed issuer shall provide "appropriate funding," as determined by the compensation committee, for payment of "reasonable compensation" to compensation advisers.<sup>76</sup>

We proposed Rules 10C-1(b)(2) and (3) to implement these statutory requirements. We are adopting these requirements substantially as proposed.

#### a. Proposed Rule

Proposed Rule 10C-1(b)(2) would implement Sections 10C(c)(1) and (d) by repeating the provisions set forth in those sections regarding the compensation committee's authority to retain or obtain a compensation adviser, its direct responsibility for the appointment, compensation and oversight of the work of any compensation adviser, and the related rules of construction. In addition, proposed Rule 10C-1(b)(3) would implement Section 10C(e) by repeating the provisions set forth in that section

regarding the requirement to provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.

In the Proposing Release, we noted that while the statute provides that compensation committees of listed issuers shall have the express authority to hire "independent legal counsel," the statute does not require that they do so. Similar to our interpretation<sup>77</sup> of Section 10A(m) of the Exchange Act, which gave the audit committee authority to engage "independent legal counsel,"<sup>78</sup> we do not construe the requirements related to independent legal counsel and other advisers as set forth in Section 10C(d)(1) of the Exchange Act as requiring a compensation committee to retain independent legal counsel or as precluding a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

#### b. Comments on the Proposed Rule

Many commentators expressed general support for the proposed requirements.<sup>79</sup> While several commentators suggested that compensation committees should use, or be permitted to use, only independent compensation advisers,<sup>80</sup> other commentators agreed with the interpretive position expressed in the Proposing Release that the statute does not require a compensation committee to retain independent legal counsel or preclude the compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or counsel retained by the issuer or management.<sup>81</sup> One commentator noted that the proposed rule should not be interpreted to "apply to or interfere with a compensation committee's dealings with legal counsel

from whom it may obtain advice, but which was not retained or selected by the committee, such as in-house and company counsel. Thus, the proposed language \* \* \* should be clear that the requirement that independent legal counsel and other advisers be subject to the direct oversight of the compensation committee applies only to such counsel and advisors who are specifically and separately retained by the compensation committee."<sup>82</sup> This commentator thought it would be helpful to include the Commission's interpretation of the statute in the text of the rule,<sup>83</sup> although one commentator viewed such clarification as unnecessary.<sup>84</sup> One commentator asked that we clarify whether the interpretive view expressed in the Proposing Release would apply equally to compensation consultants—i.e., whether a compensation committee could obtain advice from compensation consultants retained by management.<sup>85</sup>

We asked for comment on whether we should define what constitutes an "independent legal counsel." One commentator stated, without explanation, that it would not be necessary for us to define what constitutes an "independent legal counsel."<sup>86</sup> Another commentator believed that we should provide more guidance for issuers to determine whether legal counsel is "independent," so that listed issuers would have greater assurance that they are in compliance with Exchange Act Section 10C(d)(1).<sup>87</sup>

#### c. Final Rule

We are adopting the rule substantially as proposed, with modifications to clarify that the scope of the requirements is limited to only those compensation advisers retained by the compensation committee and to apply the requirement that the compensation committee be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. Under the final rules, the exchanges will be directed to adopt listing standards that provide that:

- The compensation committee may, in its sole discretion, retain or obtain the advice of a compensation adviser;

<sup>74</sup> See Exchange Act Section 10C(c)(1).

<sup>75</sup> See Exchange Act Section 10C(d)(1).

<sup>76</sup> See Exchange Act Section 10C(e).

<sup>77</sup> See Standards Relating to Listed Company Audit Committees, Release No. 33-8220 (Apr. 9, 2003) [68 FR 18788], n. 114 ("As proposed, the requirement does not preclude access to or advice from the company's internal counsel or regular outside counsel. It also does not require an audit committee to retain independent counsel.")

<sup>78</sup> See Exchange Act Section 10A(m)(5) ("Each audit committee shall have the authority to engage independent counsel and other advisers, as it determines necessary to carry out its duties.")

<sup>79</sup> See, e.g., letters from Barnard, CalSTRS, Davis Polk, Pfizer and SCSGP.

<sup>80</sup> See letters from AFL-CIO, Better Markets, CalPERS, CFA Institute, CII, FLSBA and Railpen.

<sup>81</sup> See, e.g., letters from ABA, CEC (noting that "the compensation committee is in the best position to determine whether a particular advisor would be an appropriate advisor following a review of all factors and subject to appropriate disclosure") and Merkl.

<sup>82</sup> See letter from ABA.

<sup>83</sup> See *id.*

<sup>84</sup> See letter from Merkl.

<sup>85</sup> See letter from Carl Struby.

<sup>86</sup> See letter from Merkl.

<sup>87</sup> See letter from Robert M. Fields (Apr. 6, 2011) ("Fields").

<sup>74</sup> See Exchange Act Section 10C(c)(1).

<sup>75</sup> See Exchange Act Section 10C(d)(1).

<sup>76</sup> See Exchange Act Section 10C(e).

- The compensation committee, which for this purpose includes those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee, shall be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee; and

- Each listed issuer must provide for appropriate funding for payment of reasonable compensation, as determined by the compensation committee, to any compensation adviser retained by the compensation committee.

Consistent with Sections 10C(c)(1)(c) and 10C(d)(3), the final rule may not be construed to require the compensation committee to implement or act consistently with the advice or recommendations of any adviser to the compensation committee or to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

Consistent with our interpretation of Section 10C, the final rule does not require compensation committees to retain or obtain advice only from independent advisers. A listed issuer's compensation committee may receive advice from non-independent counsel, such as in-house counsel or outside counsel retained by management, or from a non-independent compensation consultant or other adviser, including those engaged by management. The final rule does not require a compensation committee to be directly responsible for the appointment, compensation or oversight of compensation advisers that are not retained by the compensation committee, such as compensation consultants or legal counsel retained by management. Rather, the direct responsibility to oversee compensation advisers applies only to those advisers retained by a compensation committee, and the obligation of the issuer to provide for appropriate funding applies only to those advisers so retained.

Finally, in light of the provisions of our final rule and the fact that commentators did not urge us to define "independent legal counsel," we do not believe such a definition is needed.<sup>88</sup> We note that the final rule requires the payment of reasonable compensation

<sup>88</sup> Similarly, Exchange Act Rule 10A-3 provides that audit committees must have the authority to engage "independent counsel" and that listed issuers must provide for appropriate funding of such advisers. Independent counsel is not further defined in Rule 10A-3, and we do not believe that there has been any uncertainty arising from the absence of such a definition.

not only to independent legal counsel but also to "any other adviser" to the compensation committee, which includes any compensation advisers retained by the compensation committee, such as attorneys and consultants, whether or not they are independent.

#### 4. Compensation Adviser Independence Factors

Section 10C(b) of the Exchange Act provides that the compensation committee of a listed issuer may select a compensation adviser only after taking into consideration the five independence factors specified in Section 10C(b) as well as any other factors identified by the Commission. In accordance with Section 10C(b), these factors would apply to the selection of compensation consultants, legal counsel and other advisers to the committee.

The statute does not require a compensation adviser to be independent, only that the compensation committee of a listed issuer consider the enumerated independence factors before selecting a compensation adviser. Section 10C(b)(2) specifies that the independence factors identified by the Commission must be competitively neutral<sup>89</sup> and include, at minimum:

- The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;
- The amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;
- The policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;
- Any business or personal relationship of the compensation consultant, legal counsel or other

<sup>89</sup> Although there is no relevant legislative history, we assume this requirement is intended to address the concern expressed by the multi-service compensation consulting firms that the disclosure requirements the Commission adopted in 2009 are not competitively neutral because they do not address potential conflicts of interest presented by boutique consulting firms that are dependent on the revenues of a small number of clients. See letter from Towers Perrin, commenting on Proxy Disclosure and Solicitation Enhancements, Release No. 33-9052 (July 10, 2009), available at <http://www.sec.gov/comments/s7-13-09/s71309-90.pdf>. The list of independence factors in Section 10C(b)(2), which addresses both multi-service firm "other services" conflicts and boutique firm "revenue concentration" conflicts, is consistent with this assumption.

adviser with a member of the compensation committee; and

- Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser.

We proposed to direct the exchanges to adopt listing standards requiring the compensation committee of a listed issuer to consider the five factors enumerated in Section 10C(b) of the Exchange Act prior to selecting a compensation adviser. We are adopting the rule substantially as proposed, but with some changes in response to comments.

#### a. Proposed Rule

Proposed Rule 10C-1(b)(4) would direct the exchanges to adopt listing standards that require the compensation committee of a listed issuer to take into account the five factors identified in Section 10C(b)(2), in addition to any other factors identified by the relevant exchange, before selecting a compensation adviser. Under the proposed rule, the exchanges would have the ability to add other independence factors that must be considered by compensation committees. In the Proposing Release, we stated that we did not propose any additional factors because we believed that the factors set forth in Section 10C(b) are "generally comprehensive," although we solicited comment as to whether there are any additional independence factors that should be taken into consideration by a listed issuer's compensation committee.<sup>90</sup>

As noted above and in the Proposing Release, Section 10C does not require compensation advisers to be independent—only that the compensation committee consider factors that may bear upon independence. As a result, we did not believe that it would be appropriate to establish bright-line or numerical thresholds that would affect whether or when the factors listed in Section 10C, or any additional factors, must be considered by a compensation committee. For example, we did not believe that our rules should provide that a compensation committee must consider stock owned by an adviser only if ownership exceeds a specified minimum percentage of the issuer's stock, or that a committee must consider the amount of revenues that the issuer's business represents for an adviser only if the percentage exceeds a certain percentage of the adviser's revenues. Accordingly, proposed Rule 10C-1(b)(4) would require the listing standards developed by the exchanges to include

<sup>90</sup> See Proposing Release, 76 FR at 18972.

the independence factors set forth in the statute and incorporated into the rule without any materiality or bright-line thresholds or cutoffs.<sup>91</sup>

#### b. Comments on the Proposed Rule

Comments on this proposal were mixed. A number of commentators supported directing the exchanges to adopt listing standards that require the compensation committee to take into account the five factors enumerated in Section 10C, in addition to any other factors identified by the exchanges.<sup>92</sup> One multi-service compensation consulting firm believed that the five factors listed in Section 10C(b)(2) were, in total, competitively neutral, but that, on an individual basis, some of the factors were not competitively neutral.<sup>93</sup> This commentator suggested that we should provide an instruction to the final rules to emphasize that the factors should be considered in their totality and that no one factor should be viewed as a determinative factor of independence. Another commentator argued that the full effects of any independence factor on competition in the rapidly evolving advisory industry are not entirely knowable, and that the Commission should generally recommend factors that, when applied equally across the full spectrum of existing firms, help in achieving the goal of adviser independence.<sup>94</sup>

Several commentators argued that some or all of the five factors identified in Section 10C(b)(2) and included in the proposed rule were not competitively neutral.<sup>95</sup> Multi-service consulting firms argued that the consideration of other services provided to the issuer by the person that employs the compensation consultant was not competitively neutral as this factor would affect only multi-service firms. For their part, smaller consulting firms argued that the consideration of the amount of fees received from the issuer as a percentage of a firm's total revenues was not competitively neutral because the likelihood of revenue concentration would be greater in smaller firms.<sup>96</sup> Three commentators argued that our existing compensation consultant fee

disclosure requirements disproportionately affect multi-service consulting firms, and suggested that we could improve the competitive neutrality of our rules by requiring competitively neutral disclosure of fees paid to all compensation consultants or advisers.<sup>97</sup>

Many commentators urged us to add more independence factors to the list of factors that could affect the independence of a compensation adviser.<sup>98</sup> Several commentators argued that we should include a comparison of the amount of fees received for providing executive compensation consulting services to the amount of fees received for providing non-executive compensation consulting services.<sup>99</sup> Other commentators expressed support for requiring compensation committees to consider any business or personal relationship between an executive officer of the issuer and an adviser or the person employing the compensation adviser.<sup>100</sup> Some commentators, however, opposed adding new factors to the list of factors identified in the proposed rule,<sup>101</sup> although one of these commentators acknowledged that it would advise any compensation committee evaluating the independence of a potential adviser to consider the business and personal relationships between the issuer's executive officers and the adviser or adviser's firm.<sup>102</sup>

In the Proposing Release, we requested comment on the application of the independence factors to different categories of advisers. Several commentators requested that we stipulate that a compensation committee conferring with or soliciting advice from

<sup>97</sup> See letters from AON, Mercer and Towers.

<sup>98</sup> See, e.g., letters from ABA, AFL-CIO, AFSCME and USS.

<sup>99</sup> See letters from AFL-CIO, AFSCME, Frederic Cook and UAW. See also letter from Steven Hall (noting that the "requirement that a compensation committee consider the company's fees paid to a firm as a percentage of the firm's overall fees seems to overlook the more significant issue of the amount of fees the consulting firm receives for services to the compensation committee as a percentage of the total fees the firm receives including fees for other services to the company").

<sup>100</sup> See, e.g., letters from ABA (supporting consideration of relationships between adviser's employer and issuer's executive officers), Better Markets, Merkl (supporting consideration of relationships between either adviser or adviser's employer and issuer's executive officers), and USS (supporting consideration of relationships between adviser and issuer's executive officers). One commentator supported requiring consideration of business or personal relationships between an issuer's executive officers and the compensation adviser, but not the adviser's employer. See letter from Towers.

<sup>101</sup> See, e.g., letters from AON, Meridian Compensation Partners ("Meridian"), SCSSG and Steven Hall.

<sup>102</sup> See letter from Steven Hall.

the issuer's in-house or outside legal counsel would not be required to consider the independence factors with respect to such counsels.<sup>103</sup> These commentators believed that a compensation committee should be required to consider the independence factors only when the committee itself selects a compensation adviser, but not when it receives advice from, but does not select, an adviser.<sup>104</sup> Moreover, two of these commentators questioned the usefulness of the independence assessment as it relates to in-house legal counsel, outside legal counsel to an issuer or a compensation adviser retained by management, as they are not held out, or considered by the compensation committee, to be independent.<sup>105</sup>

On the other hand, a number of commentators argued that the compensation adviser independence requirements should apply to any legal counsel that provides advice to the compensation committee.<sup>106</sup> One of these commentators argued that the language of Section 10C(b)(1) is unambiguous and that the final rules should clarify that exchange listing standards must require compensation committees to consider the independence factors whenever a committee receives advice from legal counsel, regardless of whether or not the committee selected counsel.<sup>107</sup>

We also requested comment on whether we should include materiality, numerical or other thresholds that would limit the circumstances in which a compensation committee is required to consider the independence factors. Several commentators opposed including such materiality, numerical or other bright-line thresholds in the rule.<sup>108</sup> These commentators expressed concern that such thresholds may not be competitively neutral and could reduce the flexibility compensation committees have to select advisers best-suited to the issuer. A number of commentators supported a materiality threshold with respect to the stock ownership factor. One commentator suggested that consideration of this factor should be required only if an individual beneficially owns in excess of 5% of an outstanding class of an issuer's equity

<sup>103</sup> See letters from ABA, Davis Polk, McGuire Woods and S&C.

<sup>104</sup> See letters from ABA and McGuire Woods.

<sup>105</sup> See letters from ABA and S&C.

<sup>106</sup> See, e.g., letters from Better Markets, Robert M. Fields (Apr. 29, 2011), Richard Thalheimer and Towers.

<sup>107</sup> See letter from Towers.

<sup>108</sup> See letters from Longnecker, McGuireWoods, Meridian, SCSSG and Towers.

<sup>91</sup> As noted above, the exchanges would have the ability to add other independence factors that must be considered by compensation committees, and these additional factors could include materiality or bright-line thresholds or cutoffs.

<sup>92</sup> See, e.g., letters from ABA, Pfizer, SCSSG and USS.

<sup>93</sup> See letter from Aon Hewitt ("AON").

<sup>94</sup> See letter from Hodak Value Advisors.

<sup>95</sup> See, e.g., letters from Frederic Cook, Longnecker & Associates ("Longnecker"), Mercer, Steven Hall & Partners ("Steven Hall") and Towers Watson ("Towers").

<sup>96</sup> See letters from Frederic Cook and Longnecker.

securities.<sup>109</sup> Another commentator suggested a threshold of \$50,000 in fair market value or 5,000 shares of a listed issuer's stock, below which an adviser's stock ownership would not be deemed to affect his or her independence.<sup>110</sup> Other commentators suggested that compensation committees should be required to consider only stock owned by the lead adviser and not stock owned by other employees on the adviser's team.<sup>111</sup>

Comments were mixed as to whether the final rule should clarify the phrases "provision of other services" or "business or personal relationships," as used in proposed Rule 10C-1(b)(4). Some commentators thought no further clarification of the phrase "provision of other services" was necessary,<sup>112</sup> and another commented that it "is better to have a general principle than to have exhaustive detailed rules that may leave loopholes for services that may impair the independence of an advisory firm."<sup>113</sup> Two commentators suggested defining the phrase to expressly exclude certain services.<sup>114</sup> For example, one commentator suggested excluding advice related to broad-based, non-discriminatory plans or surveys.<sup>115</sup>

Some commentators urged that we further define the phrase "business or personal relationship."<sup>116</sup> One commentator suggested that we should define "business relationship" to expressly exclude any non-commercial relationship between an adviser and a member of the issuer's compensation committee, provided that such relationship does not result in significant monetary or economic gain to either party, and that we should define "personal relationship" to include only familial relationships.<sup>117</sup> Another commentator argued that business or personal relationships that are more casual in nature may not be relevant to adviser independence and suggested limiting consideration of such relationships to those that would "more likely than not" have a "material adverse effect" on an individual's independence.<sup>118</sup> Two commentators thought it would be helpful if we provided examples of the types of relationships to be considered, in order to guide compensation committees as they consider the breadth of possible

relationships that might impair adviser independence.<sup>119</sup> Another commentator thought it was unnecessary for us to further define the phrase because the "myriad possible definitions and considerations are unlikely to be fully encompassed by such a definition."<sup>120</sup>

A few commentators also urged that we clarify the scope of individuals whose relationships would need to be considered in the context of evaluating adviser independence. One commentator recommended limiting the required consideration to the individual adviser who renders services to the compensation committee,<sup>121</sup> and another commentator similarly recommended limiting the required consideration to the lead consultant, counsel or adviser to the committee, but not to other members of the adviser's team serving the compensation committee.<sup>122</sup>

We requested comment on whether we should require disclosure of a compensation committee's process for selecting advisers. Many commentators criticized this idea, citing concerns about extending already lengthy proxy statement discussions of executive compensation and expressing doubt that additional disclosure of the process for selecting advisers would provide any useful information to investors.<sup>123</sup> However, some commentators thought such disclosure could be useful in providing transparency as to whether compensation committees were following the required process for selecting advisers.<sup>124</sup>

### c. Final Rule

After considering the comments, we are adopting the requirements substantially as proposed, but with some revisions. As discussed above, this aspect of the final rule will also apply to those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. We have also decided to include one additional independence factor that compensation committees must consider before selecting a compensation adviser. Under the final rule, the exchanges will be directed to adopt listing standards that require a compensation committee to take into account the five factors

enumerated in Section 10C(b)(2), as well as any business or personal relationships between the executive officers of the issuer and the compensation adviser or the person employing the adviser. This would include, for example, situations where the chief executive officer of an issuer and the compensation adviser have a familial relationship or where the chief executive officer and the compensation adviser (or the adviser's employer) are business partners. We agree with commentators who stated that business and personal relationships between an executive officer and a compensation adviser or a person employing the compensation adviser may potentially pose a significant conflict of interest that should be considered by the compensation committee before selecting a compensation adviser.<sup>125</sup>

As was proposed, the final rule does not expand the stock ownership factor to require consideration of stock owned by the person employing a compensation adviser. As we noted in the Proposing Release, we interpret "any stock of the issuer owned by the compensation consultant, legal counsel, or other adviser" to include shares owned by the individuals providing services to the compensation committee and their immediate family members.

Other than the additional factor described above, the final rules will not require the listing standards to mandate consideration of independence factors beyond those set forth in Section 10C(b)(2). We believe that these six factors, when taken together, are competitively neutral, as they will require compensation committees to consider a variety of factors that may bear upon the likelihood that a compensation adviser can provide independent advice to the compensation committee, but will not prohibit committees from choosing any particular adviser or type of adviser. We agree with the commentator who suggested that the factors should be considered in their totality and that no one factor should be viewed as a determinative factor of independence.<sup>126</sup> We do not believe it is necessary, however, to provide an instruction to this effect, as the final rule directs the exchanges to require consideration of all of the specified factors. In response to concerns echoed by a number of commentators, we emphasize that neither the Act nor our final rule requires a compensation adviser to be independent, only that the

<sup>109</sup> See letter from Steven Hall.

<sup>110</sup> See letter from ABA.

<sup>111</sup> See letters from AON and Mercer.

<sup>112</sup> See letters from AON and Towers.

<sup>113</sup> See letter from Merkl.

<sup>114</sup> See letters from Hodak and Mercer.

<sup>115</sup> See letter from Mercer.

<sup>116</sup> See, e.g., letters from AON and Meridian.

<sup>117</sup> See letter from Meridian.

<sup>118</sup> See letter from AON.

<sup>119</sup> See letters from Merkl and Towers.

<sup>120</sup> See letter from Mercer.

<sup>121</sup> See letter from Meridian.

<sup>122</sup> See letter from Mercer (noting that the more junior members of the team rarely interact directly with the compensation committee).

<sup>123</sup> See, e.g., letters from CFA Institute and Frederic Cook.

<sup>124</sup> See, e.g., letter from Better Markets.

<sup>125</sup> See, e.g., letters from ABA, Better Markets, Merkl and USS.

<sup>126</sup> See letter from AON.

compensation committee consider the enumerated independence factors before selecting a compensation adviser.

Compensation committees may select any compensation adviser they prefer, including ones that are not independent, after considering the six independence factors outlined in the final rule.<sup>127</sup>

In response to comments,<sup>128</sup> we are including an instruction to the final rule to provide that a compensation committee need not consider the six independence factors before consulting with or obtaining advice from in-house counsel. Commentators noted that it is routine for in-house counsel to consult with, and provide advice to, the compensation committee on a variety of issues, such as, for example, the terms of an existing benefit plan or how a proposed employment contract would interrelate with other company agreements.<sup>129</sup> We agree with these commentators that, as in-house legal counsel are company employees, they are not held out to be independent. In addition, we do not believe compensation committees consider that in-house counsel serve in the same role or perform a similar function as a compensation consultant or outside legal counsel.

This instruction will not affect the obligation of a compensation committee to consider the independence of outside legal counsel or compensation consultants or other advisers retained by management or by the issuer. We believe that information gathered from an independence assessment of these categories of advisers will be useful to the compensation committee as it considers any advice that may be provided by these advisers. In addition, excluding outside legal counsel or compensation consultants retained by management or by the issuer from the required independence assessment may not be competitively neutral, since, as some commentators pointed out, they often perform the same types of services as the law firms and compensation consultants selected by the compensation committee.<sup>130</sup>

Accordingly, we are including an instruction to the final rule that provides that a listed issuer's compensation committee is required to conduct the independence assessment outlined in Rule 10C-1(b)(4) with respect to any compensation consultant,

legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

The final rule, like our proposal, does not include any materiality, numerical or other thresholds that would narrow the circumstances in which a compensation committee is required to consider the independence factors specified in the rule. We are concerned that adding materiality or other bright-line thresholds may not be competitively neutral. The absence of any such thresholds means that all facts and circumstances relevant to the six factors will be presented to the compensation committee for its consideration of the independence of a compensation adviser, and not just those factors that meet a prescribed threshold. For similar reasons, the final rule does not further define the phrases "provision of other services" or "business or personal relationship."

Consistent with the proposed rule, the final rule does not require listed issuers to describe the compensation committee's process for selecting compensation advisers pursuant to the new listing standards. We are sensitive to the concerns of commentators that adding such disclosure would increase the length of proxy statement disclosures on executive compensation without necessarily providing additional material information to investors.

#### 5. Opportunity To Cure Defects

Section 10C(f)(2) of the Exchange Act specifies that our rules must provide for appropriate procedures for an issuer to have a reasonable opportunity to cure any defects that would be the basis for a prohibition of the listing of an issuer's securities as a result of its failure to meet the requirements set forth in Section 10C, before imposition of such prohibition.<sup>131</sup> To implement this requirement, we proposed Rule 10C-1(a)(3), which would require the exchanges to establish such procedures if their existing procedures are not adequate. We are adopting the rule as proposed.

##### a. Proposed Rule

Proposed Rule 10C-1(a)(3) would provide that the exchange listing standards required by Rule 10C-1 must allow issuers a reasonable opportunity to cure violations of the compensation committee listing requirements. The proposed rule did not set forth specific procedures for curing violations of compensation committee listing

requirements, but specified that the listing standards may provide that if a member of a compensation committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable exchange, may remain a compensation committee member of the listed issuer until the earlier of the next annual shareholders' meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent. Proposed Rule 10C-1(a)(3) was patterned after similar provisions contained in Exchange Act Rule 10A-3(a)(3).<sup>132</sup>

##### b. Comments on the Proposed Rule

Commentators generally supported proposed Rule 10C-1(a)(3). Two commentators favored requiring the exchanges to provide issuers the same opportunity to cure non-compliance with the compensation committee listing requirements as they have with respect to audit committee requirements.<sup>133</sup> In response to our request for comment on whether we should direct the exchanges to adopt specific procedures for curing non-compliance, several commentators were opposed to requiring the exchanges to establish any such specific procedures.<sup>134</sup> One commentator, however, urged us to direct the exchanges to establish more limited procedures for curing defects.<sup>135</sup>

We also requested comment as to whether listed issuers that have just completed initial public offerings should be given additional time to comply with the compensation committee independence requirements, as is permitted by Exchange Act Rule 10A-3(b)(1)(iv)(A) with respect to audit committee independence requirements. Several commentators supported providing newly listed issuers with additional time to comply with the compensation committee listing requirements.<sup>136</sup> The NYSE argued that the exchanges should have the flexibility to permit an issuer applying for listing in connection with an initial public offering to have additional time to comply with compensation committee requirements.<sup>137</sup> The NYSE also requested that we clarify that the authority the exchanges would have under Rule 10C-1(a)(3) to provide issuers an opportunity to cure defects is

<sup>127</sup> The listing standards do not, of course, override any duties imposed on directors by applicable state law relating to the selection of compensation advisers.

<sup>128</sup> See letters from ABA, Davis Polk and S&C.

<sup>129</sup> See letters from Davis Polk and S&C.

<sup>130</sup> See letters from Jackson and Towers.

<sup>131</sup> See Exchange Act Section 10C(f)(2).

<sup>132</sup> 17 CFR 240.10A-3(a)(3).

<sup>133</sup> See letters from Debevoise and CalPERS.

<sup>134</sup> See, e.g., letters from Davis Polk and Merkl.

<sup>135</sup> See letter from Better Markets.

<sup>136</sup> See, e.g., letters from ABA, Davis Polk, Merkl and NYSE.

<sup>137</sup> See letter from NYSE.

not limited to situations where a previously independent compensation committee member loses his or her independent status for reasons outside his or her control.<sup>138</sup>

### c. Final Rule

After consideration of the comments, we are adopting Rule 10C–1(a)(3) as proposed. Similar to Exchange Act Rule 10A–3(a)(3), the final rule requires the exchanges to provide appropriate procedures for listed issuers to have a reasonable opportunity to cure any noncompliance with the compensation committee listing requirements that could result in the delisting of an issuer's securities. The exchanges' rules may also provide that if a member of a listed issuer's compensation committee ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable exchange, may remain a compensation committee member of the listed issuer until the earlier of the next annual shareholders' meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent. The exchanges' authority to provide issuers an opportunity to cure defects is not limited to situations where a previously independent compensation committee member loses his or her independent status for reasons outside his or her control.

As we noted in the Proposing Release, we believe that existing listing standards and delisting procedures of most of the exchanges satisfy the requirement for there to be reasonable procedures for an issuer to have an opportunity to cure any defects on an ongoing basis. Most exchanges have already adopted procedures to provide issuers with notice and opportunity for a hearing, an opportunity for an appeal and an opportunity to cure defects before their securities are delisted.<sup>139</sup> Nonetheless, we expect that the rules of each exchange would provide for definite procedures and time periods for

<sup>138</sup> See *id.*

<sup>139</sup> See, e.g., NYSE Listed Company Manual Section 801–805; Nasdaq Equity Rules 5800 Series; NYSE AMEX Company Guide Section 1009 and Part 12; Chicago Board Options Exchange Rule 31.94; Chicago Stock Exchange Article 22, Rules 4, 17A, and 22; Nasdaq OMX BX Rule 4800 series; Nasdaq OMX PHLX Rule 811. Neither NYSE Arca nor the National Stock Exchange has a rule that specifically requires listed companies to be given an opportunity to submit a plan to regain compliance with corporate governance listing standards other than audit committee requirements; issuers listed on these exchanges, however, are provided notice, an opportunity for a hearing, and an opportunity for an appeal prior to delisting. See NYSE Arca Rule 5.5(m); National Stock Exchange Rule 15.7 and Chapter X.

compliance with the final rule requirements to the extent they do not already do so.

We have not made any modifications to Rule 10C–1(a)(3) with respect to newly listed issuers. As discussed in more detail in Section II.B.2 of this release, in accordance with Exchange Act Section 10C(f)(3), our final rule will authorize the exchanges to exempt categories of issuers from the requirements of Section 10C. We believe this authority will allow the exchanges to craft appropriate limited exceptions from the required compensation committee listing standards for newly listed and other categories of listed issuers, subject to Commission review and approval pursuant to Section 19(b) of the Exchange Act.

### B. Implementation of Listing Requirements

#### 1. Exchanges and Securities Affected

We proposed to apply the requirements of Section 10C only to exchanges that list equity securities. In addition, the proposed rule would require that the exchanges adopt listing standards in compliance with the rule only with respect to issuers with listed equity securities. Along with the exemptions contained in Section 10C, the proposed rule would also exempt security futures products and standardized options. We are adopting the rule as proposed.

#### a. Proposed Rule

Section 10C(a) provides that the Commission shall direct the exchanges to prohibit the listing of any “equity security” of an issuer (other than several types of exempted issuers) that does not comply with the compensation committee member independence requirements. In contrast, Section 10C(f)(1), which states generally the scope of the compensation committee and compensation adviser listing requirements, provides that the Commission shall direct the national securities exchanges and national securities associations “to prohibit the listing of *any security* of an issuer that is not in compliance with the requirements of this section” (emphasis added).

The Senate-passed version of the bill did not distinguish between equity and non-equity securities, referencing only the prohibition against the listing of “any security” of an issuer not in compliance with the independence requirements.<sup>140</sup> The initial House-passed version would have required the

<sup>140</sup> See H.R. 4173, 111th Cong. § 952 (as passed, with amendments, by the Senate on May 20, 2010).

Commission to adopt rules to direct the exchanges to prohibit the listing of “any class of equity security” of an issuer that is not in compliance with the compensation committee independence standards, as well as with any of the other provisions of that section, including the provisions relating to compensation advisers.<sup>141</sup> According to a press release issued by the House Financial Services Committee, this language was added during deliberations by that committee to clarify that the compensation committee independence standards would apply only to “public companies, not to companies that have only an issue of publicly-registered debt.”<sup>142</sup> Because the Senate-passed version of the bill (which did not specify “equity” securities) was used as the base for the conference draft, it appears that addition of “equity” securities in Section 10C(a) of the conference draft was deliberate. Unlike the House-passed bill, however, the final bill specifically references equity securities only in connection with compensation committee member independence requirements.

As we noted in the Proposing Release, the NYSE currently exempts issuers whose only listed securities are debt securities from the compensation committee listing requirements that apply to issuers listing equity securities.<sup>143</sup> In addition, Exchange Act Rule 3a12–11 exempts listed debt securities from most of the requirements in our proxy and information statement rules.<sup>144</sup> Finally, most, if not all, issuers with only listed debt securities, other than foreign private issuers, are privately held.<sup>145</sup> In light of the

<sup>141</sup> See H.R. 4173, 111th Cong. § 2003 (as passed by the House of Representatives on Dec. 11, 2009).

<sup>142</sup> See Press Release, Financial Services Committee Passes Executive Compensation Reform, July 28, 2009, available at: <http://democrats.financialservices.house.gov/press/PRArticle.aspx?NewsID=520>.

<sup>143</sup> See NYSE Listed Company Manual Section 303A.00.

<sup>144</sup> In adopting this rule, the Commission determined that debt holders would receive sufficient protection from the indenture, the Trust Indenture Act, the proxy rules' antifraud proscriptions, and the Exchange Act rules that facilitate the transmission of materials to beneficial owners. See Exemptive Relief and Simplification of Filing Requirements for Debt Securities To Be Listed on a National Securities Exchange, Release No. 34–34922 (Nov. 1, 1994) [59 FR 55342].

<sup>145</sup> Based on a review of information reported on Forms 10–K, 20–F and 40–F and current public quotation and trade data on issuers whose debt securities are listed on an exchange, such as the *NYSE Listed and Traded Bonds* and *NYSE Amex Listed Bonds*, we estimate that there are approximately 83 issuers that list only debt securities on an exchange. Of these 83 issuers, approximately 45 are wholly-owned subsidiaries that would be exempt from proposed Exchange Act

legislative history and our and the exchanges' historical approach to issuers with only listed debt securities, we noted in the Proposing Release that we view the requirements of Section 10C as intended to apply only to issuers with listed equity securities.<sup>146</sup>

Accordingly, we proposed to apply Rule 10C-1 only to exchanges that list equity securities, and to direct these exchanges to adopt listing standards implementing our rule only as to issuers that are seeking to list or have listed equity securities. We noted in the Proposing Release that proposed Rule 10C-1 would not currently apply to FINRA, the only existing national securities association registered under Section 15A(a) of the Exchange Act, as FINRA does not list any securities and does not have listing standards under its rules.<sup>147</sup> Nevertheless, as Section 10C specifically references national securities associations, proposed Rule 10C-1 would apply to any registered national securities association that lists equity securities in the future.<sup>148</sup>

Rule 10C-1 pursuant to Section 10C(g) of the Act. None of these 83 issuers has a class of equity securities registered under Section 12 of the Exchange Act.

<sup>146</sup> Although Section 10C is, in many respects, similar to the audit committee independence requirements contained in Section 10A(m), there are differences in some of the statutory language. In this regard, we note that the requirements included in Section 10A(m) of the Exchange Act, as set forth in Section 301 of the Sarbanes-Oxley Act, are applicable generally to "listed securities," and no reference is made to equity securities. Therefore, although Section 10A(m) applies to issuers whether they have listed debt or equity, we do not believe this should necessarily prescribe the scope of Section 10C.

<sup>147</sup> Similarly, we stated that we did not expect the National Futures Association, which is a national securities association registered under Section 15A(k) for the limited purpose of regulating the activities of members who are registered as broker-dealers in security futures products, see note 8, above, to develop listing standards regarding compensation committees in compliance with proposed Rule 10C-1. See Proposing Release, 76 FR at 18974, n. 73.

<sup>148</sup> The OTC Bulletin Board (OTCBB) and the OTC Markets Group (previously known as the Pink Sheets and Pink OTC Markets) will not be affected by Rule 10C-1, and therefore issuers whose securities are quoted on these interdealer quotation systems similarly will not be affected, unless their securities also are listed on a national securities exchange. The OTCBB is an "interdealer quotation system" for over-the-counter securities that is operated by FINRA. (Exchange Act Rule 15c2-11 defines the term "interdealer quotation system." 17 CFR 240.15c2-11.) It does not, however, have a listing agreement or arrangement with the issuers whose securities are quoted on the system and are not considered listed, as that term is defined and used in Rule 10C-1. See Rules 10C-1(a)(2) and (c)(3). Although market makers may be required to review and maintain specified information about an issuer and to furnish that information to FINRA, the issuers whose securities are quoted on the OTCBB are not required to submit any information to the system. The OTC Markets Group is not a registered national securities exchange or association, nor is

Under proposed Rule 10C-1(a), exchanges would be required, to the extent that their listing standards did not conform with Rule 10C-1, to issue or amend their listing rules, subject to Commission review, to comply with the new rule. As noted in the Proposing Release, an exchange that lists or trades security futures products (as defined in Exchange Act Section 3(a)(56))<sup>149</sup> may register as an exchange under Section 6(g) of the Exchange Act solely for the purpose of trading those products. As the Exchange Act definition of "equity security" includes security futures on equity securities,<sup>150</sup> exchanges whose only listed equity securities are security futures products<sup>151</sup> would be required to comply with Rule 10C-1 absent an applicable exemption. Given that Section 10C(f) of the Exchange Act makes no distinction between exchanges registered pursuant to Section 6(a)—such as the NYSE and Nasdaq—and those registered pursuant to Section 6(g), we did not propose a wholesale exemption from the requirements of Rule 10C-1 for those exchanges registered solely pursuant to Section 6(g).

However, as discussed below, we proposed to exempt security futures products from the scope of proposed Rule 10C-1. Accordingly, we noted in the Proposing Release that, to the extent the final rule exempted the listing of security futures products from the scope of Rule 10C-1, any exchange registered solely pursuant to Section 6(g) of the Exchange Act and that lists and trades only security futures products would not be required to file a rule change in order to comply with Rule 10C-1.

We proposed to exempt security futures products and standardized options from the requirements of Rule

it operated by a registered national securities exchange or association, and thus is not covered by the terms of the final rule.

<sup>149</sup> Exchange Act Section 3(a)(56) defines the term "security futures product" to mean "a security future or any put, call, straddle, option, or privilege on any security future." 15 U.S.C. 78c(a)(56).

<sup>150</sup> Section 3(a)(11) of the Exchange Act defines the term "equity security" as any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

<sup>151</sup> Exchanges currently registered solely pursuant to Section 6(g) of the Exchange Act include the Board of Trade of the City of Chicago, Inc.; the CBOE Futures Exchange, LLC; the Chicago Mercantile Exchange, Inc.; One Chicago, LLC; the Island Futures Exchange, LLC; and NQLX LLC.

10C-1. Although the Exchange Act defines "equity security" to include any security future on any stock or similar security, the Commodity Futures Modernization Act of 2000 (the "CFMA")<sup>152</sup> permits the exchanges to trade futures on individual securities and on narrow-based security indices ("security futures")<sup>153</sup> without such securities being subject to the registration requirements of the Securities Act of 1933 (the "Securities Act") and the Exchange Act so long as they are cleared by a clearing agency that is registered under Section 17A of the Exchange Act<sup>154</sup> or that is exempt from registration under Section 17A(b)(7)(A) of the Exchange Act. In December 2002, we adopted rules that provide comparable regulatory treatment for standardized options.<sup>155</sup>

The clearing agency for security futures products and standardized options is the issuer of these securities,<sup>156</sup> but its role as issuer is fundamentally different from an issuer of equity securities of an operating company. The purchasers of security futures products and standardized options do not, except in the most formal sense, make an investment decision based on the issuer. As a result, information about the clearing agency's business, its officers and directors and its financial statements is much less

<sup>152</sup> Public Law 106-554, 114 Stat. 2763 (2000).

<sup>153</sup> Exchange Act Section 3(a)(56) [15 U.S.C. 78c(a)(56)], and Commodities Exchange Act Section 1a(32) [7 U.S.C. 1a(32)] define "security futures product" as a security future or any put, call, straddle, option, or privilege on any security future.

<sup>154</sup> 15 U.S.C. 78q-1.

<sup>155</sup> See Release No. 33-8171 (Dec. 23, 2002) [68 FR 188]. In that release, we exempted standardized options issued by registered clearing agencies and traded on a registered national securities exchange or on a registered national securities association from all provisions of the Securities Act, other than the antifraud provision of Section 17, as well as the Exchange Act registration requirements.

Standardized options are defined in Exchange Act Rule 9b-1(a)(4) [17 CFR 240.9b-1(a)(4)] as option contracts trading on a national securities exchange, an automated quotation system of a registered securities association, or a foreign securities exchange which relate to option classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate.

<sup>156</sup> See Fair Administration and Governance of Self-Regulatory Organizations; Disclosure and Regulatory Reporting by Self-Regulatory Organizations; Recordkeeping Requirements for Self-Regulatory Organizations; Ownership and Voting Limitations for Members of Self-Regulatory Organizations; Ownership Reporting Requirements for Members of Self-Regulatory Organizations; Listing and Trading of Affiliated Securities by a Self-Regulatory Organization, Release No. 34-50699 (Nov. 18, 2004) [69 FR 71126], at n. 260 ("Standardized options and security futures products are issued and guaranteed by a clearing agency. Currently, all standardized options and security futures products are issued by the Options Clearing Corporation ('OCC').").

relevant to investors in these securities than information about the issuer of the underlying security. Similarly, the investment risk in these securities is determined by the market performance of the underlying security rather than the results of operations or performance of the clearing agency, which is a self-regulatory organization subject to regulatory oversight. Furthermore, unlike a conventional issuer, the clearing agency does not receive the proceeds from the sales of security futures products or standardized options.<sup>157</sup>

In recognition of these fundamental differences, we provided exemptions for security futures products and standardized options from the audit committee listing requirements in Exchange Act Rule 10A-3.<sup>158</sup> Specifically, Rule 10A-3(c) exempts the listing of a security futures product cleared by a clearing agency that is registered pursuant to Section 17A of the Exchange Act or that is exempt from registration pursuant to Section 17A(b)(7)(A) and the listing of a standardized option issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act. For the same reasons that we exempted these securities from Rule 10A-3, we proposed to exempt these securities from Rule 10C-1.

#### b. Comments on the Proposed Rule

Commentators generally agreed that Section 10C should apply only to issuers with listed equity securities.<sup>159</sup> Some commentators argued that the proposed rule should apply to all domestic exchanges and public companies without exception.<sup>160</sup> These commentators did not specifically comment on whether the statute is intended to apply only to issuers with listed equity securities. One commentator recommended that we exempt only exchanges that do not list equity securities and agreed that our proposed exemption for security futures products and standardized options is necessary or appropriate in the public interest and consistent with the protection of investors.<sup>161</sup>

#### c. Final Rule

After consideration of the comments, we are adopting the proposals without change. As adopted, the final rule will:

- Require all exchanges that list equity securities, to the extent that their

listing standards do not already comply with the final rule, to issue or amend their listing rules to comply with the new rule;

- Provide that exchange listing standards required by the new rule need apply only to issuers with listed equity securities; and

- Exempt security futures products cleared by a clearing agency that is registered pursuant to Section 17A of the Exchange Act or that is exempt from registration pursuant to Section 17A(b)(7)(A) and standardized options that are issued by a clearing agency that is registered pursuant to Section 17A of the Exchange Act.

#### 2. Exemptions

Section 10C of the Exchange Act has four different provisions relating to exemptions from some or all of the requirements of Section 10C:

- Section 10C(a)(1) provides that our rules shall direct the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2), other than an issuer that is in one of five specified categories—controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act<sup>162</sup> and foreign private issuers that disclose in their annual reports the reasons why they do not have an independent compensation committee;

- Section 10C(a)(4) provides that our rules shall authorize the exchanges to exempt a particular relationship from the independence requirements applicable to compensation committee members, as each exchange determines is appropriate, taking into consideration the size of the issuer and any other relevant factors;

- Section 10C(f)(3) provides that our rules shall authorize the exchanges to exempt any category of issuer from the requirements of Section 10C as the exchanges determine is appropriate, and that, in making such determinations, the exchanges must take into account the potential impact of the requirements on smaller reporting issuers; and

- Section 10C(g) specifically exempts controlled companies, as defined in Section 10C(g), from all of the requirements of Section 10C.

We proposed Rule 10C-1(b)(1)(iii)(A) to exempt the five categories of issuers enumerated in Section 10C(a)(1); Rule 10C-1(b)(1)(iii)(B) to authorize the

exchanges to exempt a particular relationship from the independence requirements applicable to compensation committee members, as each exchange determines is appropriate, taking into consideration the size of the issuer and other relevant factors; Rule 10C-1(b)(5)(i) to permit the exchanges to exempt any category of issuer from the requirements of Section 10C, as each exchange determines is appropriate, taking into consideration the potential impact of such requirements on smaller reporting issuers; and Rule 10C-1(b)(5)(ii) to exempt controlled companies from the requirements of Rule 10C-1. We are adopting the proposals with changes made in response to comments.

#### a. Proposed Rule

##### i. Issuers Not Subject to Compensation Committee Independence Requirements

As noted above, Exchange Act Section 10C(a)(1) provides that our rules shall direct the exchanges to prohibit the listing of any equity security of an issuer, other than an issuer that is in one of five specified categories, that is not in compliance with the compensation committee member independence requirements of Section 10C(a)(2). Accordingly, we proposed to exempt controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment Company Act and foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee from these requirements.

Under Section 10C(g)(2) of the Exchange Act, a “controlled company” is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. We proposed to incorporate this definition into Rule 10C-1(c)(2). Section 10C did not define the terms “limited partnerships” or “companies in bankruptcy proceedings.” As noted in the Proposing Release, we believe that a limited partnership is generally understood to mean a form of business ownership and association consisting of one or more general partners who are fully liable for the debts and obligations of the partnership and one or more limited partners whose liability is limited to the amount invested.<sup>163</sup> We also noted in

<sup>157</sup> However, the clearing agency may receive a clearing fee from its members.

<sup>158</sup> See Exchange Act Rules 10A-3(c)(4) and (5).

<sup>159</sup> See, e.g., letters from Debevoise and PEGCC.

<sup>160</sup> See letters from CII and FLSBA.

<sup>161</sup> See letter from Merkl.

<sup>162</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>163</sup> See Unif. Ltd. P'ship Act §§ 102, 303 and 404 (2001).

the Proposing Release that the phrase “companies in bankruptcy proceedings” is used in several Commission rules without definition.<sup>164</sup> Accordingly, we did not further define either term in proposed Rule 10C–1(c).

Section 10C does not define the term “open-end management investment company.” As discussed in the Proposing Release, under the Investment Company Act, an open-end management investment company is an investment company, other than a unit investment trust or face-amount certificate company, that offers for sale or has outstanding any redeemable security of which it is the issuer.<sup>165</sup> We proposed to define this term in proposed Rule 10C–1(c) by referencing Section 5(a)(1) of the Investment Company Act.

Under Section 10C(a)(1), a foreign private issuer that provides annual disclosure to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee would be exempt from the compensation committee member independence requirements. Exchange Act Rule 3b–4 defines “foreign private issuer” as “any foreign issuer other than a foreign government, except for an issuer that has more than 50% of its outstanding voting securities held of record by U.S. residents and any of the following: a majority of its officers and directors are citizens or residents of the United States, more than 50% of its assets are located in the United States, or its business is principally administered in the United States.”<sup>166</sup> Since this definition applies to all Exchange Act rules, we did not believe it was necessary to include a cross-reference to Rule 3b–4 in our proposed rules.

In the Proposing Release, we noted that certain foreign private issuers have a two-tier board, with one tier designated as the management board and the other tier designated as the supervisory or non-management board. Similar to our approach to Rule 10A–3,

proposed Rule 10C–1(b)(1)(iii) would clarify that in the case of foreign private issuers with two-tier boards of directors, the term “board of directors” means the supervisory or non-management board. Accordingly, to the extent the supervisory or non-management board forms a separate compensation committee, proposed Rule 10C–1 would apply to that committee, with the exception of the committee member independence requirements, assuming the foreign private issuer discloses why it does not have an independent compensation committee in its annual report.

#### ii. Exemption of Relationships and Other Categories of Issuers

As noted above, Section 10C(a)(4) of the Exchange Act provides that the Commission’s rules shall permit an exchange to exempt a particular relationship from the compensation committee independence requirements, as such exchange deems appropriate, taking into consideration the size of the issuer and any other relevant factors. In addition, as noted above, Section 10C(f)(3) provides that our rules shall authorize an exchange to exempt a category of issuers from the requirements of Section 10C, as the exchange determines is appropriate, taking into account the potential impact of the Section 10C requirements on smaller reporting issuers. To implement these provisions, we proposed Rule 10C–1(b)(1)(iii)(B), which would authorize the exchanges to establish listing standards that exempt particular relationships between members of the compensation committee and listed issuers that might otherwise impair the member’s independence, taking into consideration the size of an issuer and any other relevant factors, and Rule 10C–1(b)(5)(i), which would allow the exchanges to exempt categories of listed issuers from the requirements of Section 10C, as each exchange determines is appropriate. In determining the appropriateness of categorical issuer exemptions, the exchanges would be required, in accordance with the statute, to consider the potential impact of the requirements of Section 10C on smaller reporting issuers.<sup>167</sup>

Other than the five categories of issuers in Section 10C(a)(1), we did not propose to exempt any relationship or any category of issuer from the compensation committee member independence requirements under Section 10C(a)(1). Instead of including specific exemptions, the proposed rule generally would leave the determination of whether to exempt particular relationships or categories of issuers to the discretion of the exchanges, subject to our review in the rule filing process. Because listed issuers frequently consult the exchanges regarding independence determinations and committee responsibilities, in the proposal we explained that we believed that the exchanges are in the best position to identify any relationships or categories of issuers that may merit exemption from the compensation committee listing requirements.

#### b. Comments on the Proposed Rule

Comments on the proposals were generally favorable. Commentators generally supported the proposed approach of deferring to the exchanges any decisions to exempt any categories of issuers or particular relationships that might compromise committee member independence.<sup>168</sup> One commentator expressed concern that the proposed definition of “controlled companies” would not exempt some listed issuers that are controlled companies under applicable listing standards, but do not actually hold director elections, such as some limited liability companies.<sup>169</sup> This commentator recommended that we revise the definition of “controlled companies” in proposed Rule 10C–1(c)(2) so that it would encompass companies that do not actually hold director elections but have more than 50% of the voting power for the election of directors held by an individual, a group or another company.

In the Proposing Release, we requested comment on whether we should exempt any types of issuers, such as registered management investment companies, foreign private issuers or smaller reporting companies,<sup>170</sup> from some or all of the requirements of Section 10C. The NYSE stated its view that the express exclusion of certain types of issuers in

19(b)(1)(C)(iii), and 21(a). Section 10C(f)(3) expressly requires the exchanges to take into account the potential impact of the listing requirements on smaller reporting issuers when exercising the exemptive authority provided to them by our rules.

<sup>168</sup> See, e.g., letters from NYSE and S&C.

<sup>169</sup> See letter from Vinson & Elkins LLP (“V&E”).

<sup>170</sup> See Exchange Act Rule 12b–2 for the definition of “smaller reporting company.”

<sup>164</sup> See, e.g., Section 55(a)(3)(A) of the Investment Company Act [15 U.S.C. 80a–54(a)(3)(A)]; Item 1107(k) of Regulation AB [17 CFR 229.1107(k)]; and Rule 457 under the Securities Act [17 CFR 230.457].

<sup>165</sup> See Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a–4 and 80a–5(a)(1)]. Open-end and closed-end management investment companies registered under the Investment Company Act are generally exempt from current exchange listing standards that require listed issuers to either have a compensation committee or to have independent directors determine, recommend, or oversee specified executive compensation matters. See, e.g., NYSE Listed Company Manual Section 303A.00; Nasdaq Rule 5615(a)(5); NYSE Arca Rule 5.3; NYSE AMEX Company Guide Section 801.

<sup>166</sup> 17 CFR 240.3b–4(c).

<sup>167</sup> See Exchange Act Section 10C(f)(3)(B). Section 10C of the Exchange Act includes no express exemptions for smaller reporting companies. Some exchanges currently have limited exemptions from requirements to have a majority independent board or a three-member audit committee for smaller issuers—for example, NYSE Amex and the Chicago Stock Exchange permit smaller issuers to have a 50% independent board and a minimum of two members on the issuer’s audit committee. See NYSE Amex Company Guide Section 801(h); Chicago Stock Exchange Article 22, Rules 19(a),

Section 10C(a)(1) should not prevent an exchange from exempting other types of issuers, and urged us to clarify that the general exemptive authority exchanges would have under Rule 10C-1 is not limited to smaller reporting companies.<sup>171</sup>

Several commentators urged us to exempt all foreign private issuers from the requirements of Section 10C.<sup>172</sup> Another commentator urged us to exempt smaller reporting companies from the requirements of Section 10C because smaller reporting companies may experience more difficulty than other issuers in finding independent directors who are willing to serve on their boards.<sup>173</sup> Other commentators, however, believed that we should not exempt foreign private issuers or smaller reporting companies from the requirements of Section 10C.<sup>174</sup> Several of these commentators supported uniform application of compensation committee independence requirements to all public companies.<sup>175</sup> One commentator believed that domestic companies should not face a stricter regime than foreign companies and suggested that foreign companies could be given a time frame within which they would be required to meet the listing standards that apply to domestic companies.<sup>176</sup>

One commentator urged us to exempt all registered investment companies from the requirements of Section 10C.<sup>177</sup> This commentator noted that registered investment companies are subject to the requirements of the Investment Company Act, including, in particular, requirements concerning potential conflicts of interest related to investment adviser compensation. The commentator also noted that most registered investment companies are externally managed, do not have compensated executives and, therefore, do not need compensation committees to oversee executive compensation.

### c. Final Rule

After consideration of the comments, we are adopting the rule with revisions in response to comments. Rule 10C-1(b)(1)(iii) will exempt from the compensation committee member independence listing standards required under Rule 10C-1(a) limited

partnerships, companies in bankruptcy proceedings, registered open-end management investment companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee.

As we proposed, we are also exempting controlled companies from the requirements of Rule 10C-1. In light of Section 10C(g)'s general exemption for controlled companies, we have eliminated the specific exemption for controlled companies from the compensation committee member independence listing standards in final Rule 10C-1(b)(1)(iii). We believe this specific exemption from the compensation committee member independence listing standards for controlled companies is unnecessary in light of the broader exemption for controlled companies provided by final Rule 10C-1(b)(5)(ii).

In response to comments that our proposed definition of controlled company would not exempt listed issuers that would otherwise be controlled companies but for the fact that they do not hold director elections, we are modifying the definition of controlled company in the final rule. Under the final rule, a controlled company will be defined as a listed company in which more than 50% of the voting power for the election of directors is held by an individual, a group or another company. We have removed from the definition the phrase "holds an election for the board of directors." The revised definition of "controlled company" will more closely follow the definition of the term currently used by the NYSE and Nasdaq.<sup>178</sup> Although the definition in the final rule is slightly broader than the definition of "controlled company" in Section 10C(g)(2), we believe this modification is consistent with the statutory intent to exempt from the requirements of Section 10C those companies that are in fact controlled by a shareholder or group of shareholders, regardless of whether director elections are actually held.

In addition to controlled companies, we are exempting smaller reporting companies, as defined in Exchange Act Rule 12b-2, from the requirements of Rule 10C-1.<sup>179</sup> As noted above, one

commentator urged us to exempt smaller reporting companies from the requirements of Section 10C because smaller reporting companies may experience more difficulty than other issuers in finding independent directors who are willing to serve on their boards.<sup>180</sup> This commentator also noted that the compensation committees of smaller reporting companies often do not hire outside compensation consultants, both because their compensation programs tend to be "relatively simple" and also because smaller reporting companies "often cannot afford to hire outside experts."<sup>181</sup>

We recognize that some commentators opposed such an exemption,<sup>182</sup> but we believe, on balance, that an exemption is appropriate. In 2006, when we substantially revised our executive compensation disclosure rules, we adopted new scaled executive compensation disclosure requirements for smaller companies in recognition of the fact that the "executive compensation arrangements of small business issuers generally are so much less complex than those of other public companies that they do not warrant the more extensive disclosure requirements imposed on companies that are not small business issuers and related regulatory burdens that could be disproportionate for small business issuers."<sup>183</sup> In light of those findings with respect to smaller reporting companies' less complex executive compensation arrangements, we are not persuaded that the additional burdens of complying with Rule 10C-1 are warranted for smaller reporting companies.

We appreciate that these burdens for listed smaller reporting companies may not be significant given that such issuers are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation

reporting companies, which is available at <http://www.sec.gov/comments/s7-13-11/s71311-60.pdf>.

<sup>180</sup> See letter from ABA.

<sup>181</sup> See *id.*

<sup>182</sup> See letters from CalPERS, CII, FLSBA, Merkl and Railpen. These commentators did not provide specific reasons for their opposition, other than two commentators noting that the matters addressed in Section 10C are relevant to all public companies. See letters from CII and FLSBA.

<sup>183</sup> See Executive Compensation and Related Person Disclosure, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158], at 53192 ("2006 Executive Compensation Release"). In 2007, we adopted a new eligibility standard for "smaller reporting companies" to replace the "small business issuer" definition then found in Item 10 of Regulation S-B. See Smaller Reporting Company Regulatory Relief and Simplification, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934].

<sup>171</sup> See letter from NYSE.

<sup>172</sup> See letters from ABA, Davis Polk and SAP AG.

<sup>173</sup> See letter from ABA.

<sup>174</sup> See letters from CalPERS, CII, FLSBA, the Local Authority Pension Fund Forum ("LAPFF"), Merkl, Railpen and USS.

<sup>175</sup> See letters from CII, FLSBA and USS.

<sup>176</sup> See letter from LAPFF.

<sup>177</sup> See letter from the Investment Company Institute ("ICI").

<sup>178</sup> See NYSE Listed Company Manual Section 303A.00 and Nasdaq Rule 5615(c).

<sup>179</sup> Approximately 1%, 25% and 53% of the operating companies listed on the NYSE, the Nasdaq Stock Market, and NYSE Amex, respectively, are smaller reporting companies. See Memorandum to File No. S7-13-11, dated May 8, 2012, concerning information on listed smaller

matters to be “independent” under the exchanges’ general independence standards. We do believe, however, that exempting smaller reporting companies from the listing standards mandated by Rule 10C–1 can offer cost savings to these listed issuers to the extent that an exchange, in connection with the listing standards review required by Rule 10C–1, chooses to create a new independence standard for compensation committee members that is more rigorous than its existing standards—for example, a new standard could address personal or business relationships between members of the compensation committee and the listed issuer’s executive officers. Issuers subject to the exchange’s new standard may need to replace existing compensation committee members, and incur the associated costs, if the existing members do not qualify as independent under the new standard. In addition, although listed smaller reporting companies do not often engage outside compensation consultants, there would be cost savings to these listed issuers from not having to comply with the listing standards involving the compensation committee’s engagement and oversight of compensation advisers. For example, the exchanges are required to adopt listing standards that require the compensation committee to consider the six independence factors listed in Rule 10C–1(b)(4) before selecting a compensation adviser. To comply with these listing standards, compensation committees will likely need to create procedures for collecting and analyzing information about potential compensation advisers before they can receive advice from such advisers, which would require the listed issuers to incur costs. We expect, however, that a portion of these cost savings would likely be offset by the costs that smaller reporting companies may incur to comply with the new requirement to disclose compensation consultants’ conflicts of interest, which is described in Section II.C below. In light of these considerations, we do not believe it is necessary to require the exchanges to go through the process of proposing to exempt smaller reporting companies in the Section 19(b) rule filing process, since we have concluded that it is appropriate to provide this exemption in any event. Accordingly, we are exempting smaller reporting companies from the requirements of Rule 10C–1.<sup>184</sup>

<sup>184</sup> When an issuer loses its smaller reporting company status, it will be required to comply with the listing standards applicable to non-smaller reporting companies. We anticipate that the exchanges will provide for a transition period for issuers that lose smaller reporting company status,

We are adopting Rules 10C–1(b)(1)(iii)(B) and 10C–1(b)(5)(i) substantially as proposed. Rule 10C–1(b)(1)(iii)(B) authorizes the exchanges to exempt a particular relationship from the compensation committee member independence requirements, as the exchanges deem appropriate, taking into consideration the size of the issuer and any other relevant factors. Rule 10C–1(b)(5)(i) authorizes the exchanges to exempt any category of issuers from the requirements of Section 10C,<sup>185</sup> as each exchange determines is appropriate, taking into consideration the potential impact of the requirements on smaller reporting issuers. In response to comment, we are clarifying that the final rule does not prohibit the exchanges from considering other relevant factors as well. The final rule will allow the exchanges flexibility to propose transactions or categories of issuers to exempt, subject to our review and approval under the Exchange Act Section 19(b) rule filing process. As we noted in the Proposing Release, we believe that relying on the exchanges in this manner to exercise the exemptive authority expressly granted to them under the final rules is consistent with the requirements of Section 10C and will result in more effective determinations as to the types of relationships and the types of issuers that merit an exemption.<sup>186</sup>

As noted by one commentator, most registered investment companies do not have compensated employees or compensation committees.<sup>187</sup> Therefore, the requirements of Rule 10C–1, which does not itself require any issuer to have

similar to what they currently have for issuers that lose controlled company status. *See, e.g.*, NYSE Listed Company Manual Section 303A.00; Nasdaq Rule 5615(c)(3).

<sup>185</sup> As noted in the Proposing Release, Rule 10C–1(b)(5)(i) does not provide the authority for the exchanges to exempt listed issuers from the disclosure requirements under Item 407 of Regulation S–K, which include Section 10C(c)(2)’s compensation consultant disclosure requirements.

<sup>186</sup> We note that the Jumpstart Our Business Startups Act, Public Law 112–106, 126 Stat. (2012) (the “JOBS Act”), which was enacted on April 5, 2012, creates a new category of issuer, an “emerging growth company,” under the Securities Act and the Exchange Act. *See* Section 2(a)(19) of the Securities Act [15 U.S.C. 77b(a)(19)]; Section 3(a)(80) of the Exchange Act [15 U.S.C. 78c(a)(80)]. An emerging growth company is defined as an issuer that had total annual gross revenues of less than \$1 billion during its most recently completed fiscal year. Existing listing standards provide no accommodation for this category of issuer, and the JOBS Act does not require that exchanges do so. The rules we are adopting will permit the exchanges to consider, subject to the Commission’s review and approval, whether any exemptions from the listing standards required by Rule 10C–1 are appropriate for emerging growth companies or any other category of issuer.

<sup>187</sup> *See* letter from ICI.

a compensation committee, will not affect most registered investment companies or impose any compliance obligations on them.<sup>188</sup> This commentator did not explain why, in the infrequent case where a registered investment company has compensated executives and a compensation committee (which are not addressed by Investment Company Act requirements related to investment adviser compensation), the registered investment company should be exempt from the requirements that apply to all other listed issuers with compensation committees. We believe that the exchanges are in a better position to determine the appropriate treatment of registered investment companies that have compensated executives and compensation committees, if any.

### C. Compensation Consultant Disclosure and Conflicts of Interest

Section 10C(c)(2) of the Exchange Act requires that, in any proxy or consent solicitation material for an annual meeting (or a special meeting in lieu of the annual meeting), each issuer must disclose, in accordance with regulations of the Commission, whether:

- The compensation committee has retained or obtained the advice of a compensation consultant; and
- The work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed.

We proposed amendments to Item 407 of Regulation S–K to require issuers to include the disclosures required by Section 10C(c)(2) in any proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected. After consideration of the comments, we are adopting a modified version of the proposal.

#### 1. Proposed Rule

Item 407 of Regulation S–K currently requires Exchange Act registrants that are subject to the proxy rules, other than registered investment companies, to provide certain disclosures concerning their compensation committees and the use of compensation consultants. Item 407(e)(3)(iii) generally requires

<sup>188</sup> We do not believe that any board committee or members of the board of a registered investment company or business development company would be a “compensation committee” under Rule 10C–1 solely as a result of carrying out the board’s responsibilities under Rule 38a–1 under the Investment Company Act to approve the designation and compensation of the fund’s chief compliance officer. Under Rule 38a–1, the approval of a majority of the board’s independent directors is required. *See* 17 CFR 270.38a–1(a)(4).

registrants to disclose “any role of compensation consultants in determining or recommending the amount or form of executive and director compensation,” including:

- Identifying the consultants;
- Stating whether such consultants were engaged directly by the compensation committee or any other person;
- Describing the nature and scope of the consultants’ assignment, and the material elements of any instructions given to the consultants under the engagement; and
- Disclosing the aggregate fees paid to a consultant for advice or recommendations on the amount or form of executive and director compensation and the aggregate fees for additional services if the consultant provided both and the fees for the additional services exceeded \$120,000 during the fiscal year.<sup>189</sup>

The current item excludes from the disclosure requirement any role of compensation consultants limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.<sup>190</sup>

As we noted in the Proposing Release, the trigger for disclosure about compensation consultants under Section 10C(c)(2) is worded differently from the existing disclosure trigger under Item 407(e)(3)(iii). Under Section 10C(c)(2), an issuer must disclose whether the “compensation committee retained or obtained the advice of a compensation consultant.” By contrast,

<sup>189</sup> See current Items 407(e)(3)(iii)(A) and (B) [17 CFR 229.407(e)(3)(iii)(A) and 229.407(e)(3)(iii)(B)]. Fee disclosure, however, is not required for compensation consultants that work with management if the compensation committee has retained a separate consultant. In promulgating these requirements, we recognized that, in this situation, the compensation committee may not be relying on the compensation consultant used by management, and therefore potential conflicts of interest are less of a concern. See Proxy Disclosure Enhancements, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334] (“Proxy Disclosure Enhancements Release”).

<sup>190</sup> See Item 407(e)(3)(iii). In adopting this exclusion, the Commission determined (based on comments it received on the rule proposal) that the provision of such work by a compensation consultant does not raise conflict of interest concerns that warrant disclosure of the consultant’s selection, terms of engagement or fees. See Proxy Disclosure Enhancements Release.

existing Item 407 requires disclosure, with limited exceptions, whenever a compensation consultant plays “any role” in determining or recommending the amount or form of executive or director compensation. Given the similarities between the disclosure required by Section 10C(c)(2) and the disclosure required by Item 407(e)(3)(iii), we proposed amendments to integrate Section 10C(c)(2)’s disclosure requirements with the existing disclosure rule. Specifically, as proposed, revised Item 407(e)(3)(iii) would include a disclosure trigger consistent with the statutory language and would, therefore, require issuers to disclose whether the compensation committee had “retained or obtained” the advice of a compensation consultant during the issuer’s last completed fiscal year. If so, the issuer would also be required to provide related disclosures describing the consultant’s assignment, any conflicts of interest raised by the consultant’s work, and how such conflicts were being addressed. In addition, our proposed rule would alter the existing consultant fee disclosure requirements to include the same disclosure trigger. We noted in the Proposing Release that we believed the practical effect of this change would be minimal, as it would be unusual for a consultant to play a role in determining or recommending the amount of executive compensation without the compensation committee also retaining or obtaining the consultant’s advice.

Our proposed integrated disclosure requirement would no longer provide an exception from the requirement to disclose the role of a compensation consultant where that role is limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular issuer or is customized based on parameters that are not developed by the consultant and about which the consultant does not provide advice. As we explained in the Proposing Release, we believed this would be “consistent with the purposes of Section 10C(c)(2), which is to require disclosure about compensation consultants and any conflicts of interest they have in a competitively neutral fashion.”<sup>191</sup> Under the proposed amendments, disclosure about the compensation consultant’s role and conflicts of interest would be required even if the consultant provided only

advice on broad-based plans or non-customized benchmark data. We proposed, however, that the compensation consultant fee disclosure requirements currently included in Item 407(e)(3) would continue to include exceptions for cases where a consultant’s role is limited to providing these types of services.

In order to clarify certain terms contained in Section 10C(c)(2) and used in the proposed rules, we proposed to add an instruction to Item 407(e)(3) to clarify the meaning of the phrase “obtained the advice.” The proposed instruction would provide that a compensation committee or management will have “obtained the advice” of a compensation consultant if it “has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice.” In addition, we proposed an instruction that identified the five independence factors that Section 10C requires a listed issuer’s compensation committee to consider before selecting a compensation adviser as among the factors that issuers should consider in determining whether there is a conflict of interest that may need to be disclosed.

Finally, under the proposed amendments, these disclosures would be required only in a proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected and would apply to issuers subject to our proxy rules, whether listed or not, and whether they are controlled companies or not.

## 2. Comments on the Proposed Rule

Comments on the proposed amendments were mixed, with the exception of our proposal to require the disclosures called for by Section 10C(c)(2) only in proxy or information statements for meetings at which directors are to be elected, which commentators generally supported.<sup>192</sup>

Several commentators expressed general support for our proposal to require disclosure about compensation consultants’ conflicts of interest.<sup>193</sup> Some of these commentators noted that timely disclosure of conflicts is needed to allow investors to adequately monitor

<sup>192</sup> See, e.g., letters from ABA, AON and Debevoise.

<sup>193</sup> See, e.g., letters from AFSCME, CII, FLSBA, Hermes, OPERS and UAW.

<sup>191</sup> See Proposing Release, 76 FR at 18980.

compensation committee performance.<sup>194</sup> For this reason, another commentator noted that disclosure concerning compensation consultant conflicts of interest “is most appropriately required in the context of other corporate governance disclosures that are most relevant in the context of making voting decisions with respect to the election of directors.”<sup>195</sup>

Several commentators expressed general support for integrating the Section 10C(c)(2) disclosure requirements into the existing compensation consultant disclosure requirements contained in Item 407(e)(3)(iii) of Regulation S-K.<sup>196</sup> One of these commentators believed that a combined rule with a single trigger for disclosure would benefit issuers and investors by simplifying the disclosure requirement and enhancing the clarity of the disclosure.<sup>197</sup> One commentator opposed integrating the disclosure requirements of Section 10C(c)(2) into Item 407(e)(3)(iii), and believed that a better approach would be to retain the existing disclosure trigger in Item 407(e)(3)(iii) and include a separate disclosure item within Item 407 to address conflict of interest disclosure requirements.<sup>198</sup> This commentator also criticized our proposed amendments because they would narrow the disclosure currently required by Item 407(e)(3)(iii) by excluding those compensation consultants that may have participated in executive compensation determinations but were not actually retained by the compensation committee.<sup>199</sup> Another commentator supported our proposal to integrate the disclosure requirements, but believed it was unnecessary to modify the wording of Item 407(e)(3)(iii) to include the “retain or obtain the advice” disclosure trigger included in the Act.<sup>200</sup> This commentator noted that issuers and consulting firms had already made significant adjustments to their business practices in light of the existing Item 407(e)(3) requirements and that it would be costly and unnecessary to make additional adjustments if the wording of the existing rules is changed simply to mirror the language included in the Act.<sup>201</sup>

A significant number of commentators expressed concern over the proposed instruction to clarify the phrase

“obtained the advice.”<sup>202</sup> These commentators believed that the proposed instruction was too broad and could potentially cover director education programs, unsolicited survey results and publications that contain executive compensation data, which they believed were not intended to be covered by Section 10C(c)(2).<sup>203</sup> A number of these commentators recommended modifications to the instruction, including:

- Excluding insubstantial or unsolicited interaction with a compensation committee;<sup>204</sup>
- Clarifying that the phrase “obtained the advice” excludes materials prepared for management by a compensation consultant engaged by management, even if such materials are made available to the compensation committee;<sup>205</sup> and
- Clarifying that “advice” has not been obtained unless the compensation consultant provides a recommendation to the committee regarding the amount or form of executive compensation.<sup>206</sup>

A few commentators supported our proposal to require disclosure about the role of compensation consultants even where that role is limited to consulting on broad-based plans or providing non-customized benchmark information.<sup>207</sup> Many more commentators, however, opposed eliminating the current disclosure exclusions under Item 407(e)(3) and recommended that we extend those disclosure exclusions to the new disclosure requirements.<sup>208</sup> Some of these commentators noted that, when the disclosure exemptions in Item 407(e)(3)(iii) were adopted in December 2009, the Commission stated that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that would warrant disclosure of the consultant’s selection, terms of engagement or fees.<sup>209</sup> Another commentator believed that retaining the existing disclosure exclusions in Item 407(e)(3)(iii) would be consistent with the purposes of Section 10C(c)(2) because a consulting firm that provided only non-customized benchmark data to

a compensation committee would not be providing “advice” to the compensation committee.<sup>210</sup>

Commentators generally supported our proposal to identify the five factors in proposed Rule 10C-1(b)(4)(i) through (v) as among the factors that should be considered in determining whether a conflict of interest exists,<sup>211</sup> though some commentators suggested additional factors that they believed should be considered.<sup>212</sup> In the Proposing Release, we requested comment on whether we should include the appearance of a conflict of interest in our interpretation of what constitutes a “conflict of interest” that must be disclosed under the proposed amendments. A few commentators believed that we should require disclosure of the appearance of a conflict of interest or potential conflicts of interest.<sup>213</sup> One of these commentators argued that including potential conflicts is necessary because actual conflicts of interest can be difficult to identify with precision.<sup>214</sup> Other commentators believed that we should not require disclosure of either an appearance of a conflict of interest or a potential conflict of interest, for various reasons, such as: potential conflicts were not covered by the text of Section 10C(c)(2);<sup>215</sup> potential conflicts would be difficult to define and would not provide investors with additional material information regarding the compensation consultant relationship;<sup>216</sup> and compensation committees are not reluctant or unable to conclude that a conflict of interest exists.<sup>217</sup>

Many commentators requested that we clarify that the amendments to Item 407(e)(3)(iii) apply only to board committees that are charged with determining executive compensation, and not to any committee of the board, if separate, that oversees the compensation of non-employee

<sup>210</sup> See letter from SCSGP.

<sup>211</sup> See letters from AON and Towers.

<sup>212</sup> See, e.g., letters from AFSCME (urging consideration of the ratio between fees paid for executive compensation and non-executive compensation consulting work, as well as equity ownership and incentive compensation arrangements of consultants) and Merkl (urging consideration of private and business relationships between the person employing the adviser and executive officers or members of the compensation committee, as well as stock ownership by the person that employs the adviser, if it is material).

<sup>213</sup> See letters from Better Markets, OPERS, and Towers.

<sup>214</sup> See letter from Better Markets.

<sup>215</sup> See letters from ABA, AON, and Mercer.

<sup>216</sup> See letter from ABA.

<sup>217</sup> See letter from AON.

<sup>202</sup> See, e.g., letters from AON, CEC, Davis Polk, Mercer, Meridian, Pearl Meyer & Partners (“Pearl Meyer”), McGuireWoods, NACD, Pfizer, SCSGP and Towers.

<sup>203</sup> See, e.g., letters from Davis Polk, Meridian, NACD and Towers.

<sup>204</sup> See, e.g., letters from Davis Polk and Meridian.

<sup>205</sup> See letters from Davis Polk and Towers.

<sup>206</sup> See letters from Pfizer and SCSGP.

<sup>207</sup> See, e.g., letters from AFSCME and UAW.

<sup>208</sup> See, e.g., letters from ABA, AON, CEC, Davis Polk, Debevoise, Meridian, SCSGP, Towers and U.S. Chamber of Commerce (Apr. 28, 2011) (“Chamber”).

<sup>209</sup> See, e.g., letter from ABA and Davis Polk.

<sup>194</sup> See letters from CII and FLSBA.

<sup>195</sup> See, e.g., letter from ABA.

<sup>196</sup> See, e.g., letters from Davis Polk, Debevoise, Meridian, Pfizer and UAW.

<sup>197</sup> See letter from Meridian.

<sup>198</sup> See letter from ABA.

<sup>199</sup> See *id.*

<sup>200</sup> See letter from AON.

<sup>201</sup> See *id.*

directors.<sup>218</sup> Several of these commentators noted that in many instances, a committee other than the company's compensation committee, such as a governance committee, determines the compensation of the company's non-executive directors.<sup>219</sup>

We requested comment on whether we should extend the Section 10C(c)(2) disclosure requirements to compensation advisers other than compensation consultants. Comments were mixed. A number of commentators believed we should require conflicts of interest disclosure for all types of advisers, including legal counsel.<sup>220</sup> One commentator stated that extending the disclosure requirements to legal counsel would benefit the investing public in its consideration of compensation issues.<sup>221</sup> Another commentator noted that requiring such disclosure would allow investors to determine whether the compensation committee had the benefit of independent legal advice in making compensation determinations.<sup>222</sup> Other commentators felt that conflicted compensation advisers of any kind could not be relied upon to serve the best interests of the issuer and its shareholders.<sup>223</sup> Two commentators opposed extending the proposed disclosure requirements to legal counsel.<sup>224</sup> One of these commentators believed that the specific statutory reference in Section 10C(c)(2) to "compensation consultants" reflects a deliberate policy choice by Congress to limit the additional required disclosures to compensation consultants alone.<sup>225</sup>

The proposed rule would apply to issuers that are required to comply with the proxy rules. One commentator supported our proposal to require controlled companies to provide disclosures relating to compensation consultants and conflicts of interest raised by the consultants' work.<sup>226</sup> Three commentators were opposed to this proposed requirement,<sup>227</sup> and one of them questioned the value of requiring disclosure of a compensation consultant's conflicts of interest in cases where the composition of the board of directors and compensation committee is subject to the direction of a control

<sup>218</sup> See, e.g., letters from CEC, Chamber, Davis Polk, Pfizer, and SCSGP.

<sup>219</sup> See letters from CEC and Chamber.

<sup>220</sup> See, e.g., letters from Better Markets, CII, Fields, FLSBA, Jackson, and Towers.

<sup>221</sup> See letter from Fields.

<sup>222</sup> See letter from Jackson.

<sup>223</sup> See letters from CII and FLSBA.

<sup>224</sup> See letters from ABA and McGuire Woods.

<sup>225</sup> See letter from McGuire Woods.

<sup>226</sup> See letter from AON.

<sup>227</sup> See letters from ABA, Debevoise, and Merkl.

person or group.<sup>228</sup> One commentator supported our proposal to require smaller reporting companies to provide disclosures relating to compensation consultant conflicts of interest, noting that "[w]e are not aware of any particular problems smaller reporting companies have had with the existing rules, and we do not believe the additional rules mandated by Dodd-Frank will be any more burdensome on smaller reporting companies."<sup>229</sup>

We received few comments on our proposal to extend the disclosure requirements to Exchange Act registrants that are not listed issuers. Two commentators supported our proposal.<sup>230</sup> One commentator who opposed the proposal believed that extending the disclosure requirements of Section 10C(c)(2) to non-listed issuers is not required by Section 10C or for the protection of investors.<sup>231</sup>

Several commentators agreed that we should not amend Forms 20-F or 40-F to require foreign private issuers that are not subject to our proxy rules to provide annual disclosure of the type required by Section 10C(c)(2).<sup>232</sup> Two of these commentators noted that imposing such requirements would be inconsistent with the current disclosure paradigm for compensation matters, which generally defers to a foreign private issuer's home country rules.<sup>233</sup> One commentator, however, expressed the view that foreign private issuers should have to comply with the same compensation consultant disclosure requirements as domestic issuers.<sup>234</sup>

### 3. Final Rule

After consideration of the comments, we are adopting a modified version of the proposed amendments. The amendments we are adopting implement the disclosure requirements of Section 10C(c)(2) while preserving the existing disclosure requirements under Item 407(e)(3).

#### a. Disclosure Requirements

Rather than integrating the new disclosure requirements with the existing compensation consultant disclosure provisions, as proposed, we are retaining the existing disclosure trigger and requirements of Item 407(e)(3)(iii) and adding a new subparagraph to Item 407(e)(3) to require the disclosures mandated by

<sup>228</sup> See letter from Debevoise.

<sup>229</sup> See letter from AON.

<sup>230</sup> See letters from AON and Merkl.

<sup>231</sup> See letter from Debevoise.

<sup>232</sup> See letters from ABA, AON, Debevoise, and SAP.

<sup>233</sup> See letters from Debevoise and SAP.

<sup>234</sup> See letter from Merkl.

Section 10C(c)(2)(B). With respect to Section 10C(c)(2)(A), which requires an issuer to disclose whether its compensation committee retained or obtained the advice of a compensation consultant, we believe existing Item 407(e)(3)(iii) implements this disclosure requirement, as it requires disclosure, with certain exceptions discussed more fully below, of any role compensation consultants played in determining or recommending the amount or form of executive and director compensation. As we noted in the Proposing Release, we believe it would be unusual for a compensation consultant to play "any role" in determining or recommending the amount of executive compensation without the compensation committee also retaining or obtaining the compensation consultant's advice.

With respect to the disclosures mandated by Section 10C(c)(2)(B), we are persuaded by comments noting that our proposal to use the "retain or obtain the advice" disclosure trigger included in Section 10C could result in unnecessary, and potentially costly, adjustments by issuers and consulting firms that have adapted their business practices in light of the existing Item 407(e)(3)(iii) disclosure requirements. In addition, we note the comment pointing out that our proposal would eliminate the existing requirement to disclose the role of compensation consultants retained by management rather than the compensation committee. Consequently, we have concluded that this change to the existing requirement is not appropriate. In lieu of our proposal to integrate the Section 10C(c)(2) disclosure requirements with the existing disclosure rule, we have determined to adopt a new disclosure provision, new Item 407(e)(3)(iv), to implement Section 10C(c)(2).

Under Item 407(e)(3)(iii), registrants will continue to be required to disclose "any role of compensation consultants in determining or recommending the amount or form of executive and director compensation." Specifically, registrants will continue to be required to:

- Identify the consultants;
- State whether such consultants were engaged directly by the compensation committee or any other person;
- Describe the nature and scope of the consultant's assignment and the material elements of any instructions given to the consultants under the engagement; and
- Disclose the aggregate fees paid to a consultant for advice or recommendations on the amount or form of executive and director

compensation and the aggregate fees for additional services if the consultant provided both and the fees for the additional services exceeded \$120,000 during the fiscal year.<sup>235</sup>

With respect to the new requirement in Item 407(e)(3)(iv) to disclose compensation consultant conflicts of interest, we have decided to use the “any role” disclosure trigger rather than the “obtained or retained the advice” trigger included in Section 10C. Hence, the new requirement will apply to any compensation consultant whose work must be disclosed pursuant to Item 407(e)(3)(iii), regardless of whether the compensation consultant was retained by management or the compensation committee or any other board committee. We believe that this approach is consistent with the meaning of the words “retained or obtained” (emphasis added) in Section 10C, as there will be little practical difference in the application of the two disclosure triggers as they relate to consultants advising on executive compensation matters. Based on the comments on this aspect of the proposal, we also believe that the existing disclosure trigger is well-understood by issuers. Because we are not changing the disclosure trigger, we no longer find it necessary to include an instruction to clarify when a compensation committee has “obtained” advice. We are persuaded by commentators who expressed the view that the instruction, as proposed, was overly broad.

As is the case with our existing requirement to disclose the role of compensation consultants in determining or recommending the amount or form of executive and director compensation, issuers will be required to comply with the new disclosure requirement relating to compensation consultant conflicts of interest in a proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected. Although Section 10C(c)(2) is not explicitly limited to proxy statements for meetings at which directors will be elected, we believe this approach is appropriate in light of the approach in our rules to disclosure of compensation consultant matters generally.

<sup>235</sup> The rule will continue not to require fee disclosure for compensation consultants that work with management if the compensation committee has retained a separate compensation consultant. As we noted in the Proxy Disclosure Enhancements Release, in this situation, the compensation committee may not be relying on the compensation consultant retained by management and potential conflicts of interest are therefore less of a concern.

This new subparagraph will apply to issuers subject to our proxy rules, including controlled companies, non-listed issuers and smaller reporting companies.<sup>236</sup> Although Section 10C(c)(2) does not mandate this disclosure for issuers that will not be subject to the listing standards required by Rule 10C–1, we believe that investors are better served by requiring all issuers subject to our proxy rules to provide timely disclosure of compensation consultants’ conflicts of interests, which will enable investors to adequately monitor compensation committee performance and will help investors make better informed voting decisions with respect to the election of directors, including members of the compensation committee. Under the final amendments, issuers subject to our proxy rules will be required to disclose, with respect to any compensation consultant that is identified pursuant to Item 407(e)(3)(iii) as having played a role in determining or recommending the amount or form of executive and director compensation, whether the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. As commentators generally supported our proposal to identify the independence factors that a compensation committee must consider before selecting a compensation adviser as among the factors that should be considered in determining whether a consultant conflict of interest exists, the final amendments will include an instruction to Item 407(e)(3) noting that, in deciding whether there is a conflict of interest that may need to be disclosed, issuers should, at a minimum, consider the six factors set forth in Rule 10C–1(b)(4)(i) through (vi).

We are sensitive to the additional burdens placed on issuers from the expansion of disclosure obligations under our rules. In light of those concerns, the final rule will not require disclosure of potential conflicts of interest or an appearance of a conflict of interest, nor will it require disclosure with respect to compensation advisers other than compensation consultants. These additional disclosures are not

<sup>236</sup> Foreign private issuers that are not subject to our proxy rules will not be required to provide this disclosure. Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation consultant disclosure requirement in Item 407(e)(3) of Regulation S–K. See Item 7(g) of Schedule 14A. As we proposed, registered investment companies will continue to provide disclosure under Item 22 and will not be subject to the amendments to Item 407(e) adopted in this release.

mandated by Section 10C, and we are not persuaded that the additional burdens of requiring this disclosure are justified by the potential benefit to investors.

#### b. Disclosure Exemptions

We proposed to eliminate the disclosure exemption in Item 407(e)(3) for compensation consulting services involving only broad-based, non-discriminatory plans and the provision of non-customized survey data. Several commentators opposed to the proposed elimination noted that, when the disclosure exemptions in Item 407(e)(3)(iii) were adopted in December 2009, we stated that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that would warrant disclosure of the consultant’s selection, terms of engagement, or fees.<sup>237</sup> We continue to believe that compensation consulting work limited to these activities does not raise conflict of interest concerns. Accordingly, consulting on broad-based plans and providing non-customized benchmark data will continue to be exempted from the compensation consultant disclosure requirements under Item 407(e)(3), including the new conflicts of interest disclosure required in our rules implementing Section 10C(c)(2).

#### c. Disclosure Regarding Director Compensation

Several commentators requested that we clarify that the proposed amendments to Item 407(e)(3)(iii) apply only to board committees that are charged with determining executive compensation and not to other committees that oversee the compensation of non-employee directors.<sup>238</sup> We believe these comments were prompted by our proposal, described above, to replace the existing disclosure trigger in Item 407(e)(3)(iii) with our proposed trigger, which referenced compensation consultants retained by the compensation committee. As discussed above, we have determined to retain the existing disclosure trigger in Item 407(e)(3), which requires disclosure of the role played by compensation consultants in determining or recommending “executive and director compensation” (emphasis added).

Issuers are currently required to discuss in proxy and information statements the role played by

<sup>237</sup> See letters from ABA, Davis Polk and SCSP.

<sup>238</sup> See, e.g., letters from CEC, Chamber, Davis Polk, Pfizer, and SCSP.

compensation consultants in determining or recommending the amount or form of director compensation, including the nature and scope of their assignment and any material instructions or directions governing their performance under the engagement and to provide fee disclosure, all to the same extent that the disclosure is required regarding executive compensation. In light of the approach we are taking to the new disclosure requirement generally, which is to add the new requirement to the existing disclosure requirements using the existing triggers, we believe it is appropriate to apply the compensation consultant conflict of interest disclosure requirement to director compensation in the same manner as executive compensation. We believe this will benefit investors by providing for more complete and consistent disclosures on how the board manages compensation-related conflicts of interest. Accordingly, to the extent consulting on director compensation raises a conflict of interest on the part of the compensation consultant, disclosure would be required in response to new Item 407(e)(3)(iv).

#### D. Transition and Timing

The Act did not establish a specific deadline by which the listing standards promulgated by the exchanges must be in effect. To facilitate timely implementation of the proposals, we proposed that each exchange must provide to the Commission, no later than 90 days after publication of our final rule in the **Federal Register**, proposed listing rules or rule amendments that comply with our final rule. Further, we proposed that each exchange would need to have final rules or rule amendments that comply with our final rule approved by the Commission no later than one year after publication of our final rule in the **Federal Register**.

Comments were mixed on these proposals. One commentator did not believe that the 90-day period would afford the exchanges enough time to draft the proposed rules or rule amendments or to work through related concerns or issues.<sup>239</sup> The only comment letter we received from an exchange, however, indicated that the 90-day period would be adequate.<sup>240</sup> The exchange recommended, however, that instead of obligating exchanges to have rules approved by the Commission within any set timeframe, we should instead require exchanges to respond to

any written comments issued by the Commission or its staff within 90 days.

Two commentators requested that we clarify that the exchanges may provide their listed issuers a transition period to come into compliance with the listing standards required by Rule 10C-1.<sup>241</sup> Two other commentators requested that the Commission include a transition period for newly listed issuers directly in Rule 10C-1.<sup>242</sup> One of these commentators also recommended a two-year delayed phase-in period for smaller reporting companies, if they are not exempted entirely from the compensation committee and independence requirements and consultant disclosures.<sup>243</sup> Another commentator requested that we establish a specific time period by which all listed issuers must comply with an exchange's new or amended rules meeting the requirements of our final rules.<sup>244</sup> This commentator believed that a longer time frame, such as a year, would give listed issuers sufficient time to comply with the new standards.

After consideration of the comments, we are adopting the implementation period as proposed. We believe that retaining the requirement for each exchange to have final rules or rule amendments that comply with our final rule approved by the Commission no later than one year after publication of our final rule in the **Federal Register** will ensure that the exchanges work expeditiously and in good faith to meet the requirements of the new rule. We also note that Rule 10A-3 included a similar requirement with a significantly shorter compliance period.<sup>245</sup> Although the final rule does not provide an extended transition period for newly listed issuers, we note that the exemptive authority provided to the exchanges under the final rule permits them to propose appropriate transition periods. As noted above, we are exempting smaller reporting companies from the requirements of Rule 10C-1.

Section 10C(c)(2) provides that the compensation consultant conflict of interest disclosure would be required with respect to meetings occurring on or after the date that is one year after the enactment of Section 10C, which was July 21, 2011; however, the statute also

requires these disclosures to be "in accordance with regulations of the Commission," and, prior to the adoption of these new rules, our regulations have not required such disclosures to be made. We recognize that issuers will need to implement disclosure controls and procedures to collect and analyze information relevant to whether their compensation consultants have a conflict of interest. As a result, we have decided to require compliance with new Item 407(e)(3)(iv) in any proxy or information statement for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting) at which directors will be elected occurring on or after January 1, 2013.

### III. Paperwork Reduction Act

#### A. Background

Certain provisions of the final rule and rule amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>246</sup> We published a notice requesting comment on the collection of information requirements in the Proposing Release for the rule amendments, and we submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with the PRA.<sup>247</sup> The titles for the collection of information are:

- (1) "Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059);
- (2) "Regulation 14C and Schedule 14C" (OMB Control No. 3235-0057); and
- (3) "Regulation S-K" (OMB Control No. 3235-0071).<sup>248</sup>

Regulation S-K was adopted under the Securities Act and Exchange Act; Regulations 14A and 14C and the related schedules were adopted under the Exchange Act. The regulations and schedules set forth the disclosure requirements for proxy and information statements filed by companies to help investors make informed investment and voting decisions. The hours and costs associated with preparing, filing and sending the schedules constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to,

<sup>241</sup> See letters from NYSE and S&C.

<sup>242</sup> See letters from ABA and Davis Polk.

<sup>243</sup> See letter from ABA.

<sup>244</sup> See letter from Debevoise.

<sup>245</sup> The release adopting Rule 10A-3 was published in the **Federal Register** on April 16, 2003. The exchanges were required to have final rules or rule amendments that complied with Rule 10A-3 approved by the Commission no later than December 1, 2003.

<sup>246</sup> 44 U.S.C. 3501 *et seq.*

<sup>247</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>248</sup> The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosure requirements in Regulation S-K and is reflected in the analysis of these forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burden imposed by Regulation S-K to be a total of one hour.

<sup>239</sup> See letter from Debevoise.

<sup>240</sup> See letter from NYSE.

a collection of information unless it displays a currently valid OMB control number. Compliance with the new rule and rule amendments will be mandatory. Responses to the information collections will not be kept confidential, and there is no mandatory retention period for the information disclosed.

#### *B. Summary of the Final Rules*

As discussed in more detail above, we are adopting new Rule 10C-1 under the Exchange Act and amendments to Item 407(e)(3) of Regulation S-K. Rule 10C-1 will direct the exchanges to prohibit the listing of any equity security of an issuer, subject to certain exceptions, that is not in compliance with several enumerated standards relating to the issuer's compensation committee and the process for selecting a compensation adviser to the compensation committee. Rule 10C-1 will not impose any collection of information requirements on the exchanges or on listed issuers.

The amendments to Item 407(e)(3) will require issuers, other than registered investment companies,<sup>249</sup> to disclose, in any proxy or information statement relating to an annual meeting of shareholders (or a special meeting in lieu of an annual meeting) at which directors are to be elected, whether the work of any compensation consultant that has played any role in determining or recommending the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice) has raised a conflict of interest. If so, the issuer must also disclose the nature of the conflict and how the conflict is being addressed.

#### *C. Summary of Comment Letters and Revisions to Proposals*

In the Proposing Release, we requested comment on our PRA burden hour and cost estimates and the analysis

<sup>249</sup> Registered investment companies are subject to separate proxy disclosure requirements set forth in Item 22 of Schedule 14A, which do not include the compensation consultant disclosure requirement in Item 407(e)(3) of Regulation S-K. See Item 7(g) of Schedule 14A. As we proposed, registered investment companies will continue to provide disclosure under Item 22 and will not be subject to the amendments to Item 407(e) adopted in this release.

used to derive such estimates. Only one commentator specifically addressed our PRA analysis and burden estimates of the proposed amendments.<sup>250</sup> This commentator asserted that some of the estimates we used to calculate the burden hours of the proposed amendments may be inaccurate, which could result in our underestimating the actual burden of the amendments. This commentator, however, did not provide any alternative burden hour or cost estimates for us to consider and did not identify any particular estimates included in the Proposing Release that it believed to be inaccurate.

In response to comments on the proposals, we have made modifications to the rule proposals that will reduce the compliance burden on issuers. First, the final rule amendments leave intact the existing exemption from the requirement to disclose the role of a compensation consultant where that role is limited to providing advice on broad-based plans and information that either is not customized for a particular issuer or is customized based on parameters that are not developed by the consultant and about which the consultant does not provide advice. Accordingly, issuers will be required to provide less disclosure than would have been required under the proposed amendments. Second, we have retained the existing disclosure trigger in Item 407(e)(3) and eliminated the proposed instruction regarding whether a compensation committee has "obtained the advice" of a compensation consultant. Based on comments received that issuers are already familiar with and have adopted business practices to comply with the existing disclosure trigger, we believe retaining the existing disclosure trigger will make it easier for issuers to determine whether conflict of interest disclosure is required for a particular compensation consultant.

#### *D. Revisions to PRA Reporting and Cost Burden Estimates*

As a result of the changes described above, we have reduced our reporting and cost burden estimates for the collection of information under the final amendments. The final rule amendments to Item 407(e)(3) of Regulation S-K will require additional disclosure in proxy or information statements filed on Schedule 14A or Schedule 14C of whether the work of a compensation consultant that has played any role in determining or recommending the amount or form of executive and director compensation,

<sup>250</sup> See letter from Chamber.

with certain exceptions, has raised a conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed. The instruction to Item 407(e)(3)(iv) provides that an issuer, in determining whether there is any such conflict, should consider the same six independence factors that the compensation committee of a listed issuer is required to consider before selecting a compensation adviser. For purposes of the PRA, we now estimate that the total annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed amendments will be approximately 11,970 hours of in-house personnel time and approximately \$1,596,000 for the services of outside professionals.<sup>251</sup> We estimate that the amendments to Item 407(e)(3) of Regulation S-K would impose on average a total of two incremental burden hours per issuer. These estimates include the time and the cost of collecting the required information, preparing and reviewing responsive disclosure, and retaining records. We continue to believe it is appropriate to assume that the burden hours associated with the amendments will be comparable to the burden hours related to similar disclosure requirements under our current rules regarding compensation consultants. Our estimates, as well as their reasonableness, were presented to the public for consideration, and we received no alternative burden hour or cost estimates in response.<sup>252</sup>

The table below shows the total annual compliance burden, in hours and in costs, of the collection of information pursuant to the final amendments to Item 407(e)(3) of Regulation S-K.<sup>253</sup> The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take an issuer to prepare and review the adopted disclosure requirements. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. For purposes of the PRA, we estimate that 75% of the burden of preparation of Schedules 14A and 14C is carried by

<sup>251</sup> Our estimates represent the average burden for all issuers, both large and small.

<sup>252</sup> See Proxy Disclosure Enhancements Release (in which the Commission estimated the average incremental disclosure burden for the rule amendments to Item 407(e)(3) relating to compensation consultants to be three hours).

<sup>253</sup> For convenience, the estimated hour and cost burdens in the table have been rounded to the nearest whole number.

the issuer internally and that 25% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per

hour. There is no change to the estimated burden of the collections of information under Regulation S–K because the burdens that this regulation

imposes are reflected in our burden estimates for Schedules 14A and 14C.

TABLE 1—ESTIMATED INCREMENTAL PAPERWORK BURDEN UNDER THE FINAL RULES FOR SCHEDULES 14A AND 14C

	Number of responses (A) <sup>254</sup>	Incremental burden hours/form (B)	Total incremental burden hours (C)=(A)*(B)	Internal company time (D)	External professional time (E)	Professional costs (F)=(E)*\$400
Sch. 14A .....	7,300	2	14,600	10,950	3,650	\$1,460,000
Sch. 14C .....	680	2	1,360	1,020	340	136,000
Total .....	7,980	.....	15,960	11,970	3,990	\$1,596,000

**IV. Economic Analysis**

*A. Background and Summary of the Rule Amendments*

As discussed above, we are adopting a new rule and rule amendments to implement Section 10C of the Exchange Act, as added by Section 952 of the Act. Section 10C of the Exchange Act requires us to adopt rules directing the exchanges to prohibit the listing of any equity security of an issuer, with certain exceptions, that is not in compliance with several enumerated standards regarding compensation committees. In addition, Section 10C(c)(2) requires each listed issuer to disclose in any proxy or consent solicitation material for an annual meeting of shareholders (or a special meeting in lieu of the annual meeting), in accordance with Commission regulations, whether the issuer’s compensation committee retained or obtained the advice of a compensation consultant; whether the work of the compensation consultant has raised any conflict of interest; and, if so, the nature of the conflict and how the conflict is being addressed. The rule and rule amendments we are adopting implement these mandates, and also include the following provisions:

- New Rule 10C–1 will direct the exchanges to adopt listing standards that apply to any board committee that oversees executive compensation, whether or not such committee performs other functions or is formally designated as a “compensation committee.”
- The exchanges will be directed to apply the required listing standards, other than those relating to the authority to retain compensation advisers in Rule 10C–1(b)(2)(i) and required funding for

payment of such advisers in Rule 10C–1(b)(3), also to those members of a listed issuer’s board of directors who, in the absence of a board committee performing such functions, oversee executive compensation matters on behalf of the board of directors.

- With respect to the factors required by Section 10C(b) of the Exchange Act, we are adopting one additional independence factor that compensation committees must consider before engaging a compensation adviser.

- An instruction to final Rule 10C–1(b)(4) will provide that the compensation committee of a listed issuer is not required to consider the independence factors before consulting with or receiving advice from in-house counsel.

- We are exempting security futures products, standardized options, and smaller reporting companies from the scope of Rule 10C–1.

- For purposes of Rule 10C–1, we are modifying the definition of a controlled company, which is exempt from Rule 10C–1, to be a listed company in which more than 50% of the voting power for the election of directors is held by an individual, a group or another company, which is consistent with the definition used by the NYSE and Nasdaq.

- The final rules will require the disclosures relating to compensation consultant conflicts of interest called for by Section 10C(c)(2) only in proxy or information statements for meetings at which directors are to be elected.

- The compensation consultant conflicts of interest disclosure requirement will apply when a compensation consultant plays “any role” in “determining or recommending the amount or form of executive and director compensation,” other than any role limited to consulting on broad-based plans or providing non-customized benchmark data, which is consistent with the existing Item 407(e)(3)(iii) of Regulation S–K standard.

- The compensation consultant conflicts of interest disclosure requirement will apply to all issuers subject to our proxy rules, including controlled companies, smaller reporting companies and non-listed issuers.

- The compensation consultant conflicts of interest disclosure requirement will require disclosure of compensation consultant conflicts of interest that relate to director compensation, in addition to executive compensation.

- The instruction to the compensation consultant conflicts of interest disclosure requirement provides that an issuer, in determining whether there is a conflict of interest, should consider the same six independence factors that the compensation committee of a listed issuer is required to consider before selecting a compensation adviser.

We are sensitive to the costs and benefits imposed by our rules. The discussion below attempts to address both the costs and benefits of Section 10C, as well as the incremental costs and benefits of the rule and rule amendments we are adopting within our discretion to implement Section 10C. These two types of costs and benefits may not be entirely separable to the extent our discretion is exercised to realize the benefits that we believe were intended by Section 952 of the Act. Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition.<sup>255</sup> In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 2(b) of the Securities Act<sup>256</sup> and Section 3(f) of the Exchange Act<sup>257</sup> require us, when engaging in rulemaking where we

<sup>254</sup> The information in this column is based on the number of responses for these schedules as reported in the OMB’s Inventory of Currently Approved Information Collections, available at <http://www.reginfo.gov/public/do/PRAMain;jsessionid=D37174B5F6F9148DB767D63DF6983A65>.

<sup>255</sup> 15 U.S.C. 78w(a)(2).

<sup>256</sup> 15 U.S.C. 77b(b).

<sup>257</sup> 15 U.S.C. 78c(f).

are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. We have integrated our consideration of those issues into this economic analysis.

In the Proposing Release, we solicited comment on the costs and benefits of the proposed rules, whether the proposed rule and rule amendments would place a burden on competition, and the effect of the proposal on efficiency, competition, and capital formation. Only one commentator specifically addressed the cost-benefit analysis we included in the Proposing Release or our analysis of whether the proposals would burden competition or impact efficiency, competition, and capital formation.<sup>258</sup> This commentator argued that the proposals would impose additional compensation disclosure and director independence requirements that could be burdensome and result in additional disclosure of an issuer's use of compensation consultants, without in every case providing meaningful benefit to issuers or investors, and that could also confuse investors or deter investors from "reading proxy materials by increasing their length and density without pruning other, less pertinent, or dated disclosures."<sup>259</sup> As discussed throughout this release, we have made numerous revisions to the proposed rules in order to address these concerns and reduce compliance burdens where consistent with investor protection. Other commentators addressed specific aspects of the proposed rule amendments that identified possible costs, benefits, or effects on efficiency, competition or capital formation, which we discuss in more detail below.

### *B. Benefits and Costs, and Impact on Efficiency, Competition and Capital Formation*

#### 1. Section 10C of the Exchange Act, as Added by Section 952 of the Act

New Rule 10C-1 implements the listing standard requirements of Section 10C by directing the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with the following standards:

- Each member of the compensation committee of the issuer must be a member of the issuer's board of directors and independent according to independence criteria determined by

each exchange following consideration of specified factors;

- The compensation committee of each issuer must be directly responsible for the appointment, compensation, retention and oversight of the work of any compensation adviser retained by the committee, and each such compensation adviser must report directly to the compensation committee;
- Each compensation committee must have the authority to retain independent legal counsel and other compensation advisers;
- The compensation committee of each issuer may select a compensation adviser only after assessing the adviser's independence using specified factors; and
- Each issuer must provide appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to compensation advisers retained by the compensation committee.

Under the final rule, subject to our review in accordance with Section 19(b) of the Exchange Act, an exchange may exempt any category of issuers from the compensation committee listing requirements and any particular relationships from the compensation committee member independence requirements, as the exchange determines is appropriate, after consideration of the impact of the requirements on smaller reporting issuers and other relevant factors.

The rules we are adopting are intended to benefit both issuers and investors. The final rules are expected to help achieve Congress's intent that listed issuers' board committees that set compensation policy consist only of directors who are independent. By requiring compensation committees to consider the independence of potential compensation advisers before they are selected, the final rules should also help assure that compensation committees of affected listed issuers are better informed about potential conflicts, which could reduce the likelihood that they are unknowingly influenced by conflicted compensation advisers. The provisions of the listing standards that will require compensation committees to be given the authority to engage, oversee and compensate independent compensation advisers should bolster the access of board committees of affected listed issuers that are charged with oversight of executive compensation to the resources they need to make better informed compensation decisions. Taken as a whole, these requirements could benefit issuers and investors to the extent they

enable compensation committees to make better informed decisions regarding the amount or form of executive compensation.

The listing standard provisions of the rule and rule amendments will also result in certain costs to exchanges and affected listed issuers. Final Rule 10C-1 directs the exchanges to prohibit the listing of any equity security of an issuer that is not in compliance with Section 10C's compensation committee and compensation adviser requirements. Exchanges will incur direct costs to comply with the rule, as they will need to review their existing rules and propose appropriate rule changes to implement the requirements of Rule 10C-1. Once the exchanges have adopted listing standards required by Rule 10C-1, listed issuers will incur costs in assessing and demonstrating their compliance with the new listing standards. We note that these costs are primarily imposed by statute.

The adoption of new listing standards may have some distributional effects as some listed issuers may seek to list on foreign exchanges or other markets to avoid compliance with listing requirements that an exchange develops. To the extent they do so, listed issuers would incur costs in seeking to transfer their listings, and exchanges that lose issuer listings would, as a result, lose related fees and trading volume. We believe that any such effect would be minimal as the exchanges already require directors on compensation committees or directors determining or recommending executive compensation matters for domestic issuers to be "independent" under their general independence standards.<sup>260</sup>

As required by Section 10C, Rule 10C-1 directs the exchanges to develop a definition of independence applicable to compensation committee members after considering the relevant factors set forth in Exchange Act Section 10C(a)(3). These factors include:

- A director's source of compensation, including any consulting, advisory or compensatory fee paid by the issuer; and
- whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

We are not adopting any additional factors that the exchanges must consider in determining independence requirements for compensation committee members. Instead, Rule 10C-1 affords the exchanges latitude in

<sup>260</sup> See, e.g., NYSE Listed Company Manual Section 303A.05(a) and Nasdaq Rule 5605(d). Foreign private issuers are permitted under these listing standards to follow home country practice with respect to executive compensation oversight.

<sup>258</sup> See letter from Chamber.

<sup>259</sup> *Id.*

determining the required independence standards. Several commentators indicated that the proposed rule would permit the exchanges to determine listing standards that take into account the characteristics of each exchange's listed issuers.<sup>261</sup> We believe that affording the exchanges flexibility in determining the required independence standards, subject to our review pursuant to Section 19(b) of the Exchange Act, will result in more efficient and effective determinations as to the types of relationships that should preclude a finding of independence with respect to membership on a board committee that oversees executive compensation. We believe that because listed issuers frequently consult the exchanges regarding independence determinations, the exchanges will be in the best position to identify the types of relationships that are likely to compromise the ability of an issuer's compensation committee to make impartial determinations on executive compensation.

We acknowledge, however, that because exchanges compete for listings, they may have an incentive to propose standards that issuers will find less onerous. This could affect investor confidence in the degree of independent oversight of executive compensation at issuers listed on exchanges with less onerous standards and could also result in costs to exchanges that adopt relatively more rigorous standards, to the extent they lose issuer listings as a result.

In accordance with Section 10C(a)(1), Rule 10C-1(b)(1)(iii) exempts limited partnerships, companies in bankruptcy proceedings, registered open-end management investment companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee from the compensation committee member independence listing standards required under Rule 10C-1(a). With respect to the independence requirements of Rule 10C-1, we have not provided any exemptions for categories of issuers beyond those specified in Section 10C(a)(1). The final rule, however, exempts smaller reporting companies, controlled companies, security futures products and standardized options from all of the requirements of Rule 10C-1, including the independence requirements. Under Rule 10C-1, exchanges are provided the authority to propose additional exemptions for appropriate categories of issuers. An

exchange that exercises this authority will incur costs to evaluate what exemptions to propose and to make any required rule filings pursuant to Section 19(b) of the Exchange Act.

We are implementing the disclosure requirements of Section 10C by adopting amendments to Item 407(e)(3) of Regulation S-K. Given the number of discretionary choices that we have made in implementing this provision of Section 10C, we discuss the amendments to Item 407 as a whole below.

## 2. Discretionary Amendments

As adopted, new Rule 10C-1 will direct the exchanges to adopt listing standards that apply to any committee of the board that oversees executive compensation, whether or not such committee performs other functions or is formally designated as a "compensation committee." Some exchange listing standards currently require issuers to form compensation or equivalent committees, and others permit independent directors to oversee specified compensation matters in lieu of the formation of a compensation or equivalent committee. The final rule will also direct the exchanges to apply the required listing standards relating to director independence, consideration of a compensation adviser's independence and responsibility for the appointment, compensation and oversight of compensation advisers to those members of a listed issuer's board of directors who, in the absence of a board committee performing such functions, oversee executive compensation matters on behalf of the board of directors.<sup>262</sup> Several commentators supported our proposal to apply the Section 10C requirements to all board committees that oversee executive compensation, and also recommended that the requirements also apply to those independent directors who oversee executive compensation in lieu of a board committee.<sup>263</sup> We believe these

<sup>262</sup> With respect to these aspects of the rule, we have defined "compensation committee" to include those board members who oversee executive compensation matters on behalf of the board of directors in the absence of a board committee. In our discussion of the final rule throughout this release, references to an issuer's "compensation committee" include, unless the context otherwise requires, any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not formally designated as a "compensation committee," as well as, to the extent applicable, those members of a listed issuer's board of directors who oversee executive compensation matters on behalf of the board of directors in the absence of such a committee.

<sup>263</sup> See, e.g., letters from Barnard, CFA and Railpen.

aspects of the rule will help achieve the objectives of the statute and benefit listed issuers by providing clarity and reducing any uncertainty about the application of Section 10C. Moreover, this should benefit investors because it will limit the ability of listed issuers to avoid the compensation committee independence requirements under Section 10C simply by delegating oversight of executive compensation to a board committee that is not formally designated as the "compensation committee," but performs that function or to directors acting outside of a formal committee structure.

If we did not apply Rule 10C-1 to apply the requirements relating to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to directors who oversee executive compensation matters in the absence of a board committee, issuers could be incentivized to seek to list on exchanges that do not require the formation of a compensation or equivalent committee in order to avoid having to comply with the compensation committee independence standards that would otherwise apply. Our decision to apply the requirements relating to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to these directors should minimize any such incentive. As a result, we believe this application also minimizes any potential costs that issuers might incur to alter their existing committee structure or seek to list on a different exchange to avoid having to comply with the new standards, as well as any related costs that exchanges would incur from any resulting loss of issuer listings, related fees, and trading volume. These impacts may not be significant, however, since the exchanges' existing requirements already impose independence requirements on directors who oversee executive compensation matters. Finally, we note that, in overseeing executive compensation matters, these independent directors are acting as the board of directors, and the same board processes that attend to other types of board decisions—e.g., scheduling meetings, preparing review materials, attending meetings, preparing and reviewing meeting minutes—also presumably attend to board decisions about executive compensation. Accordingly, we do not believe that the application of the requirements relating

<sup>261</sup> See letters from ABA and NYSE.

to director independence, consideration of the independence of compensation advisers and responsibility for the appointment, compensation and oversight of compensation advisers to directors who oversee executive compensation matters in the absence of a board committee will result in any disproportionate incremental burdens for issuers that do not have a compensation committee or any other board committee that oversees executive compensation.

As required by Section 10C(g), controlled companies are exempt from all requirements of Rule 10C-1 pursuant to final Rule 10C-1(b)(5)(ii). Rule 10C-1 as adopted includes a slightly broader definition of “controlled company” than the definition provided in Section 10C. Under Section 10C(g)(2) of the Exchange Act, a “controlled company” is defined as an issuer that is listed on an exchange and that holds an election for the board of directors of the issuer in which more than 50% of the voting power is held by an individual, a group or another issuer. We proposed to incorporate this definition into Rule 10C-1(c)(2). In response to comments that our proposed definition would not exempt listed issuers that would otherwise be controlled companies but for the fact that they do not hold director elections,<sup>264</sup> we have removed from the definition the phrase “holds an election for the board of directors” in order to align the definition in Rule 10C-1 more closely to the definition of controlled company currently used by the NYSE and Nasdaq. This change will eliminate any unnecessary compliance burdens for listed issuers that do not hold director elections but satisfy the definition of “controlled company” pursuant to listing standards of the NYSE, Nasdaq and other exchanges with a similar definition.

Under Rule 10C-1(b)(4), the exchanges are directed to adopt listing standards that require a compensation committee to take into account the five independence factors enumerated in Section 10C(b)(2) before selecting a compensation adviser. In addition to these five factors, we are including in the final rule one additional independence factor that must be considered before a compensation adviser is selected: any business or personal relationships between the executive officers of the issuer and the compensation adviser or the person employing the adviser. Several commentators supported requiring compensation committees to consider any business or personal relationship

between an executive officer of the issuer and an adviser or the person employing the compensation adviser.<sup>265</sup> This would include, for example, situations where the chief executive officer of a listed issuer and the compensation adviser have a familial relationship or where the chief executive officer and the compensation adviser (or the adviser’s employer) are business partners. We agree with commentators that such relationships would be relevant to an assessment of the independence of the compensation adviser and believe that adding this factor complements the five independence factors enumerated in Section 10C(b)(2). Adding this factor should help compensation committees reach better informed decisions in selecting compensation advisers since any business or personal relationship that a compensation adviser, or the person employing the adviser, may have with an executive officer may be relevant to assessing whether there is a conflict of interest. Section 10C(b) mandates that the independence factors to be considered must be competitively neutral among categories of compensation advisers and that compensation committees must be able to retain the services of members of any such category. We believe that the six factors included in the final rule, when considered as a whole, are competitively neutral and that this requirement will therefore not inhibit competition among categories of compensation advisers.

We have included an instruction to Rule 10C-1(b)(4) that provides that the compensation committee of a listed issuer is not required to consider the independence factors with respect to in-house counsel with whom the compensation committee consults or obtains advice. Several commentators noted that, as in-house legal counsel are employees of the issuer, they are not held out to be independent.<sup>266</sup> As such, the benefits of requiring the compensation committee to consider the independence factors with respect to in-house counsel would seem to be minimal. We do not believe that our determination to exclude in-house counsel from this required consideration will negatively impact competition among compensation advisers, as we do not believe compensation committees consider that in-house counsel serve in the same role

as a compensation consultant or outside legal counsel.

As adopted, the final rule exempts security futures products and standardized options from the scope of Rule 10C-1. We believe that exempting security futures products and standardized options is appropriate because these securities are fundamentally different than the equity securities of an operating company. This exemption will benefit the issuers of these securities and the exchanges on which such securities trade by providing clarity and eliminating any regulatory uncertainty about the application of Section 10C to these products.

In addition, we are exempting smaller reporting companies from the requirements of Rule 10C-1. We appreciate that the burdens of complying with the listing standards mandated by Rule 10C-1 for listed smaller reporting companies may not be significant given that such issuers are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation matters to be “independent” under the exchanges’ general independence standards. We do believe, however, that exempting smaller reporting companies from the listing standards mandated by Rule 10C-1 can offer cost savings to these issuers to the extent that an exchange, in connection with the listing standards review required by Rule 10C-1, chooses to create a new independence standard for compensation committee members that is more rigorous than its existing standards—for example, a new standard could address personal or business relationships between members of the compensation committee and the listed issuer’s executive officers. Issuers subject to the exchange’s new standard may need to replace existing compensation committee members, and incur the associated costs, if they do not qualify as independent under the new standard. In addition, although listed smaller reporting companies do not often engage outside compensation consultants, there would be cost savings to these listed issuers from not having to comply with the listing standards involving the compensation committee’s engagement and oversight of compensation advisers. For example, the exchanges are required to adopt listing standards that require the compensation committee to consider the six independence factors listed in Rule 10C-1(b)(4) before selecting a compensation adviser. To comply with these listing standards, compensation committees will likely need to create

<sup>265</sup> See, e.g., letters from ABA, Better Markets, Merk1 and USS.

<sup>266</sup> See letters from Davis Polk and S&C.

<sup>264</sup> See letter from V&E.

procedures for collecting and analyzing information about potential compensation advisers before they can receive advice from such advisers, which would require the listed issuers to incur costs. We expect, however, that a portion of these cost savings would likely be offset by the costs that smaller reporting companies may incur in order to comply with the new disclosure requirements in Item 407(e)(3)(iv) of Regulation S-K relating to compensation consultants' conflicts of interest.

We are adopting amendments to Item 407(e)(3) of Regulation S-K to implement the disclosure requirements of Section 10C(c)(2). Under these amendments, issuers subject to our proxy rules will be required to disclose whether the work of any compensation consultant that has played any role in determining or recommending the form or amount of executive and director compensation has raised a conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed. Issuers subject to our existing proxy disclosure rules must already discuss the role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, including the nature and scope of their assignment and any material instructions or directions governing their performance under the engagement. The current item excludes from the disclosure requirement any role of compensation consultants limited to consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the registrant and that is available generally to all salaried employees, or limited to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice. We believe the amendments complement our existing disclosure requirements by increasing the transparency of issuers' policies regarding compensation consultant conflicts of interest for all issuers subject to the existing disclosure requirement.

The final amendments preserve the existing disclosure requirements under Item 407(e)(3), including the disclosure trigger in Item 407(e)(3)(iii) of "any role" played by the consultant and the disclosure exemption for compensation consulting services involving only broad-based, non-discriminatory plans

and the provision of non-customized survey data. Some commentators suggested that retaining the existing disclosure trigger in Item 407(e)(3)(iii) and including a separate disclosure item within Item 407 to address the conflict of interest disclosure requirements of Section 10C(c)(2)(B) would be the better approach to implement Section 10C(c)(2) requirements.<sup>267</sup> Additionally, commentators contended that eliminating the disclosure exemptions in Item 407(e)(3)(iii) would be inconsistent with our past determination that consulting on broad-based plans or providing non-customized benchmark data did not raise conflict of interest concerns that warrant disclosure of the consultant's selection, terms of engagement or fees.<sup>268</sup> We agree with these commentators and believe that the amendment to Item 407(e)(3) that we are adopting, which retains the existing disclosure exemptions, is the better approach to implementing Section 10C(c)(2)'s requirements. By retaining the existing disclosure trigger and disclosure exemptions under Item 407(e)(3)(iii), the final amendments will require disclosure of conflicts of interest only when a compensation consultant's role is otherwise required to be disclosed. We believe this will promote efficiency by mitigating an issuer's compliance burden in situations where a compensation consultant does not provide "analytical input, discretionary judgment or advice."<sup>269</sup>

To promote comprehensive disclosure about compensation consultants, the amendments to Item 407(e)(3) extend the disclosure requirements of Section 10C(c)(2) to proxy and information statements where action is to be taken with respect to an election of directors, as well as to conflicts of interests for compensation consultants who play any role in determining or recommending the amount or form of director compensation. Existing Item 407(e)(3) already requires these proxy and information statements to include disclosure about any role of compensation consultants in determining or recommending the amount or form of executive compensation and director compensation, including the nature and scope of their assignment, any material instructions or directions governing their performance under the engagement, and specified information with respect to fees paid to the compensation consultants.

<sup>267</sup> See, e.g., letter from ABA.

<sup>268</sup> See letters from ABA, Chamber and SCSGP.

<sup>269</sup> See letter from SCSGP.

Several commentators supported applying the new disclosure requirements to all Exchange Act issuers subject to our proxy rules.<sup>270</sup> However, other commentators believed that this is not required by Section 10C and opposed extending the disclosure requirements to non-listed issuers.<sup>271</sup> We are expanding the statutory disclosure requirement to those categories of issuers that will not be subject to the listing standards adopted by the exchanges pursuant to Rule 10C-1, including non-listed issuers, smaller reporting companies and controlled companies, because we believe that timely disclosure of compensation consultants' conflicts of interests will enable investors in these categories of issuers to better monitor compensation committee performance and will help investors make better informed voting decisions with respect to the election of directors, including members of the compensation committee. In addition, this would promote consistent disclosure on these topics among reporting companies and should benefit investors by fostering comparability of disclosure of compensation practices across companies.

Non-listed issuers, smaller reporting companies and controlled companies may incur additional costs to develop more formalized selection processes than they otherwise would have absent such a disclosure requirement. For example, even though they will not be subject to the listing standard requiring compensation committees to consider independence factors before selecting a compensation adviser, in light of this disclosure requirement, at the time any compensation consultant is selected, compensation committees of non-listed issuers, smaller reporting companies and controlled companies may devote time and resources to analyzing and assessing the independence of the compensation consultant and addressing and resolving any conflicts of interest.<sup>272</sup> Although the disclosure

<sup>270</sup> See, e.g., letters from AON and Merkl.

<sup>271</sup> See letter from Debevoise.

<sup>272</sup> For purposes of the PRA, we estimated that the total annual increase in the paperwork burden for all companies to prepare the disclosure that would be required under the proposed amendments will be approximately 11,970 hours of in-house personnel time and approximately \$1,596,000 for the services of outside professionals. One commentator asserted that some of the estimates we used to calculate the burden hours of the proposed amendments may be inaccurate, which could result in our underestimating the PRA burden of the final amendments. See letter from Chamber. As described in the discussion of the PRA, we received no alternative paperwork burden hour or cost estimates in response to our estimate of the paperwork burden in the Proposing Release. We believe our reduced paperwork burden estimate is

requirement does not prohibit a compensation committee from selecting a compensation consultant of its choosing, some committees may elect to engage new, alternative or additional compensation consultants after considering what disclosure might be required under our final rules. Such decisions could result in additional costs to issuers, including costs related to termination of existing services and search and engagement costs to retain new consultants. In addition, costs may increase if an issuer decides to engage multiple compensation consultants for services that had previously been provided by a single consultant. We believe these potential costs are likely to be limited because our existing disclosure rules already require disclosure of any role played by compensation consultants in determining or recommending the amount or form of executive and director compensation, including the nature and scope of their assignment, any material instructions or directions governing their performance under the engagement, and specified information with respect to fees paid to the compensation consultants. To the extent the new requirement to disclose compensation consultant conflicts of interest results in an issuer significantly modifying its consultant selection processes, we believe it would also likely result in such issuer making better-informed choices regarding compensation consultant selection.

To the extent that providing advice on director compensation raises a conflict of interest on the part of a compensation consultant, disclosure would be required in response to new Item 407(e)(3)(iv). Issuers are currently required to discuss in proxy and information statements the role played by compensation consultants in determining or recommending the amount or form of director compensation to the same extent that the disclosure is required regarding executive compensation. In light of the approach we are taking to the new disclosure requirement generally, which is to add the new requirement to the existing disclosure requirements using the existing triggers, we determined that the compensation consultant conflict of interest disclosure requirement should apply to director compensation in the same manner as executive compensation. We believe this will benefit investors by providing for more complete and consistent disclosures on

how the board manages compensation-related conflicts of interest.

The amendments to Regulation S-K may promote efficiency and competitiveness of the U.S. capital markets by increasing the transparency of executive compensation decision-making processes. Increased transparency may improve the ability of investors to make better informed voting and investment decisions, which may encourage more efficient capital allocation and formation. Some commentators asserted that the increased disclosure should improve the ability of investors to monitor performance of directors responsible for overseeing compensation consultants, thus enabling them to make more informed voting and investment decisions.<sup>273</sup>

The amendments also may affect competition among compensation consultants. By requiring disclosure of the existence of compensation consultant conflicts of interest and how those conflicts of interest are addressed, the new disclosure requirement may lead compensation committees to engage in more thorough and deliberative analyses of adviser independence. This could result in the selection of compensation advisers that are more independent or impartial than might otherwise be chosen, which, in turn, could promote more effective executive compensation practices. The amendments may also incentivize compensation consultants to adopt policies that serve to minimize any conflicts of interest and for compensation committees to avoid hiring consultants perceived as having a conflict of interest.

#### **V. Final Regulatory Flexibility Act Analysis**

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act.<sup>274</sup> This FRFA relates to new Exchange Act Rule 10C-1, which will require the exchanges to prohibit the listing of an equity security of an issuer that is not in compliance with several enumerated requirements relating to the issuer's compensation committee, and to amendments to Item 407(e)(3) of Regulation S-K, which will require new disclosure from issuers regarding any conflict of interest raised by the work of a compensation consultant that has played a role in determining or recommending the form

or amount of executive and director compensation.

#### *A. Need for the Amendments*

We are adopting the new rule and rule amendments to implement Section 10C of the Exchange Act. Exchange Act Rule 10C-1 directs the exchanges to prohibit the listing of the equity securities of any issuer that does not comply with Section 10C's compensation committee and compensation adviser requirements. The amendments to Regulation S-K will require issuers to provide certain disclosures regarding their use of compensation consultants and how they address compensation consultant conflicts of interest.

#### *B. Significant Issues Raised by Public Comments*

In the Proposing Release, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed rules, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed rule and amendments. We did not receive comments specifically addressing the IRFA. However, some commentators addressed aspects of the proposed rules that could potentially affect small entities. In particular, one commentator expressed concern that smaller issuers may experience difficulty in locating qualified candidates to serve on compensation committees who could meet the independence standards that will be developed by the exchanges.<sup>275</sup> This commentator advocated that smaller companies should be exempted from all or parts of the amendments.

#### *C. Small Entities Subject to the Final Rules*

The final rules will affect some companies that are small entities. The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."<sup>276</sup> The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Exchange Act Rule 0-10(e)<sup>277</sup> provides that the term "small business" or "small organization," when referring to an exchange, means any exchange that: (1) Has been exempted from the reporting requirements of Exchange Act Rule

reasonable in light of the modifications we have made to the proposals to reduce the compliance burden on issuers.

<sup>273</sup> See, e.g., letters from CalSTRS and FLSBA.

<sup>274</sup> 5 U.S.C. 603.

<sup>275</sup> See letter from ABA.

<sup>276</sup> 5 U.S.C. 601(6).

<sup>277</sup> 17 CFR 240.0-10(e).

601;<sup>278</sup> and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization, as defined under Exchange Act Rule 0–10. No exchanges are small entities because none meet these criteria. Securities Act Rule 157<sup>279</sup> and Exchange Act Rule 0–10(a)<sup>280</sup> define a company, other than an investment company, to be a “small business” or “small organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year. The final rules will affect small entities that have a class of equity securities that are registered under Section 12 of the Exchange Act. We estimate that there are approximately 457 such registrants, other than registered investment companies, that may be considered small entities. An investment company, including a business development company, is considered to be a “small business” if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>281</sup> We believe that the amendments to Regulation S–K will affect some small entities that are business development companies that have a class of securities registered under Section 12 of the Exchange Act. We estimate that there are approximately 28 business development companies that may be considered small entities.

#### *D. Reporting, Recordkeeping and Other Compliance Requirements*

Under new Exchange Act Rule 10C–1, the exchanges will be directed to prohibit the listing of an equity security of an issuer that is not in compliance with Section 10C’s compensation committee and compensation adviser requirements. These requirements relate to:

- The independence of compensation committee members;
- The authority of the compensation committee to retain compensation advisers;
- The compensation committee’s responsibility to assess factors that affect the independence of compensation advisers before their selection by the compensation committee; and
- The compensation committee’s responsibility for the appointment, compensation, and oversight of the work of compensation advisers retained

by the compensation committee; and funding for consultants and other advisers retained by the compensation committee.

Rule 10C–1 will not impose any reporting or recordkeeping obligations on the exchanges, or any issuers with equity securities listed on an exchange. Furthermore, the rule does not require a listed issuer to establish or maintain a compensation committee. As discussed in more detail below, we have exempted smaller reporting companies from the requirements of Rule 10C–1. We do not believe the new rule will have a significant impact on small entities because the listing requirements will apply only to issuers that have equity securities listed on an exchange and that are not smaller reporting companies.<sup>282</sup> All of the exchanges generally impose a combination of quantitative requirements such as market capitalization, minimum revenue, and shareholder equity thresholds that an issuer must satisfy in order to be listed on the exchange. Consequently, the substantial majority of small entities are not listed on an exchange but are quoted on the OTC Bulletin Board or the OTC Markets Group.<sup>283</sup> Rule 10C–1 will not apply to the OTC Bulletin Board or the OTC Markets Group, and therefore small entities whose securities are quoted on these interdealer quotation systems would not need to comply with any listing standards developed under the rule by the exchanges. Small entities that are listed on an exchange and that

are not smaller reporting companies would generally need to comply with the standards adopted by the exchange pursuant to Rule 10C–1 if they wish to have their equity securities listed on the exchange. Small entities subject to these listing standards may need to spend additional time and incur additional costs to comply with these standards. Consistent with Section 10C(f)(3), the final rule will allow the exchanges flexibility to propose exemptions for small entities, subject to our review and approval under the Exchange Act Section 19(b) rule filing process.

The amendments to Item 407(e)(3) of Regulation S–K will impose some reporting and recordkeeping obligations on small entities. Under the amendments, an issuer will be required to disclose whether the work of any compensation consultant that has played a role in determining or recommending the amount or form of executive and director compensation has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. This disclosure requirement will apply equally to both large and small issuers. One commentator has noted that many small entities do not use the services of a compensation consultant,<sup>284</sup> which should significantly minimize the impact of the reporting and recordkeeping requirements under the amendments on small entities.

#### *E. Agency Action to Minimize Effect on Small Entities*

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

In connection with Exchange Act Rule 10C–1, we considered, but did not establish, different compliance requirements, or an exemption, for small entities. As noted above, very few small entities list their securities on an exchange. The substantial majority of small entities with publicly held equity

<sup>282</sup> Based on data obtained from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were two exchange-listed small entities that would not qualify as a smaller reporting company.

<sup>283</sup> Based on information retrieved from the Thomson Financial’s Worldscope database, we estimate that as of December 31, 2010, there were less than twelve issuers that had total assets of \$5 million or less listed on an exchange.

In 2011, the Commission approved a proposal from NASDAQ OMX BX to create a new listing market, the BX Venture Market, which allows issuers meeting minimal quantitative requirements—including those with fewer than \$5 million in assets—to list on that exchange. A BX Venture Market-listed company is required to meet qualitative requirements that are, in many respects, similar to those required for listing on Nasdaq or other exchanges, including a requirement to have independent directors make decisions regarding the compensation of executive officers. See Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Order Granting Approval of Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Thereto to Create a Listing Market on the Exchange, Release No. 34–64437 (May 6, 2011) [76 FR 27710]. We understand that this new market has not yet listed any issuers or become operational. Small entities eligible to list on this market that are not smaller reporting companies would be subject to the listing standards required by Rule 10C–1.

<sup>284</sup> See letter from ABA.

<sup>278</sup> 17 CFR 242.601.

<sup>279</sup> 17 CFR 230.157.

<sup>280</sup> 17 CFR 240.0–10(a).

<sup>281</sup> 17 CFR 270.0–10(a).

securities are quoted on the OTC Bulletin Board and the OTC Markets Group. As these interdealer quotation systems are not affected by Rule 10C-1, the substantial majority of small entities will not be affected by the requirements under the rule.

In addition, we are providing an exemption from the requirements in Rule 10C-1 for smaller reporting companies. We estimate that as of December 31, 2010, the most recent data available, most of the small entities that were listed on an exchange would qualify as a smaller reporting company.<sup>285</sup> Smaller reporting companies that are listed on an exchange are already subject to listing standards requiring directors on compensation committees or directors determining or recommending executive compensation matters to be "independent" under the exchanges' general independence standards. Accordingly, we do not believe that the additional burdens of complying with Rule 10C-1 are warranted for smaller reporting companies.

In addition, under Rule 10C-1, the exchanges will be expressly authorized to exempt particular categories of issuers from the requirements of Section 10C and particular relationships from the compensation committee membership requirements of Section 10C(a), taking into account the potential impact of the requirements on smaller reporting issuers. Because of the close relationship and frequent interaction between the exchanges and their listed issuers, we believe the exchanges will be in the best position to determine additional types of issuers, including any small entities that are not smaller reporting companies, that should be exempted from the listing requirements under the rule.

In connection with the amendments to Regulation S-K, we considered alternatives, including establishing different compliance or reporting requirements that take into account the resources available to small entities, clarifying or simplifying compliance and reporting requirements under the amendments for small entities, using performance rather than design standards, and exempting small entities from all or part of the amendments. We considered, but did not establish, different compliance requirements, or an exemption, for small entities. Although we believe it is appropriate to exempt smaller reporting companies

from Rule 10C-1 because we do not believe that the additional burdens of complying with Rule 10C-1 are warranted for smaller reporting companies, we are unable to reach the same conclusion with respect to the disclosure requirements of amended Item 407(e)(3).

In our view, mandating uniform and comparable disclosures for all issuers subject to our proxy rules is consistent with the statute and will promote investor protection. We believe that investors have an interest in, and would benefit from disclosure regarding, conflicts of interest involving compensation consultants, to the extent that they are used by small entities. Several commentators opposed providing an exemption to small issuers and noted that the required disclosure would provide investors with additional information that would allow them to make better informed investment and voting decisions.<sup>286</sup> Different compliance requirements or an exemption from the amendments to Regulation S-K for small entities would interfere with achieving the goal of enhancing the information provided to all investors.

The amendments to Regulation S-K clarify, consolidate and simplify the compliance and reporting requirements for all entities, including small entities. Under the amendments, disclosure will only be required if a compensation consultant plays a role in determining or recommending the form or amount of executive and director compensation and the compensation consultant's work raises a conflict of interest. Although we believe the disclosure requirements are clear and straightforward, we have attempted to further clarify, consolidate and simplify the compliance and reporting requirements, by including an instruction to the amendments to provide guidance to issuers as to when a conflict of interest may be present that would require disclosure.

Final Rule 10C-1 uses a mix of performance and design standards. We are not specifying the procedures or arrangements an issuer or compensation committee must develop to comply with the listing standards required by Rule 10C-1, but compensation committees will be required to consider the factors specified in Rule 10C-1(b)(4) when conducting the required independence assessments. The amendments to Regulation S-K employ design standards rather than performance standards, as Section 10C(c)(2) mandates the specific disclosures that

must be provided. Moreover, based on our past experience, we believe specific disclosure requirements will promote consistent and comparable disclosure among all companies, and the amendments are intended to result in more comprehensive and clear disclosure.

## VI. Statutory Authority and Text of the Amendments

The amendments contained in this release are being adopted under the authority set forth in Sections 6, 7, 10, and 19(a) of the Securities Act and Sections 3(b), 10C, 12, 14, 23(a) and 36 of the Exchange Act.

### List of Subjects in 17 CFR Parts 229 and 240

Reporting and recordkeeping requirements, Securities.

### Text of the Amendments

For the reasons set out in the preamble, the Commission amends title 17, chapter II, of the Code of Federal Regulations as follows:

#### PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

■ 1. The general authority citation for part 229 is revised and the sectional authorities are removed to read as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

■ 2. Section 229.407 is amended by adding paragraph (e)(3)(iv) and an instruction to paragraph (e)(3)(iv) to read as follows:

#### § 229.407 (Item 407) Corporate governance.

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(iv) With regard to any compensation consultant identified in response to Item 407(e)(3)(iii) whose work has raised any conflict of interest, disclose the nature of the conflict and how the conflict is being addressed.

*Instruction to Item 407(e)(3)(iv).*

For purposes of this paragraph (e)(3)(iv), the factors listed in § 240.10C-1(b)(4)(i) through (vi) of this chapter are

<sup>285</sup> Based on data obtained from the Thomson Financial's Worldscope database, we estimate that as of December 31, 2010, there were two exchange-listed small entities that would not qualify as a smaller reporting company.

<sup>286</sup> See, e.g., letters from CalPERS, FLSBA and RailPen.

among the factors that should be considered in determining whether a conflict of interest exists.

\* \* \* \* \*

**PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

■ 3. The general authority citation for Part 240 is revised to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78j-3, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

\* \* \* \* \*

■ 4. Add an undesignated center heading following § 240.10A-3 to read as follows:

**Requirements Under Section 10C**

■ 5. Add § 240.10C-1 immediately following the new undesignated center heading to read as follows:

**§ 240.10C-1 Listing standards relating to compensation committees.**

(a) Pursuant to section 10C(a) of the Act (15 U.S.C. 78j-3(a)) and section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Pub. L. 111-203, 124 Stat. 1900):

(1) *National securities exchanges.* The rules of each national securities exchange registered pursuant to section 6 of the Act (15 U.S.C. 78f), to the extent such national securities exchange lists equity securities, must, in accordance with the provisions of this section, prohibit the initial or continued listing of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(2) *National securities associations.* The rules of each national securities association registered pursuant to section 15A of the Act (15 U.S.C. 78o-3), to the extent such national securities association lists equity securities in an automated inter-dealer quotation system, must, in accordance with the provisions of this section, prohibit the initial or continued listing in an automated inter-dealer quotation system of any equity security of an issuer that is not in compliance with the requirements of any portion of paragraph (b) or (c) of this section.

(3) *Opportunity to cure defects.* The rules required by paragraphs (a)(1) and (a)(2) of this section must provide for appropriate procedures for a listed issuer to have a reasonable opportunity

to cure any defects that would be the basis for a prohibition under paragraph (a) of this section, before the imposition of such prohibition. Such rules may provide that if a member of a compensation committee ceases to be independent in accordance with the requirements of this section for reasons outside the member's reasonable control, that person, with notice by the issuer to the applicable national securities exchange or national securities association, may remain a compensation committee member of the listed issuer until the earlier of the next annual shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

(4) *Implementation.* (i) Each national securities exchange and national securities association that lists equity securities must provide to the Commission, no later than 90 days after publication of this section in the **Federal Register**, proposed rules or rule amendments that comply with this section. Each submission must include, in addition to any other information required under section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, a review of whether and how existing or proposed listing standards satisfy the requirements of this rule, a discussion of the consideration of factors relevant to compensation committee independence conducted by the national securities exchange or national securities association, and the definition of independence applicable to compensation committee members that the national securities exchange or national securities association proposes to adopt or retain in light of such review.

(ii) Each national securities exchange and national securities association that lists equity securities must have rules or rule amendments that comply with this section approved by the Commission no later than one year after publication of this section in the **Federal Register**.

(b) *Required standards.* The requirements of this section apply to the compensation committees of listed issuers.

(1) *Independence.* (i) Each member of the compensation committee must be a member of the board of directors of the listed issuer, and must otherwise be independent.

(ii) *Independence requirements.* In determining independence requirements for members of compensation committees, the national securities exchanges and national securities associations shall consider

relevant factors, including, but not limited to:

(A) The source of compensation of a member of the board of directors of an issuer, including any consulting, advisory or other compensatory fee paid by the issuer to such member of the board of directors; and

(B) Whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

(iii) *Exemptions from the independence requirements.* (A) The listing of equity securities of the following categories of listed issuers is not subject to the requirements of paragraph (b)(1) of this section:

- (1) Limited partnerships;
- (2) Companies in bankruptcy proceedings;

- (3) Open-end management investment companies registered under the Investment Company Act of 1940; and

- (4) Any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee.

(B) In addition to the issuer exemptions set forth in paragraph (b)(1)(iii)(A) of this section, a national securities exchange or a national securities association, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, may exempt from the requirements of paragraph (b)(1) of this section a particular relationship with respect to members of the compensation committee, as each national securities exchange or national securities association determines is appropriate, taking into consideration the size of an issuer and any other relevant factors.

(2) *Authority to retain compensation consultants, independent legal counsel and other compensation advisers.* (i) The compensation committee of a listed issuer, in its capacity as a committee of the board of directors, may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser.

(ii) The compensation committee shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel and other adviser retained by the compensation committee.

(iii) Nothing in this paragraph (b)(2) shall be construed:

(A) To require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant, independent legal counsel

or other adviser to the compensation committee; or

(B) To affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee.

(3) *Funding.* Each listed issuer must provide for appropriate funding, as determined by the compensation committee, in its capacity as a committee of the board of directors, for payment of reasonable compensation to a compensation consultant, independent legal counsel or any other adviser retained by the compensation committee.

(4) *Independence of compensation consultants and other advisers.* The compensation committee of a listed issuer may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration the following factors, as well as any other factors identified by the relevant national securities exchange or national securities association in its listing standards:

(i) The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;

(ii) The amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;

(iii) The policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;

(iv) Any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee;

(v) Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser; and

(vi) Any business or personal relationship of the compensation consultant, legal counsel, other adviser

or the person employing the adviser with an executive officer of the issuer.

*Instruction to paragraph (b)(4) of this section:* A listed issuer's compensation committee is required to conduct the independence assessment outlined in paragraph (b)(4) of this section with respect to any compensation consultant, legal counsel or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

(5) *General exemptions.* (i) The national securities exchanges and national securities associations, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)) and the rules thereunder, may exempt from the requirements of this section certain categories of issuers, as the national securities exchange or national securities association determines is appropriate, taking into consideration, among other relevant factors, the potential impact of such requirements on smaller reporting issuers.

(ii) The requirements of this section shall not apply to any controlled company or to any smaller reporting company.

(iii) The listing of a security futures product cleared by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) or that is exempt from the registration requirements of section 17A(b)(7)(A) (15 U.S.C. 78q-1(b)(7)(A)) is not subject to the requirements of this section.

(iv) The listing of a standardized option, as defined in § 240.9b-1(a)(4), issued by a clearing agency that is registered pursuant to section 17A of the Act (15 U.S.C. 78q-1) is not subject to the requirements of this section.

(c) *Definitions.* Unless the context otherwise requires, all terms used in this section have the same meaning as in the Act and the rules and regulations thereunder. In addition, unless the context otherwise requires, the following definitions apply for purposes of this section:

(1) In the case of foreign private issuers with a two-tier board system, the

term *board of directors* means the supervisory or non-management board.

(2) The term *compensation committee* means:

(i) A committee of the board of directors that is designated as the compensation committee; or

(ii) In the absence of a committee of the board of directors that is designated as the compensation committee, a committee of the board of directors performing functions typically performed by a compensation committee, including oversight of executive compensation, even if it is not designated as the compensation committee or also performs other functions; or

(iii) For purposes of this section other than paragraphs (b)(2)(i) and (b)(3), in the absence of a committee as described in paragraphs (c)(2)(i) or (ii) of this section, the members of the board of directors who oversee executive compensation matters on behalf of the board of directors.

(3) The term *controlled company* means an issuer:

(i) That is listed on a national securities exchange or by a national securities association; and

(ii) Of which more than 50 percent of the voting power for the election of directors is held by an individual, a group or another company.

(4) The terms *listed* and *listing* refer to equity securities listed on a national securities exchange or listed in an automated inter-dealer quotation system of a national securities association or to issuers of such securities.

(5) The term *open-end management investment company* means an open-end company, as defined by Section 5(a)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-5(a)(1)), that is registered under that Act.

By the Commission.

Dated: June 20, 2012.

**Elizabeth M. Murphy,**  
*Secretary.*

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**BILLING CODE 8011-01-P**

## C. DETERMINATION OF NAMED EXECUTIVE OFFICERS

### Rules

The executive officers generally covered by the rules are defined in Item 402(a)(3) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” may use the definition set forth in paragraph (m)(2) of Item 402 instead of paragraph (a)(3) of such Item.

- *See Part T. Smaller Reporting Companies.*

Item 402(a)(3) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

(a) *General.*

(3) *Persons covered.* Disclosure shall be provided pursuant to this Item for each of the following (the “named executive officers”):

- (i) All individuals serving as the registrant’s principal executive officer or acting in a similar capacity during the last completed fiscal year (“PEO”), regardless of compensation level;
- (ii) All individuals serving as the registrant’s principal financial officer or acting in a similar capacity during the last completed fiscal year (“PFO”), regardless of compensation level;
- (iii) The registrant’s three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year; and
- (iv) Up to two additional individuals for whom disclosure would have been provided pursuant to paragraph (a)(3)(iii) of this Item but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year.

#### **Instructions to Item 402(a)(3).**

1. *Determination of most highly compensated executive officers.* The determination as to which executive officers are most highly compensated shall be made by reference to total compensation for the last completed fiscal year (as required to be disclosed pursuant to paragraph (c)(2)(x) of this Item) reduced by the amount required to be disclosed pursuant to paragraph (c)(2)(viii) of this Item, *provided, however*, that no disclosure need be provided for any executive officer, other than the PEO and PFO, whose total compensation, as so reduced, does not exceed \$100,000.

2. *Inclusion of executive officer of subsidiary.* It may be appropriate for a registrant to include as named executive officers one or more executive officers or other employees of subsidiaries in the disclosure required by this Item. See Rule 3b-7 under the Exchange Act (17 CFR 240.3b-7).
3. *Exclusion of executive officer due to overseas compensation.* It may be appropriate in limited circumstances for a registrant not to include in the disclosure required by this Item an individual, other than its PEO or PFO, who is one of the registrant's most highly compensated executive officers due to the payment of amounts of cash compensation relating to overseas assignments attributed predominantly to such assignments.
4. *Information for full fiscal year.* If the PEO or PFO served in that capacity during any part of a fiscal year with respect to which information is required, information should be provided as to all of his or her compensation for the full fiscal year. If a named executive officer (other than the PEO or PFO) served as an executive officer of the registrant (whether or not in the same position) during any part of the fiscal year with respect to which information is required, information shall be provided as to all compensation of that individual for the full fiscal year.
5. *Omission of table or column.* A table or column may be omitted if there has been no compensation awarded to, earned by, or paid to any of the named executive officers or directors required to be reported in that table or column in any fiscal year covered by that table.

## Practice Pointers

### Changes

- The rules modified the definition of “named executive officer” by:
  - automatically including the Chief Financial Officer, in addition to the Chief Executive Officer; and
  - causing the determination of the three other most highly compensated executive officers to be based on *total compensation* (excluding the impact of changes in pension values and earnings on deferred compensation) rather than just salary and bonus.

### Treatment of Former Executives

- If an executive officer becomes a non-executive employee during a fiscal year, consider the compensation the person received during the entire fiscal year for purposes of determining whether the person is a named executive officer. If the person thus would qualify as a named executive officer, disclose all of the person's compensation for the full fiscal year, i.e. compensation for when the person was an executive officer and for when the person was a non-executive employee.
  - See *Appendix B-III. SEC Compliance & Disclosure Interpretations regarding Regulation S-K, Section 217.07.*

## **Treatment of Severance**

- Note that severance payments (and even equity awards granted to and then forfeited by an executive who departs) are included in total compensation.
  - As a result, departed executives, who under the old rules would not have been “named executive officers,” may now so qualify.

## **Disclosure Controls and Procedures**

- Companies should review their disclosure controls and procedures to ensure adequate systems are in place to track total compensation (including severance payments, benefits and perquisites) for each executive officer.

## **Smaller Reporting Companies**

- A registrant that qualifies as a “smaller reporting company” may provide the scaled disclosure called for by paragraphs (m) through (r) of Item 402 instead of paragraphs (a) through (k) and (s) of such Item.
  - Paragraph (m)(2) of Item 402 contains an alternative definition of “named executive officer.”
  - *See Part T. Smaller Reporting Companies.*

## D. DEFINITIONS

### Rules

Important terms used throughout the rules are defined in Item 402(a)(6) of Regulation S-K which reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

##### *(a) General.*

*(6) Definitions.* For purposes of this Item:

- (i) The term *stock* means instruments such as common stock, restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or any similar instruments that do not have option-like features, and the term *option* means instruments such as stock options, stock appreciation rights and similar instruments with option-like features. The term *stock appreciation rights* (“SARs”) refers to SARs payable in cash or stock, including SARs payable in cash or stock at the election of the registrant or a named executive officer. The term *equity* is used to refer generally to stock and/or options.
- (ii) The term *plan* includes, but is not limited to, the following: Any plan, contract, authorization or arrangement, whether or not set forth in any formal document, pursuant to which cash, securities, similar instruments, or any other property may be received. A plan may be applicable to one person. Except with respect to the disclosure required by paragraph (t) of this Item, registrants may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees .
- (iii) The term *incentive plan* means any plan providing compensation intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the registrant or an affiliate, the registrant’s stock price, or any other performance measure. An *equity incentive plan* is an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of FASB ASC Topic 718, *Compensation – Stock Compensation*. A *non-equity incentive plan* is an incentive plan or portion of an incentive plan that is not an equity incentive plan. The term *incentive plan award* means an award provided under an incentive plan.
- (iv) The terms *date of grant* or *grant date* refer to the grant date determined for financial statement reporting purposes pursuant to FASB ASC Topic 718.
- (v) *Closing market price* is defined as the price at which the registrant’s security was last sold in the principal United States market for such security as of the date for which the closing market price is determined.

### **“Bonus” vs. “Non-Equity Incentive Plan” Compensation**

- Awards that were previously reported as bonuses must now be reported as non-equity incentive plan compensation if:
  - pre-determined performance targets are communicated to executives; and
  - the outcomes with respect to the awards are substantially uncertain at the time the performance targets are established.
- *See Part F. Summary Compensation Table.*

### **Definition of “Plan” and Relocation Benefits**

- The new definition of “plan” no longer permits the omission of benefits provided to executives under relocation plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors and that are available generally to all salaried employees.
  - Other than in connection with disclosures required in the say-on-golden parachute context, the definition of “plan” still permits the omission of benefits provided to executives under group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors and that are available generally to all salaried employees.

### **Definition of “Equity Incentive Plan”**

- An equity incentive plan is an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of FASB ASC Topic 718. The scope of FASB ASC Topic 718 is broad and includes both stock and liability awards (as defined in FASB ASC Topic 718).
  - As such, when in doubt, companies should consult with their accountants to determine whether a particular award falls within the scope of FASB ASC Topic 718. *See Part F. Summary Compensation Table.*

## E. COMPENSATION DISCUSSION AND ANALYSIS

The centerpiece of the rules is the requirement to include a Compensation Discussion and Analysis (CD&A) section in the annual proxy statement providing narrative disclosure that puts into context the compensation disclosure provided elsewhere.

### Rules

The requirement to include CD&A is contained in Item 402(b) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to prepare CD&A.

- *See Part T. Smaller Reporting Companies.*

Item 402(b) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

*(b) Compensation discussion and analysis.*

- (1) Discuss the compensation awarded to, earned by, or paid to the named executive officers. The discussion shall explain all material elements of the registrant’s compensation of the named executive officers. The discussion shall describe the following:
  - (i) The objectives of the registrant’s compensation programs;
  - (ii) What the compensation program is designed to reward;
  - (iii) Each element of compensation;
  - (iv) Why the registrant chooses to pay each element;
  - (v) How the registrant determines the amount (and, where applicable, the formula) for each element to pay;
  - (vi) How each compensation element and the registrant’s decisions regarding that element fit into the registrant’s overall compensation objectives and affect decisions regarding other elements; and
  - (vii) Whether and, if so, how the registrant has considered the results of the most recent shareholder advisory vote on executive compensation required by section 14A of the Exchange Act (15 U.S.C. 78n-1) or §240.14a-20 of this chapter in determining compensation policies and decisions and, if so, how that consideration has affected the registrant’s executive compensation decisions and policies.

- (2) While the material information to be disclosed under Compensation Discussion and Analysis will vary depending upon the facts and circumstances, examples of such information may include, in a given case, among other things, the following:
- (i) The policies for allocating between long-term and currently paid out compensation;
  - (ii) The policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation;
  - (iii) For long-term compensation, the basis for allocating compensation to each different form of award (such as relationship of the award to the achievement of the registrant's long-term goals, management's exposure to downside equity performance risk, correlation between cost to registrant and expected benefits to the registrant);
  - (iv) How the determination is made as to when awards are granted, including awards of equity-based compensation such as options;
  - (v) What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions;
  - (vi) How specific forms of compensation are structured and implemented to reflect these items of the registrant's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal(s) or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified named executive officers or to all compensation subject to the relevant performance goal(s);
  - (vii) How specific forms of compensation are structured and implemented to reflect the named executive officer's individual performance and/or individual contribution to these items of the registrant's performance, describing the elements of individual performance and/or contribution that are taken into account;
  - (viii) Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;
  - (ix) The factors considered in decisions to increase or decrease compensation materially;
  - (x) How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (*e.g.*, how gains from prior option or stock awards are considered in setting retirement benefits);
  - (xi) With respect to any contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) at, following, or in connection with any

termination or change-in-control, the basis for selecting particular events as triggering payment (*e.g.*, the rationale for providing a single trigger for payment in the event of a change-in-control);

- (xii) The impact of the accounting and tax treatments of the particular form of compensation;
- (xiii) The registrant's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership), and any registrant policies regarding hedging the economic risk of such ownership;
- (xiv) Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies); and
- (xv) The role of executive officers in determining executive compensation.

**Instructions to Item 402(b).**

1. The purpose of the Compensation Discussion and Analysis is to provide to investors material information that is necessary to an understanding of the registrant's compensation policies and decisions regarding the named executive officers.
2. The Compensation Discussion and Analysis should be of the information contained in the tables and otherwise disclosed pursuant to this Item. The Compensation Discussion and Analysis should also cover actions regarding executive compensation that were taken after the registrant's last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.
3. The Compensation Discussion and Analysis should focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions. The Compensation Discussion and Analysis shall reflect the individual circumstances of the registrant and shall avoid boilerplate language and repetition of the more detailed information set forth in the tables and narrative disclosures that follow.
4. Registrants are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant. The standard to use when determining whether disclosure would cause competitive harm for the registrant is the same standard that would apply when a registrant requests confidential treatment of confidential trade secrets or confidential commercial or financial information pursuant to Securities Act Rule 406 (17 CFR 230.406) and Exchange Act Rule 24b-2 (17 CFR 240.24b-2), each of which incorporates the criteria for non-disclosure when

relying upon Exemption 4 of the Freedom of Information Act (5 U.S.C. 552(b)(4)) and Rule 80(b)(4) (17 CFR 200.80(b)(4)) thereunder. A registrant is not required to seek confidential treatment under the procedures in Securities Act Rule 406 and Exchange Act Rule 24b-2 if it determines that the disclosure would cause competitive harm in reliance on this instruction; however, in that case, the registrant must discuss how difficult it will be for the executive or how likely it will be for the registrant to achieve the undisclosed target levels or other factors.

5. Disclosure of target levels that are non-GAAP financial measures will not be subject to Regulation G (17 CFR 244.100 - 102) and Item 10(e) (§229.10(e)); however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements.

## Adopting Release Excerpts

Excerpts from the adopting release include:

- The purpose of the Compensation Discussion and Analysis disclosure is to provide material information about the compensation objectives and policies for named executive officers without resorting to boilerplate disclosure.
- The Compensation Discussion and Analysis is intended to put into perspective for investors the numbers and narrative that follow it.
- As described in the Proposing Release and as adopted, the Compensation Discussion and Analysis requirement is principles-based, in that it identifies the disclosure concept and provides several illustrative examples.
  - As we explained in the Proposing Release, overall we designed the proposals to state the requirements sufficiently broadly to continue operating effectively as future forms of compensation develop, without suggesting that items that do not fit squarely within a “box” specified by the rules need not be disclosed. We believe that the adopted principles-based Compensation Discussion and Analysis, utilizing a disclosure concept along with illustrative examples, strikes an appropriate balance that will effectively elicit meaningful disclosure, even as new compensation vehicles develop over time.
- The Compensation Discussion and Analysis should reflect the individual circumstances of a company and should avoid boilerplate disclosure.
- The Compensation Discussion and Analysis should be sufficiently precise to identify material differences in compensation policies and decisions for individual named executive officers where appropriate. Where policies or decisions are materially similar, officers can be grouped together. Where, however, the policy or decisions for a named executive officer are materially different, for example in the case of a principal executive officer, his or her compensation should be discussed separately.
- We are adopting instructions to make clear that the Compensation Discussion and Analysis should focus on the material principles underlying the company’s executive compensation policies and decisions, and the most important factors relevant to analysis of those policies and decisions, without using boilerplate language or repeating the more detailed information set forth in the tables and related narrative disclosures that follow. The instructions also provide that the Compensation Discussion and Analysis should concern the information contained in the tables and otherwise disclosed. Because this section is intended to provide meaningful analysis, it may specifically refer to the tabular or other disclosures where helpful to make the discussion more robust.
- Further, many commenters expressed the view that the Compensation Discussion and Analysis should, in effect, be the report of the compensation committee, submitted under the names of its members, for which they should be accountable. Some of these objections may reflect a misconception of the purpose of the Compensation Discussion and Analysis.

Although the Compensation Discussion and Analysis discusses company compensation policies and decisions, the Compensation Discussion and Analysis does not address the deliberations of the compensation committee, and is not a report of that committee. Consequently, in certifying the Compensation Discussion and Analysis, principal executive officers and principal financial officers will not need to certify as to the compensation committee deliberations.

### Principles Matter

- The CD&A requirement is principles-based.
  - *See Part B. The Rules.*

### Focus on Analysis

- The SEC has made it clear that CD&A must provide better disclosure than that previously contained in most compensation committee reports and that boilerplate disclosure will be unacceptable.
- An important focus of CD&A should be *how and why* compensation decisions were made.
  - *See John W. White, Speech by SEC Staff: Where's the Analysis?* (October 9, 2007), a copy of which is located at [Appendix E-I](#).
  - *See also Staff Observations in the Review of Executive Compensation Disclosure* (Oct. 9, 2007), a copy of which is located at [Appendix B-IV](#).
  - *See also John W. White, Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009* (Oct. 21, 2008), a copy of which is located at [Appendix E-VI](#).
  - *See also Shelley Parratt, Speech by SEC Staff: Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010* (Nov. 9, 2009), a copy of which is located at [Appendix E-VII](#).
- CD&A should analyze the entire compensation program, explaining why the individual elements of the program were selected and how they operate together to meet the program's objectives.
  - The compensation program's processes and procedures should generally be described in the description of the compensation committee required by item 407(e) of Regulation S-K, not in CD&A.
    - *See Part Q. Compensation Committee Disclosures and Compensation Committee Report.*
- CD&A should be approached in a manner similar to the way in which the Management's Discussion and Analysis of Financial Condition and Results of Operations section of Forms 10-K and 10-Q is approached.

- *See Interpretation: Commission Guidance Regarding Managements’ Discussion and Analysis of Financial Condition and Results of Operations*, SEC Release Nos. 33-8350; 34-48960 (Dec. 29, 2003), a copy of which is located at [Appendix E-II](#).

### **Adoption by Compensation Committee**

- In the compensation committee report required by Item 407(e)(5) of Regulation S-K, the compensation committee will be required to state that it has reviewed the CD&A, discussed it with management and recommends its inclusion in the Form 10-K and the proxy statement.
  - As with the audit committee report, the name of each compensation committee member must appear below the report.
- Because the compensation committee sets executive compensation policies and makes executive compensation decisions, it is ultimately responsible for the disclosures required to be made in CD&A.
- *See Part Q. Compensation Committee Disclosures and Compensation Committee Report.*

### **“Filed” not “Furnished”**

- CD&A will be deemed “filed” and will therefore be subject to certification by the CEO and CFO.
  - Given Form 10-K certification requirements, the CEO and CFO will need to see a substantially complete draft of CD&A prior to filing of Form 10-K.
  - Internal control over financial reporting should be updated to ensure compensation disclosures are covered.
    - *See John W. White, Executive Compensation Disclosure and the Important Role of CFOs*, Remarks Before the CFO Executive Board (Oct. 3, 2006), a copy of which is located at [Appendix E-III](#).
- The adopting release notes that the CEO and CFO will be able to look to the Compensation Committee Report in providing their certifications.
  - *See Part Q. Compensation Committee Disclosures and Compensation Committee Report.*

### **Preparing CD&A**

- Regardless of who will take the lead in drafting CD&A, a necessary first step is gathering the critical information regarding the company’s executive compensation programs in one place. We recommend preparing a notebook that would be provided to and used on an ongoing basis by the compensation committee that would include:
  - A description of the items required to be disclosed in CD&A (and in turn, considered by the compensation committee).

- The compensation committee’s charter.
- A description of the compensation committee’s compensation philosophies and objectives as described in last years’ compensation committee report or as otherwise established by the committee.
- Tally sheets adding up all the elements of each executive officer’s compensation.
- A description of each element of executive compensation (including copies of underlying documents) and a description of when, how and why each element was established.
- Drafts of the new tables that will be required to be included in next years’ proxy statement (including potential amounts payable under termination and change in control provisions including any tax gross-up payments).
- A description of the material terms of each executive’s employment agreement.
- A description of all perquisites provided to executive officers.
- Any recent analyses and reports prepared by compensation consultants.
- The next step would be to work with the compensation committee to create a detailed process for preparation and review of CD&A. In so doing, companies should keep in mind the focus of CD&A is *analysis*. As a result, it is important to make sure that the compensation committee critically considers all the factors required to be disclosed in CD&A (*e.g.*, why are we paying this element of compensation?) in making its compensation decisions and that the company’s records (*e.g.*, compensation committee minutes) reflect such consideration.
  - In this regard, and to enable counsel to adequately assist in preparing CD&A, companies should consider whether to have counsel (inside our outside) present at compensation committee meetings to monitor the proceedings and ensure adequate records are kept of such proceedings.
- CD&A is required to be drafted in plain english.
  - *See Part R. Plain English Requirement.*

### **Potential Disclosure of Performance Targets**

- In CD&A, companies are required to disclose how they determine the amount (and, where applicable, the formula) for each element of executive compensation. An instruction to the rules specifies that companies are not required to provide actual target levels if disclosure would result in competitive harm for the company, provided that if the company relies on this instruction to omit target levels the company must discuss in CD&A how difficult it will be for the company to achieve the undisclosed target levels.

- For interpretive guidance concerning how a company determines if it may omit disclosure of performance targets see *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 118.04.*
- Proper disclosures regarding use of performance targets is a major focus of SEC review of executive compensation disclosures.
  - See *Staff Observations in the Review of Executive Compensation Disclosure* (Oct. 9, 2007), a copy of which is located at Appendix B-IV.
  - See also Shelley Parratt, *Speech by SEC Staff: Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010* (Nov. 9, 2009), a copy of which is located at Appendix E-VII.
- The standard for determining whether information does not have to be disclosed because it is likely to result in “competitive harm” is the same standard that currently applies when companies request confidential treatment of trade secrets or confidential commercial or financial information. See the following for additional information regarding this standard and its application:
  - Securities Act Rule 406, Exchange Act Rule 24b-2, Exemption 4 of the Freedom of Information Act [5 U.S.C. 552(b)(4)], and Rule 80(b)(4) promulgated under the Freedom of Information Act [17 CFR 200.80(b)(4)].
  - *Division of Corporation Finance Staff Legal Bulletin No. 1 (with Addendum), “Confidential Treatment Requests,”* which can be found at <http://www.sec.gov/interps/legal/slbcf1r.htm>.
  - United States Department of Justice, *Department of Justice Freedom of Information Act Guide* (May 2004), which can be found at <http://www.usdoj.gov/oip/foi-act.htm>.
- If a company has executive compensation programs that utilize specific performance measures, it should consider what disclosures may be required regarding the performance measures and targets and whether the programs may need to be modified to avoid disclosures the company may be uncomfortable making.
  - Companies should also document their analyses and conclusions with respect to any determinations not to disclose performance measures and targets.
- Note if a company makes a disclosure concerning the difficulty of achieving performance targets it should be sure to include a forward-looking statements disclaimer with such disclosure.

### **Identify Differences in Policies and Decisions Among Executives**

- CD&A should be sufficiently precise to identify material differences in compensation policies and decisions for individual named executive officers.

- See *Staff Observations in the Review of Executive Compensation Disclosure* (Oct. 9, 2007), a copy of which is located at [Appendix B-IV](#).

### **Required Benchmarking Disclosures**

- If a company uses benchmarking, and it is material to its compensation policies and decisions, the company must “identify the benchmark and, if applicable, its components (including component companies).”
  - See *Staff Observations in the Review of Executive Compensation Disclosure* (Oct. 9, 2007), a copy of which is located at [Appendix B-IV](#).
  - See also John W. White, *Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009* (Oct. 21, 2008), a copy of which is located at [Appendix E-VI](#).

### **Disclosure of Option Grant Practices**

- One of the examples of potentially material information that may need to be discussed in CD&A is how the determination is made as to when stock option awards are granted.
- In the adopting release the SEC:
  - highlighted this item;
  - noted that it understood that some companies grant options in coordination with the release of material non-public information;
  - stated the Commission believes that in many circumstances the existence of a program, plan or practice to time the grant of stock options to executives in coordination with material non-public information would be material to investors and thus should be fully disclosed under the new rules; and
  - explained that a program, plan or practice of awarding options and setting the exercise price based on the stock’s price on a date other than the actual grant date should also be disclosed.
- See John W. White, *The Principles Matter: Options Disclosure*, Remarks Before the Corporation Counsel Conference (Sept. 11, 2006), a copy of which is located at [Appendix E-IV](#).
- Note, the disclosures required about option grant practices also apply to restricted stock and other non-option equity award practices.
  - See *SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 118.01*, a copy of which is located at [Appendix B-III](#).

## **Importance of Quality CD&A to Investors**

- High quality CD&A is important to institutional investors.
  - See *Letter from Council of Institutional Investors to Christopher Cox Re: Compensation Disclosure Compliance Review Process; Shareowner Perspective on Improving the Compensation Discussion and Analysis (CD&A)* (Sep. 27, 2007), a copy of which is located at [Appendix E-V](#).

## **Fiscal Years Covered by CD&A**

- Since one of the goals of CD&A is to provide a framework of the executive compensation program of a company, CD&A:
  - is not necessarily limited to a discussion of compensation awarded in the last fiscal year; and
  - may require discussion of compensation decisions that were taken after the end of the last fiscal year, including the modification, implementation or adoption of new policies or programs that could affect a fair understanding of compensation for the last fiscal year.
- See John W. White, *Principles Matter*, Address at the Practising Law Institute Conference (Sept. 6, 2006), a copy of which is located at [Appendix B-VI](#).

## **Addition of Requirement to Disclose How Most Recent Say-on-Pay Vote Was Considered in Determining the Company’s Compensation Decisions and Policies**

- The rules adopted by the SEC in January 2011 to implement the Dodd-Frank Act’s say-on-pay requirements include the requirement that companies disclose in CD&A how the company has considered the results of the most recent say-on-pay vote in determining compensation policies and decisions and how that consideration has affected the company’s executive compensation decisions and policies.

## **Say-on-Pay Effect on CD&A**

- In light of the advent of “say-on-pay” lawsuits and the voting policies of proxy advisory firms, issuers should be working closely with their compensation committees, outside advisors and management to craft a CD&A that will withstand stockholder scrutiny and clearly communicate the company’s pay-for-performance approach. While there is no “boilerplate” approach to drafting the CD&A, there are evolving best practices, such as the use of an “executive summary” and other forms of “layered disclosures” to provide easy-to-read summary information within the CD&A. Many companies are developing ways to visually display the pay-for-performance link. Companies are also considering disclosures regarding the linkage between performance and “realized” or “realizable” pay.
  - See *Part V. Say-on-Pay*.

### **Location of CD&A in the Proxy Statement**

- Based on Instruction B to Item 402(b) of Regulation S-K and various comments in the adopting release, the SEC expects that the tables and other narrative disclosures regarding executive compensation will “follow” CD&A in the proxy statement.

### **Smaller Reporting Companies**

A registrant that qualifies as a “smaller reporting company” is not required to prepare CD&A.

- *See Part T. Smaller Reporting Companies.*

**APPENDIX E-I**

**John W. White, *Speech by SEC Staff: Where's the Analysis?*  
(October 9, 2007)**



## U.S. Securities and Exchange Commission

**Speech by SEC Staff:  
Where's the Analysis?***by***John W. White***Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

Tackling Your 2008 Compensation Disclosures:  
The 2nd Annual Proxy Disclosure Conference  
San Francisco, California  
October 9, 2007

Good afternoon. Thank you Jesse [Brill]. I am excited to return to San Francisco to talk about executive compensation disclosure in the 2007 proxy season — the first season under the new requirements the Commission adopted just over a year ago. The staff's observations on the first year disclosures were published this morning, and what a great forum this is to reflect on where we are in our pursuit of the "clearer and more complete picture of compensation" that the Commission sought in adopting the new rules.

In the next half hour, I plan to share with you some of my views on where the first-year disclosures have realized this goal and where they have not. The positives are substantial — and there is a wealth of new information available to investors for the first time. Investors have been provided with the most comprehensive disclosure ever regarding how much public companies pay their executives and directors. There are some very important areas, however, where work remains for next year.

As I noted, these are my views — so let me go ahead and provide you the required disclaimer — the views that I'm going to express today are solely my own and do not necessarily reflect the views of the Securities and Exchange Commission or of any members of the Commission or its staff, other than myself.

It was in this city, at this series of conferences, three years ago in 2004, that my predecessor Alan Beller started it all off with his memorable "all means all" speech.<sup>1</sup> We have come a long way since then — 382 pages of proposals,<sup>2</sup> almost 30,000 comment letters,<sup>3</sup> 489 pages of adopting releases,<sup>4</sup> 112 interpretations,<sup>5</sup> a first full season of disclosures and, most recently, a staff report on the first year disclosures after 350 reviews.<sup>6</sup> On Alan's "all means all" point, we have made great progress — the rules are pretty clear on what compensation companies need to disclose, and what they need to quantify. The new tables and footnotes, and what companies are required to put in them, take us a long way toward our disclosure goals in this area.

The Commission made clear in adopting the new rules, however, that it is looking for more than just the value of the components of compensation and a total value of compensation. What is that "more" it is looking for? In order to provide investors with more than just tables of numbers, the Commission created the new Compensation Discussion and Analysis requirement to "put into perspective for investors the numbers and narrative that follow it." This "overview" is very much a principles-based requirement, like the MD&A section with which we are all so familiar. In an instruction to the CD&A requirement, the Commission made clear that CD&A "should focus on the material principles underlying the registrant's executive compensation policies and decisions and the most important factors relevant to the *analysis* of those policies and decisions." My emphasis on the word "analysis" should provide you with a pretty good idea of the principal place where I believe many companies came up short — where disclosure can be improved. More on that in just a moment.

Let's turn to the Division's report, which was published this morning. Our report largely provides an overview of our principal areas of comment. Rather than waiting to reflect the give and take of the individual company comment process, we have published our observations as soon as initial comments were issued to all the companies. One observation: these comments reflect places where we believe companies may need to provide additional or clearer disclosure in future filings. That's the very nature of the comment process. But we should not lose sight of the fact that implementing the new disclosure requirements, gathering the new information, and crafting the new disclosures for investors, often writing on a clean slate, was a substantial task in the first year. As a whole, company efforts were quite admirable, and investors are well-served by the new disclosures.

### **Principles-Based Disclosure and Materiality**

For context, let me briefly go back to the principles-based regime of CD&A, to the role of examples, and to materiality. Last year as we headed into the first season, I made a series of remarks based on the idea that, in drafting first-year CD&As, companies needed to focus on using the principles-based regime outlined in the adopting release — because, "principles matter."<sup>7</sup> That certainly remains the case, and "principles still matter."

Recall how principles-based disclosure works. There are overarching disclosure principles — and the Commission laid those out in the release and the rules. You've heard them and read them. And then there are examples — and the Commission provided 15 of them. These examples are just that. They neither encompass the universe of possible required disclosures, nor are they mandatory. Companies need not discuss each example, as disclosure is required only where material. The instructions to the CD&A provide a pretty clear mandate in this regard. Let me repeat what I just said. Disclosure is required only where material.

### **Analysis**

Now, back to our comments. Several key themes recur in our comments, one of which I want to lay out a bit more bluntly than in the report. And these are my views of course.

Far too often, meaningful analysis is missing — this is the biggest shortcoming of the first-year disclosures. Stated simply — Where's the analysis?

I know no better way to emphasize this than to go to the very examples that the staff highlighted in the report. A good starting point, and a representative example, is disclosure of compensation philosophies and decision-making processes. We saw a great deal of detail this year, but what was missing was a discussion of *how* and *why* those philosophies and processes resulted in the numbers the company presented in its tabular disclosure. There also was a great deal of detail on individual compensation components, but little discussion of how the amounts paid or awarded under each compensation element — and how the total compensation delivered from all these elements (what some refer to as wealth accumulation) — affected the decisions that companies made regarding amounts paid or awarded under other compensation elements. That's missing analysis.

A few more examples where analysis was missing include disclosures with respect to benchmarks, differences in compensation policies and decisions among executive officers, and change-in-control arrangements. I don't plan to go through these today — they are discussed in the report if you'd like more detail. I will instead take you through one additional example — performance targets. I'm spending a bit of extra time on this area for a couple reasons. It was one of the most commented on areas in the first-year disclosures and it also brings together not only the missing analysis theme, but also the concepts of principles and materiality as the foundation for your disclosure decisions.

As we all know, and as I just noted, the new rules include 15 examples of items that may be material elements of a company's compensation policies and decisions, and therefore require CD&A disclosure. Two of these examples go to what items of corporate performance are used in setting compensation and how they are used. Discussion of performance targets comes up in the context of these examples.

In reviewing the first year disclosures on performance targets, we were disappointed to find that, though a significant number of companies apparently use performance goals or targets, far too often an analysis of *how* the targets were used in setting compensation was missing. In our comment process, we approached these disclosures from the starting point of materiality — as we all know, the CD&A rules require disclosure with respect to an example only where material. So, just to say it another way, depending on whether the CD&A examples that relate to corporate performance are material for your company, performance targets are a disclosure point that may or may not need to be addressed.

What did we ask for? You guessed it — for more analysis. We often found it difficult to understand how companies used targets or considered qualitative individual performance to set compensation and make decisions.

Our comments were not intended to suggest that every CD&A must necessarily address disclosure regarding targets for the year in question, or any other year. In the first instance, a company needs to determine whether use of corporate performance items is material, and for which years, and to address disclosure and confidentiality accordingly. Where targets appeared to be material based on what was disclosed, but the company did not disclose specific targets, we asked that the company either disclose the targets or demonstrate why doing so would cause competitive harm. In those instances where a target is properly omitted based on the competitive harm standard, the company must discuss, in a meaningful way, how difficult it will be for the executive or how likely it will be for the company to achieve that target.

Just to expand briefly on one last related point — my references to the years for which disclosure must be addressed. This takes us back to principles (as well as to an instruction in the rules).<sup>8</sup> As we know, CD&A must cover the last fiscal year, but depending on materiality, there are a number of situations where a company may also find it necessary to discuss targets for either prior years, the current year, or later years, to place their disclosure in context or “affect a fair understanding” of a named executive officer’s compensation. This might occur with a multi-year compensation plan or where targets varied materially from year-to-year.

So, I hope that gives perspective on where many of our comments fell regarding analysis. In looking at disclosures and staff comment letters on those disclosures, you certainly can come up with more. But I think that if you look at the areas I’ve mentioned, you will understand where the Division feels companies can improve their analysis in the coming proxy season.

### **Presentation**

With that, I’m going to take you briefly through a second key area of our comments on the first-year disclosures — manner of presentation. Put simply, “presentation matters.” The revised rules require companies to disclose a great deal of information — and that information goes to the heart of how it compensates its executive officers. How a company provides that information is, in many ways, as important as its content.

Manner of presentation is not limited to plain English principles, although our requests for clearer and more understandable disclosure constitute a significant portion of our comments in this area. The Commission specifically affirmed its support for plain English principles in the adopting release for the new rules, noting that “[c]learer, more concise presentation of executive and director compensation ... can facilitate more informed investing and voting decisions in the face of complex information about these important areas.” And I think that we can all agree that with executive compensation we often are dealing with complex information.

Chairman Cox, who is particularly focused on the importance of clear, concise, and understandable disclosure in all Commission initiatives, will be speaking later this week on plain English principles at a symposium on plain language in Washington DC,<sup>9</sup> so I am going to leave the real message on manner of presentation for him. But I will mention a couple things I’d like you to focus on.

Disclosure can fail in either of two different ways — it can be presented clearly and understandably without being meaningful or responsive to disclosure requirements or, conversely, it can be responsive in content without being clear and understandable. The first of these failures takes us back to analysis. Although companies generally appear to have made a good faith effort to provide clear and understandable disclosure, we found that many omitted critical information — largely the “how” and “why” of their executive compensation decisions. This is where we asked for enhanced disclosure most often. Where we ask companies to add or enhance their analysis, this does not mean that we are trying to undermine efforts at plain English-compliant disclosure. Our requests for improved analysis need not lengthen disclosure. Rather, with careful drafting, I believe companies can achieve a succinct and effective discussion that provides the required disclosure *and* embraces plain English principles.

In this regard, I refer you to the Division's report, where we have described a few of the ways we have suggested companies can improve the content of their disclosure without compromising plain English principles. Where companies include boilerplate discussions of individual performance, they should instead provide specific analysis of how they considered and used individual performance to determine each individual's compensation. Where a company has simply repeated in its CD&A information that it also presents in the required compensation tables, it should replace the redundant disclosure with a clear and concise analysis of that information. Where disclosure has been (or appears to have been) lifted directly from the technical language of a compensation plan or employment agreement, the company should redraft that disclosure in a more clear, concise, and understandable manner.

I think that if companies and their disclosure counsel embrace this guidance, and make changes consistent with the spirit of the guidance, it will quickly become apparent that you can be responsive to both staff requests for additional analysis and the plain English requirements.

One final thought in this area, one that intersects both the topics of presentation and analysis, and that appears in the report in our discussion of performance targets. We have heard concerns expressed by company executives and disclosure counsel that the staff, in its comment process, may be asking for quantitative explanations of decisions that may in fact be subjective assessments of individual performance. Let me assure you — that is not our intent. We are simply asking these companies to present how these decisions were made — as the report phrases it, "to clearly lay out the way that qualitative inputs are ultimately translated into objective pay determinations." In talking to company executives and disclosure counsel in the past couple of months, we frequently have been provided with very clear, straightforward explanations of this. That is exactly what we are looking for — *in* the filing.

### **Second Year Disclosure**

After all that, I know that many will now say, "Show us the good examples." However, even with my disclaimer, I feel constrained from highlighting individual company disclosures — good or bad. I also don't want to see everyone coming back with identical boilerplate disclosure next year. But I will say, there are good disclosures out there — they will be discussed at this and other conferences I'm sure — and I would challenge you all to consider those examples as you draft disclosure tailored to reflect the individual circumstances of your company, and next year to aspire to become one of those examples — if you are not one already. Don't let this coming year's disclosures be just a mark-up of the first year. Instead step back and ask some very important questions.

- What is material to my shareholders, to my investors, as they examine the compensation of our executives and make their voting decisions for our board of directors and investment decisions with respect to our company?
- What are the material elements of individual executive and corporate performance that are considered in setting executive compensation?
- What is the relationship between the objectives of our compensation program and the different elements of compensation?

- What are the material factors that relate to our compensation decision-making process?

Then, sit down and focus on two very important aspects of your disclosure:

*Analysis.* Focus on *how* and *why* you reached the compensation decisions you made in your CD&A. Don't provide a laundry list of facts. Discuss and analyze the elements of your decision-making. Some have suggested that the way to ensure proper emphasis of analysis is to require companies to provide a separate section titled "Analysis" in the CD&A. This suggestion is one of many good ideas. I will leave it to you, however, to determine how best to highlight the analysis.

*Presentation matters.* Focus on being clear, concise and understandable. Our rules require you to provide substantial amounts of information. Consider ways to present your information in a manner that helps people understand it. Consider presenting layered disclosure. Consider using tables and charts to present complex information. Continue your innovative efforts to use these tools to illustrate the relationship between compensation objectives and different forms of pay.

So, going forward, the question becomes — where do you, and we at the SEC, fit into this process?

*Disclosure Counsel.* Let's start with you — disclosure counsel and other advisors. What is your role in improving second-year disclosures? Alan Beller said it in 2004, I've said it in the past, and I will keep saying it. You must not lose sight of who your client is — the company. Not the CEO. Not the CFO. Not any other member of management. And, not the board. It is troublesome, to say the least, when I hear the suggestion that some have lost sight of their role in this very sensitive area. Executive compensation disclosure must be guided by counsel acting for the company. The information the company's shareholders seek and need should guide your disclosure advice, and the company's disclosure decisions. A company's shareholders want to see what executive compensation decisions a company makes and how it makes them. That is your audience. That is your client.

*SEC Staff.* Those of us on the SEC staff, where do we fit in? In our future reviews of executive compensation disclosures, we will have the benefit of what we learned and continue to learn in the first year. We will certainly expect to see the results of our call for more and better analysis and clearer, more concise disclosure. In issuing comments this year, we realized that each company was faced with an entirely new disclosure regime for executive compensation. We took into account each company's learning curve. We issued a lot of comments in which we asked companies to revise their future disclosure, not their current disclosure. We asked a lot of questions so we could better understand why companies made the disclosure they did.

As we enter the second season, we will expect companies to have taken our guidance to heart, and I anticipate that you will see that heightened expectation reflected in the type and focus of our comments and reactions next year.

With that, I want to close with one thought, which is really quite simple, and you have no doubt heard it before — step back next year and start with

a clean slate, a blank sheet of paper. Now when I listen to that, it sounds like pretty dull jargon — a nice platitude. You'll no doubt nod, and then go on.

So let me try a simple, more practical suggestion. One that perhaps will show up in those lists of practice points many of you develop.

This fall. Before anyone starts drafting your CD&A. Ask every key participant (from the compensation committee chair on down) to turn in one page — no more than a page — perhaps even with the caption "Analysis." Hand them a copy of our just-issued staff report so that they see our concerns about missing analysis. Then ask for bullets. Those bullets should reflect what he or she sees, from their perspective, as the key "hows" and "whys," including, as appropriate

- the key analytic tools used by the compensation committee,
- the findings that emerged from the analysis, and
- the resulting actions taken impacting executive compensation in the last year.

In short, the key points of analysis. The next step for the drafting team is obvious. Call this process collecting the "clean slate" lists. Consider building it into your procedures. Follow up on getting the lists.

So, that's it. Thank you for inviting me, and I look forward to seeing your disclosures next year.

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<sup>1</sup> "Remarks Before Conference of the NASPP, the Corporate Counsel and the Corporate Executive," Alan L. Beller, Director, Division of Corporation Finance, October 20, 2004, available at [/news/speech/spch102004alb.htm](#).

<sup>2</sup> SEC Release No. 33-8655, "Executive Compensation and Related Party Disclosure," January 27, 2006, available at <http://www.sec.gov/rules/proposed/33-8655.pdf>; SEC Release No. 33-8735, "Executive Compensation Disclosure," August 29, 2006, available at <http://www.sec.gov/rules/proposed/2006/33-8735.pdf>.

<sup>3</sup> Comment File No. S7-03-06, available at <http://www.sec.gov/rules/proposed/s70306.shtml>.

<sup>4</sup> SEC Release No. 33-8732A, "Executive Compensation and Related Person Disclosure (conforming amendments)," August 29, 2006, available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>; SEC Release No. 33-8765, "Executive Compensation Disclosure," December 22, 2006, available at <http://www.sec.gov/rules/final/2006/33-8765.pdf>.

<sup>5</sup> Division of Corporation Finance Disclosure and Compliance Interpretations, available at <http://www.sec.gov/divisions/corpfm/cfguidance.shtml#regs-k>.

<sup>6</sup> "Staff Observations in the Review of Executive Compensation Disclosure, Division of Corporation Finance," available at <http://www.sec.gov/divisions/corpfm/guidance/execcompdisclosure.htm>.

<sup>7</sup> "Principles Matter," John W. White, Director, Division of Corporation Finance, September 6, 2006, available at <http://www.sec.gov/news/speech/2006/spch090606jww.htm>; "The Principles Matter: Options Disclosure," John W. White, Director, Division of Corporation Finance, September 11, 2006, available at <http://www.sec.gov/news/speech/2006/spch091106jww.htm>; "Principles Matter: Related Person Transactions Disclosure and Disclosure Controls and Procedures," John W. White, Director, Division of Corporation Finance, October 12, 2006, available at <http://www.sec.gov/news/speech/2006/spch101206jww.htm>.

<sup>8</sup> Instruction 2 to Item 402(b) of Regulation S-K states:

The Compensation Discussion and Analysis should be of the information contained in the tables and otherwise disclosed pursuant to this Item. The Compensation Discussion and Analysis should also cover actions regarding executive compensation that were taken after the registrant's last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.

See also, SEC Release No. 8732A, "Executive Compensation and Related Person Disclosure (conforming amendments)," August 29, 2006 ("Commenters also requested clarification as to whether Compensation Discussion and Analysis is limited to compensation for the last fiscal year, like the former Board Compensation Committee Report on Executive Compensation that was required prior to these amendments. While the Compensation Discussion and Analysis must cover this subject, the Compensation Discussion and Analysis may also require discussion of post-termination compensation arrangements, on-going compensation arrangements, and policies that the company will apply on a going-forward basis. Compensation Discussion and Analysis should also cover actions regarding executive compensation that were taken after the last fiscal year's end. Actions that should be addressed might include, as examples only, the adoption or implementation of new or modified programs and policies or specific decisions that were made or steps that were taken that could affect a fair understanding of the named executive officer's compensation for the last fiscal year. Moreover, in some situations it may be necessary to discuss prior years in order to give context to the disclosure provided.").

<sup>9</sup> Symposium on Plain Language: Public Policy and Good Business, Center for Plain Language, October 12, 2007.

<http://www.sec.gov/news/speech/2007/spch100907jww.htm>

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Modified: 10/09/2007

**APPENDIX E-II**

***Interpretation: Commission Guidance Regarding Managements'  
Discussion and Analysis of Financial Condition and Results of  
Operations, SEC Release Nos. 33-8350; 34-48960 (Dec. 29,  
2003)***



## U.S. Securities and Exchange Commission

### **Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Securities and Exchange Commission**

**17 CFR Parts 211, 231 and 241**

**[Release Nos. 33-8350; 34-48960; FR-72]**

**Agency:** Securities and Exchange Commission.

**Action:** Interpretation.

**Summary:** The Commission is publishing interpretive guidance regarding the disclosure commonly known as Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, which is required by Item 303 of Regulation S-K, Items 303(b) and (c) of Regulation S-B, Item 5 of Form 20-F and Paragraph 11 of General Instruction B of Form 40-F. This guidance is intended to elicit more meaningful disclosure in MD&A in a number of areas, including the overall presentation and focus of MD&A, with general emphasis on the discussion and analysis of known trends, demands, commitments, events and uncertainties, and specific guidance on disclosures about liquidity, capital resources and critical accounting estimates.

**Effective Date:** December 29, 2003

**For Further Information Contact:** Questions about specific filings should be directed to staff members responsible for reviewing the documents the registrant files with the Commission. General questions about this release should be referred to Todd Hardiman, Karl Hiller, Nina Mojiri-Azad, Mara Ransom, or Sondra Stokes, Division of Corporation Finance, at (202) 824-5300, Securities and Exchange Commission, 450 5th Street N.W., Washington, D.C. 20549-0401.

#### **Supplementary Information:**

##### **I. Overview**

##### **A. Purpose**

This release interprets requirements for Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A").<sup>1</sup> It provides guidance to assist companies:

- in preparing MD&A disclosure that is easier to follow and understand;  
and

- in providing information that more completely satisfies our previously enunciated principal objectives of MD&A.

We believe that management's most important responsibilities include communicating with investors in a clear and straightforward manner. MD&A is a critical component of that communication. The Commission has long sought through its rules, enforcement actions and interpretive processes to elicit MD&A that not only meets technical disclosure requirements but generally is informative and transparent. We believe and expect that when companies follow the guidance in this release, the overall quality of their MD&A will improve. The Division of Corporation Finance will continue to review MD&A submitted after this guidance is released and take action as appropriate. In addition, we have instructed the Division to keep us apprised of whether this guidance has produced improved disclosure, and to suggest additional Commission action related to MD&A as appropriate.

### **B. Approach to MD&A**

The purpose of MD&A is not complicated. It is to provide readers information "necessary to an understanding of [a company's] financial condition, changes in financial condition and results of operations."<sup>2</sup> The MD&A requirements are intended to satisfy three principal objectives:

- to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management;
- to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
- to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.<sup>3</sup>

MD&A should be a discussion and analysis of a company's business as seen through the eyes of those who manage that business. Management has a unique perspective on its business that only it can present. As such, MD&A should not be a recitation of financial statements in narrative form or an otherwise uninformative series of technical responses to MD&A requirements, neither of which provides this important management perspective. Through this release we encourage each company and its management to take a fresh look at MD&A with a view to enhancing its quality. We also encourage early top-level involvement by a company's management in identifying the key disclosure themes and items that should be included in a company's MD&A.

Based on our experience with many companies' current disclosures in MD&A, we believe there are a number of general ways for companies to enhance their MD&A consistent with its purpose. The recent review experiences of the staff of the Division of Corporation Finance, including its Fortune 500 review,<sup>4</sup> have led us to conclude that additional guidance would be especially useful in the following areas:

- the overall presentation of MD&A;
- the focus and content of MD&A (including materiality, analysis, key

performance measures and known material trends and uncertainties);

- disclosure regarding liquidity and capital resources; and
- disclosure regarding critical accounting estimates.

Therefore, in this release, we emphasize the following points regarding overall presentation:

- within the universe of material information, companies should present their disclosure so that the most important information is most prominent;
- companies should avoid unnecessary duplicative disclosure that can tend to overwhelm readers and act as an obstacle to identifying and understanding material matters; and
- many companies would benefit from starting their MD&A with a section that provides an executive-level overview that provides context for the remainder of the discussion.

We also emphasize the following points regarding focus and content:

- in deciding on the content of MD&A, companies should focus on material information and eliminate immaterial information that does not promote understanding of companies' financial condition, liquidity and capital resources, changes in financial condition and results of operations (both in the context of profit and loss and cash flows);<sup>5</sup>
- companies should identify and discuss key performance indicators, including non-financial performance indicators, that their management uses to manage the business and that would be material to investors;
- companies must identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance;<sup>6</sup> and
- companies should provide not only disclosure of information responsive to MD&A's requirements, but also an analysis that is responsive to those requirements that explains management's view of the implications and significance of that information and that satisfies the objectives of MD&A.

### **C. Impact of Increased Amounts of Information Available to Companies**

Companies have access to and use substantially more detailed and timely information about their financial condition and operating performance than they did when our MD&A requirements initially were introduced or when we last provided general interpretive guidance.<sup>7</sup> Some of this information is itself non-financial in nature, but bears on companies' financial condition and operating performance. The increased availability of information is relevant to companies in preparing MD&A for the following reasons:

- First, companies must evaluate an increased amount of information to determine which information they must disclose. In doing so,

companies should avoid the unnecessary information overload for investors that can result from disclosure of information that is not required, is immaterial, and does not promote understanding.

- Second, in identifying, discussing and analyzing known material trends and uncertainties, companies are expected to consider all relevant information, even if that information is not required to be disclosed.

#### **D. Liquidity and Capital Resources**

We devote a separate section of this release to disclosure in MD&A regarding liquidity and capital resources. In that section, we emphasize the need for attention to disclosure of cash requirements and sources of cash. We believe that:

- companies should consider enhanced analysis and explanation of the sources and uses of cash and material changes in particular items underlying the major captions reported in their financial statements, rather than recitation of the items in the cash flow statements;
- companies using the indirect method<sup>8</sup> in preparing their cash flow statements should pay particular attention to disclosure and analysis of matters that are not readily apparent from their cash flow statements; and
- companies also should consider whether their MD&A should include enhanced disclosure regarding debt instruments, guarantees and related covenants.

#### **E. Critical Accounting Estimates**

Finally, we have included a separate section in this release regarding accounting estimates and assumptions that may be material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change, and that have a material impact on financial condition or operating performance. Companies should consider enhanced discussion and analysis of these critical accounting estimates and assumptions that:

- supplements, but does not duplicate, the description of accounting policies in the notes to the financial statements; and
- provides greater insight into the quality and variability of information regarding financial condition and operating performance.

#### **F. Effect on Prior Commission Statements**

This release does not modify existing legal requirements or create new legal requirements. Rather, we intend this release to assist companies in preparing MD&A by providing interpretive guidance and, in some cases, providing additional guidance in areas that the Commission has addressed previously. We do not believe that the guidance in this release conflicts with prior Commission guidance, nor is it our intention to alter any prior Commission guidance.

## **II. Background**

The following is a chronology of certain prior Commission action regarding MD&A:

1980 — We adopted the present form of the disclosure requirements for MD&A.<sup>9</sup>

1981 — We published the staff's interpretive guidance for MD&A after its review of disclosures that were prepared in accordance with the then-recently adopted disclosure requirements.<sup>10</sup>

1987 — We sought public comment on the adequacy of MD&A and on proposed revisions submitted by members of the professional accounting community.<sup>11</sup>

1989 — We published an interpretive release that addressed a number of disclosure matters that should be considered by companies in preparing MD&A.<sup>12</sup> The 1989 Release provided guidance in various areas, including required prospective information, analysis of long and short-term liquidity and capital resources, material changes in financial statement line items, required interim period disclosure, segment analysis, participation in high-yield financings, highly leveraged transactions or non-investment grade loans and investments, the effects of federal financial assistance upon the operations of financial institutions and the disclosure of preliminary merger negotiations.

December 2001 — As part of its process of reviewing financial and non-financial disclosures made by public companies, the Division of Corporation Finance announced that it would preliminarily review the annual reports filed in 2002 by the Fortune 500 companies, and undertake further review as appropriate, consistent with its selective review program. The focus of the project was to identify "disclosure that appeared to be critical to an understanding of each company's financial position and results, but which, at least on its face, seemed to conflict significantly with generally accepted accounting principles [GAAP] or SEC rules, or to be materially deficient in explanation or clarity."<sup>13</sup> As a result of this review, comment letters, many of which commented on companies' MD&A, were sent to more than 350 of the Fortune 500 companies. Earlier this year, the Division published a summary of the most frequent general areas of comment resulting from this review.<sup>14</sup>

December 2001 — The Commission issued cautionary advice to companies regarding the need for greater investor awareness of the sensitivity of financial statements to the methods, assumptions, and estimates underlying their preparation. This cautionary advice encouraged public companies to include in their MD&A full explanations of their "critical accounting policies," the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions.<sup>15</sup>

January 2002 — After receiving a petition requesting additional MD&A interpretive guidance,<sup>16</sup> we issued a statement "to suggest steps that issuers should consider in meeting their current disclosure obligations with respect to the topics described."<sup>17</sup> The statement provided explicit interpretive guidance on certain MD&A topics considered material to an understanding of companies' operations. The topics addressed by the release were liquidity and capital resources (including off-balance sheet

arrangements), trading activities involving non-exchange traded contracts accounted for at fair value, and relationships and transactions with persons or entities that derive benefits from their non-independent relationships with the company or the company's related parties.<sup>18</sup>

May 2002 — We proposed additional MD&A disclosure requirements, which remain under consideration, regarding the application of companies' critical accounting estimates.<sup>19</sup>

January 2003 — We adopted additional disclosure requirements regarding off-balance sheet arrangements and aggregate contractual obligations.<sup>20</sup> The new rules require the disclosure of off-balance sheet arrangements in a designated section of MD&A and an overview of certain known contractual obligations in a tabular format.<sup>21</sup>

We also have brought numerous enforcement actions based on alleged violations of MD&A requirements and will continue to bring such actions under appropriate circumstances.<sup>22</sup>

Based on recent experiences, we have determined that additional interpretive guidance regarding the requirements of MD&A will be useful to companies in enhancing overall disclosure under MD&A requirements.

### **III. Overall Approach to MD&A**

#### **A. The Presentation of MD&A**

Since the introduction of our MD&A requirements, many companies have become larger, more global and more complex. At the same time, the combination of our rules and investors' demands have led to an increase in the number of subjects and matters addressed in MD&A. For these and other reasons, many companies' MD&A have become necessarily lengthy and complex. Unfortunately, the presentation of the MD&A of too many companies also may have become unnecessarily lengthy, difficult to understand and confusing.

MD&A, like other disclosure, should be presented in clear and understandable language. We understand that complex companies and situations require disclosure of complex matters and we are not in any way seeking over-simplification or "dumbing down" of MD&A. However, we believe that companies can improve the clarity and understandability of their MD&A by using language that is clearer and less convoluted. We believe that efforts by companies to provide clearer and better organized presentations of MD&A can result in more understandable disclosure that does not sacrifice the appropriate level of complexity or nuance. In order to engender better understanding, companies should prepare MD&A with a strong focus on the most important information, provided in a manner intended to address the objectives of MD&A. In particular:

- Companies should consider whether a tabular presentation of relevant financial or other information may help a reader's understanding of MD&A. For example, a company's MD&A might be clearer and more concise if it provides a tabular comparison of its results in different periods, which could include line items and percentage changes as well as other information determined by a company to be useful, followed by a narrative discussion and analysis of known changes, events, trends, uncertainties and other matters. A reader's

understanding of a company's fair value calculations or discounted cash flow figures also could, in some situations, be enhanced by providing a tabular summary of the company's various material interest and discount rate assumptions in one location.

- Companies should consider whether the headings they use assist readers in following the flow of, or otherwise assist in understanding, MD&A, and whether additional headings would be helpful in this regard.
- Many companies' MD&A could benefit from adding an introductory section or overview that would facilitate a reader's understanding. As with all disclosure, what companies would appropriately include in an introduction or overview will depend on the circumstances of the particular company. As a general matter, an introduction or overview should include the most important matters on which a company's executives focus in evaluating financial condition and operating performance and provide the context for the discussion and analysis of the financial statements. Therefore, an introduction or overview should not be a duplicative layer of disclosure that merely repeats the more detailed discussion and analysis that follows.
- While all required information must of course be disclosed, companies should consider using a "layered" approach. Such an approach would present information in a manner that emphasizes, within the universe of material information that is disclosed, the information and analysis that is most important. This presentation would assist readers in identifying more readily the most important information. Using an overview or introduction is one example of a layered approach. Another is to begin a section containing detailed analysis, such as an analysis of period-to-period information, with a statement of the principal factors, trends or other matters that are the principal subjects covered in more detail in the section.

We would expect a good introduction or overview to provide a balanced, executive-level discussion that identifies the most important themes or other significant matters with which management is concerned primarily in evaluating the company's financial condition and operating results. A good introduction or overview would:

- include economic or industry-wide factors relevant to the company;
- serve to inform the reader about how the company earns revenues and income and generates cash;
- to the extent necessary or useful to convey this information, discuss the company's lines of business, location or locations of operations, and principal products and services (but an introduction should not merely duplicate disclosure in the Description of Business section); and
- provide insight into material opportunities, challenges and risks, such as those presented by known material trends and uncertainties, on which the company's executives are most focused for both the short and long term, as well as the actions they are taking to address these opportunities, challenges and risks.

Because these matters do not generally remain static from period to period, we would expect the introduction to change over time to remain current. As

is true with all sections of MD&A, boilerplate disclaimers and other generic language generally are not helpful in providing useful information or achieving balance, and would detract from the purpose of the introduction or overview.

An introduction or overview, by its very nature, cannot disclose everything and should not be considered by itself in determining whether a company has made full disclosure. Further, the failure to include disclosure of every material item in an introduction or overview should not trigger automatically the application of the "buried facts" doctrine, in which a court would consider disclosure to be false and misleading if its overall significance is obscured because material is "buried," such as in a footnote or an appendix.<sup>23</sup>

Throughout MD&A, including in an introduction or overview, discussion and analysis of financial condition and operating performance includes both past and prospective matters. In addressing prospective financial condition and operating performance, there are circumstances, particularly regarding known material trends and uncertainties, where forward-looking information is required to be disclosed. We also encourage companies to discuss prospective matters and include forward-looking information in circumstances where that information may not be required, but will provide useful material information for investors that promotes understanding.

## **B. The Content and Focus of MD&A**

In addition to enhancing MD&A through the use of clearer language and presentation, many companies could improve their MD&A by focusing on the most important information disclosed in MD&A. Disclosure should emphasize material information that is required or promotes understanding and de-emphasize (or, if appropriate, delete) immaterial information that is not required and does not promote understanding.

Our MD&A requirements call for companies to provide investors and other users with material information that is necessary to an understanding of the company's financial condition and operating performance, as well as its prospects for the future.<sup>24</sup> While the desired focus of MD&A for a particular company will depend on the facts and circumstances of the company, some guidance about the content and focus of MD&A is generally applicable.

### **1. Focus on Key Indicators of Financial Condition and Operating Performance**

As discussed, one of the principal objectives of MD&A is to give readers a view of the company through the eyes of management by providing both a short and long-term analysis of the business.<sup>25</sup> To do this, companies should "identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company."<sup>26</sup>

Financial measures generally are the starting point in ascertaining these key variables and other factors. However, financial measures often tell only part of how a company manages its business. Therefore, when preparing MD&A, companies should consider whether disclosure of all key variables and other factors that management uses to manage the business would be material to investors, and therefore required.<sup>27</sup> These key variables and other factors may be non-financial, and companies should consider whether

that non-financial information should be disclosed.

Many companies currently disclose non-financial business and operational data.<sup>28</sup> Academics, authors, and consultants also have researched the types of information, outside of financial statement measures, that would be helpful to investors and other users.<sup>29</sup> Such information may relate to external or macro-economic matters as well as those specific to a company or industry. For example, interest rates or economic growth rates and their anticipated trends can be important variables for many companies. Industry-specific measures can also be important for analysis, although common standards for the measures also are important. Some industries commonly use non-financial data, such as industry metrics and value drivers.<sup>30</sup> Where a company discloses such information, and there is no commonly accepted method of calculating a particular non-financial metric, it should provide an explanation of its calculation to promote comparability across companies within the industry. Finally, companies may use non-financial performance measures that are company-specific.

In addition, if companies disclose material information (historical or forward-looking) other than in their filed documents (such as in earnings releases or publicly accessible analysts' calls or companion website postings) they also should evaluate that material information to determine whether it is required to be included in MD&A, either because it falls within a specific disclosure requirement or because its omission would render misleading the filed document in which the MD&A appears. We are not seeking to sweep into MD&A all the information that a company communicates. Rather, companies should consider their communications and determine what information is material and is required in, or would promote understanding of, MD&A.

Since we adopted the MD&A requirements, and even since the last comprehensive guidance on MD&A we released in 1989, there have been significant advancements in the ability to develop and access information quickly and effectively. Changes in business enterprise systems, communications and other aspects of information technology have significantly increased the amount of information available to management, as well as the speed with which they receive and are able to use information.<sup>31</sup> There is therefore a larger and more up-to-date universe of information, financial and non-financial alike, that companies have and should evaluate in determining whether disclosure is required. This situation presents companies with the challenge of identifying information that is required to be disclosed or that promotes understanding, while avoiding unnecessary information overload for readers by not disclosing a greater body of information, just because it is available, where disclosure is not required and does not promote understanding. Further, with advances in technology contributing to increasing amounts and currency of information, the factors relied upon by companies to operate and analyze the business may change. As this occurs, the discussion in MD&A should change over time to maintain an appropriate focus on material factors.

The focus on key performance indicators can be enhanced not only through the language and content of the discussion, but also through a format that will enhance the understanding of the discussion and analysis. The order of the information need not follow the order presented in Item 303 of Regulation S-K if another order of presentation would better facilitate readers' understanding. MD&A should provide a frame of reference that allows readers to understand the effects of material changes and events and known material trends and uncertainties arising during the periods

being discussed, as well as their relative importance. To satisfy the objectives of MD&A, companies also should provide a balanced view of the underlying dynamics of the business, including not only a description of a company's successes, but also of instances when it failed to realize goals, if material. Good MD&A will focus readers' attention on these key matters.

## 2. Focus on Materiality

Companies must provide specified material information in their MD&A,<sup>32</sup> and they also must provide other material information that is necessary to make the required statements, in light of the circumstances in which they are made, not misleading.<sup>33</sup> MD&A must specifically focus on known material events and uncertainties that would cause reported financial information not to be necessarily indicative of future operating performance or of future financial condition.<sup>34</sup> Companies must determine, based on their own particular facts and circumstances, whether disclosure of a particular matter is required in MD&A. However, the effectiveness of MD&A decreases with the accumulation of unnecessary detail or duplicative or uninformative disclosure that obscures material information.<sup>35</sup> Companies should view this guidance as an opportunity to evaluate whether there is information in their MD&A that is no longer material or useful, and therefore should be deleted, for example where there has been a change in their business or the information has become stale.

As the complexity of business structures and financial transactions increase, and as the activities undertaken by companies become more diverse, it is increasingly important for companies to focus their MD&A on material information. In preparing MD&A, companies should evaluate issues presented in previous periods and consider reducing or omitting discussion of those that may no longer be material or helpful, or revise discussions where a revision would make the continuing relevance of an issue more apparent.

Companies also should focus on an analysis of the consolidated financial condition and operating performance, with segment data provided where material to an understanding of consolidated information. Segment discussion and analysis should be designed to avoid unnecessary duplication and immaterial detail that is not required and does not promote understanding of a company's overall financial condition and operating performance.

Both Instruction 4 to Item 303 of Regulation S-K and the 1989 Release address the requirement of discussion and analysis of changes in line items. A review of current MD&A provided by some companies, however, reveals that this is a portion of MD&A that can include an excessive amount of duplicative disclosure, as well as disclosure of immaterial items that do not promote understanding. The 1989 Release explicitly provides for the grouping of line items for purposes of discussion and analysis in a manner that avoids duplicative disclosure. In addition, Instruction 4 and the guidance in the 1989 Release do not require a discussion of every line item and its changes without regard to materiality. Discussion of a line item and its changes should be avoided where the information that would be disclosed is not material and would not promote understanding of MD&A.

Companies also must assess the materiality of items in preparing disclosure in their quarterly reports. There may be different quantitative and qualitative factors to consider when deciding whether to include certain information in a specific quarterly or annual report. The 1989 Release

addresses some aspects of MD&A disclosure in the context of quarterly filings. That release clarifies that material changes to items disclosed in MD&A in annual reports should be discussed in the quarter in which they occur.<sup>36</sup> There also may be circumstances where an item may not be material in the context of a discussion of annual results of operations but is material in the context of interim results.

Disclosure in MD&A in quarterly reports is complementary to that made in the most recent annual report and in any intervening quarterly reports. Therefore, there may be cases, particularly where adequate disclosure is included in the MD&A in those earlier reports, where further disclosure in a quarterly report is not necessary. If, however, disclosure in those earlier reports does not adequately foreshadow subsequent events, or if new information that impacts known trends and uncertainties becomes apparent in a quarterly period, additional disclosure should be considered and may be required:

### 3. Focus on Material Trends and Uncertainties

One of the most important elements necessary to an understanding of a company's performance, and the extent to which reported financial information is indicative of future results, is the discussion and analysis of known trends, demands, commitments, events and uncertainties. Disclosure decisions concerning trends, demands, commitments, events, and uncertainties generally should involve the:

- consideration of financial, operational and other information known to the company;
- identification, based on this information, of known trends and uncertainties; and
- assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the company's liquidity, capital resources or results of operations.

As we have explained in prior guidance, disclosure of a trend, demand, commitment, event or uncertainty is required unless a company is able to conclude either that it is not reasonably likely that the trend, uncertainty or other event will occur or come to fruition, or that a material effect on the company's liquidity, capital resources or results of operations is not reasonably likely to occur.<sup>37</sup> (In this release we sometimes use the term "known material trends and uncertainties" to describe trends, demands, commitments, events or uncertainties as to which disclosure is required.)

In identifying known material trends and uncertainties, companies should consider the substantial amount of financial and non-financial information available to them, and whether or not the available information itself is required to be disclosed. This information, over time, may reveal a trend or general pattern in activity, a departure or isolated variance from an established trend, an uncertainty, or a reasonable likelihood of the occurrence of such an event that should be disclosed.

One of the principal objectives of MD&A is to provide information about the quality and potential variability of a company's earnings and cash flow, so that readers can ascertain the likelihood that past performance is indicative of future performance. Ascertaining this indicative value depends to a significant degree on the quality of disclosure about the facts and

circumstances surrounding known material trends and uncertainties in MD&A. Quantification of the material effects of known material trends and uncertainties can promote understanding. Quantitative disclosure should be considered and may be required to the extent material if quantitative information is reasonably available.

As discussed in the 1989 Release, the disclosures required to address known material trends and uncertainties in the discussion and analysis should not be confused with optional forward-looking information. Not all forward-looking information falls within the realm of optional disclosure. In particular, material forward-looking information regarding known material trends and uncertainties is required to be disclosed as part of the required discussion of those matters and the analysis of their effects.<sup>38</sup> In addition, forward-looking information is required in connection with the disclosure in MD&A regarding off-balance sheet arrangements.<sup>39</sup>

#### 4. Focus on Analysis

MD&A requires not only a "discussion" but also an "analysis" of known material trends, events, demands, commitments and uncertainties. MD&A should not be merely a restatement of financial statement information in a narrative form. When a description of known material trends, events, demands, commitments and uncertainties is set forth, companies should consider including, and may be required to include, an analysis explaining the underlying reasons or implications, interrelationships between constituent elements, or the relative significance of those matters.

Identifying the intermediate effects of trends, events, demands, commitments and uncertainties alone, without describing the reasons underlying these effects, may not provide sufficient insight for a reader to see the business through the eyes of management. A thorough analysis often will involve discussing both the intermediate effects of those matters and the reasons underlying those intermediate effects. For example, if a company's financial statements reflect materially lower revenues resulting from a decline in the volume of products sold when compared to a prior period, MD&A should not only identify the decline in sales volume, but also should analyze the reasons underlying the decline in sales when the reasons are also material and determinable. The analysis should reveal underlying material causes of the matters described, including for example, if applicable, difficulties in the manufacturing process, a decline in the quality of a product, loss in competitive position and market share, or a combination of conditions.

Similarly, where a company's financial statements reflect material restructuring or impairment charges, or a decline in the profitability of a plant or other business activity, MD&A should also, where material, analyze the reasons underlying these matters, such as an inability to realize previously projected economies of scale, a failure to renew or secure key customer contracts, or a failure to keep downtime at acceptable levels due to aging equipment. Whether favorable or unfavorable conditions constitute or give rise to the material trends, demands, commitments, events or uncertainties being discussed, the analysis should consist of material substantive information and present a balanced view of the underlying dynamics of the business.

If there is a reasonable likelihood that reported financial information is not indicative of a company's future financial condition or future operating performance due, for example, to the levels of subjectivity and judgment

necessary to account for highly uncertain matters and the susceptibility of such matters to change, appropriate disclosure in MD&A should be considered and may be required. For example, if a change in an estimate has a material favorable impact on earnings, the change and the underlying reasons should be disclosed so that readers do not incorrectly attribute the effect to operational improvements. In addition, if events and transactions reported in the financial statements reflect material unusual or non-recurring items, aberrations, or other significant fluctuations, companies should consider the extent of variability in earnings and cash flow, and provide disclosure where necessary for investors to ascertain the likelihood that past performance is indicative of future performance. Companies also should consider whether the economic characteristics of any of their business arrangements, or the methods used to account for them, materially impact their results of operations or liquidity in a structured or unusual fashion, where disclosure would be necessary to understand the amounts depicted in their financial statements.

#### **IV. Liquidity and Capital Resources**

Our rules require companies to provide disclosure in the related categories of liquidity and capital resources.<sup>40</sup> This information is critical to an assessment of a company's prospects for the future and even the likelihood of its survival.<sup>41</sup> A company is required to include in MD&A the following information, to the extent material:

- historical information regarding sources of cash and capital expenditures;
- an evaluation of the amounts and certainty of cash flows;
- the existence and timing of commitments for capital expenditures and other known and reasonably likely cash requirements;
- discussion and analysis of known trends and uncertainties;
- a description of expected changes in the mix and relative cost of capital resources;
- indications of which balance sheet or income or cash flow items should be considered in assessing liquidity; and
- a discussion of prospective information regarding companies' sources of and needs for capital, except where otherwise clear from the discussion.<sup>42</sup>

Discussion and analysis of this information should be considered and may be required to provide a clear picture of the company's ability to generate cash and to meet existing and known or reasonably likely future cash requirements.

In determining required or appropriate disclosure, companies should evaluate separately their ability to meet upcoming cash requirements over both the short and long term.<sup>43</sup> Merely stating that a company has adequate resources to meet its short-term and/or long-term cash requirements is insufficient unless no additional more detailed or nuanced information is material. In particular, such a statement would be insufficient if there are any known material trends or uncertainties related to cash flow, capital resources, capital requirements, or liquidity.

## **A. Cash Requirements**

In order to identify known material cash requirements, companies should consider whether the following information would have a material impact on liquidity (discussion of immaterial matters, and especially generic disclosure or boilerplate, should be avoided):

- funds necessary to maintain current operations, complete projects underway and achieve stated objectives or plans;
- commitments for capital or other expenditures;<sup>44</sup> and
- the reasonably likely exposure to future cash requirements associated with known trends or uncertainties, and an indication of the time periods in which resolution of the uncertainties is anticipated.

One starting point for a company's discussion and analysis of cash requirements is the tabular disclosure of contractual obligations,<sup>45</sup> supplemented with additional information that is material to an understanding of the company's cash requirements.<sup>46</sup>

For example, if a company has incurred debt in material amounts, it should explain the reasons for incurring that debt and the use of the proceeds, and analyze how the incurrence of that debt fits into the overall business plan, in each case to the extent material.<sup>47</sup> Where debt has been incurred for general working capital purposes, the anticipated amount and timing of working capital needs should be discussed, to the extent material.<sup>48</sup>

Companies should address, where material, the difficulties involved in assessing the effect of the amount and timing of uncertain events, such as loss contingencies, on cash requirements and liquidity. Any such discussion should be specific to the circumstances and informative, and companies should avoid generic or boilerplate disclosure. In addition, because of these difficulties and uncertainties, companies should consider whether they need to make or change disclosure in connection with quarterly as well as annual reports.

## **B. Sources and Uses of Cash**

As with the discussion and analysis of the results of operations, a company's discussion and analysis of cash flows should not be a mere recitation of changes and other information evident to readers from the financial statements. Rather, MD&A should focus on the primary drivers of and other material factors necessary to an understanding of the company's cash flows and the indicative value of historical cash flows.

In addition to explaining how the cash requirements identified in MD&A fit into a company's overall business plan, the company should focus on the resources available to satisfy those cash requirements. Where there has been material variability in historical cash flows, MD&A should focus on the underlying reasons for the changes, as well as on their reasonably likely impact on future cash flows and cash management decisions. Even where reported amounts of cash provided and used by operations, investing activities or financing have been consistent, if the underlying sources of those cash flows have materially varied, analysis of that variability should be provided. The discussion and analysis of liquidity should focus on material changes in operating, investing and financing cash flows, as

depicted in the statement of cash flows, and the reasons underlying those changes.

### 1. Operations

The discussion and analysis of operating cash flows should not be limited by the manner of presentation in the statement of cash flows.<sup>49</sup> Alternate accounting methods of deriving and presenting cash flows exist, and while they generally yield the same numeric result in the major captions, they involve the disclosure of different types of information. When preparing the discussion and analysis of operating cash flows, companies should address material changes in the underlying drivers (e.g. cash receipts from the sale of goods and services and cash payments to acquire materials for manufacture or goods for resale), rather than merely describe items identified on the face of the statement of cash flows, such as the reconciling items used in the indirect method of presenting cash flows.<sup>50</sup>

For example, consider a company that reports an overall increase in the components of its working capital other than cash<sup>51</sup> with the effect of having a material decrease in net cash provided by operations in the current period. If the increase in working capital was driven principally by an increase in accounts receivable that is attributable not to an increase in sales, but rather to a revised credit policy resulting in an extended payment period for customers, these facts would need to be addressed in MD&A to the extent material, along with the resulting decrease in cash provided by operations, if not otherwise apparent. In addition, if there is a material trend or uncertainty, the impact of the new credit policy on cash flows from operations should be disclosed.<sup>52</sup> While a cash flow statement prepared using the indirect method would report that various individual components of working capital increased or decreased during the period by a specified amount, it would not provide a sufficient basis for a reader to analyze the change. If the company reports negative cash flows from operations, the disclosure provided in MD&A should identify clearly this condition, discuss the operational reasons for the condition if material, and explain how the company intends to meet its cash requirements and maintain operations. If the company relies on external financing in these situations, disclosure of that fact and the company's assessment of whether this financing will continue to be available, and on what terms, should be considered and may be required.

A company should consider whether, in order to make required disclosures, it is necessary to expand MD&A to address the cash requirements of and the cash provided by its reportable segments or other subdivisions of the business, including issues related to foreign subsidiaries, as well as the indicative nature of those results.<sup>53</sup> A company also should discuss the effect of an inability to access the cash flow and financial assets of any consolidated entities. For example, an entity may be consolidated but, because the company lacks sufficient voting interests or the assets are legally isolated, the company may be unable to utilize the entity's cash flow, cash on hand, or other assets to satisfy its own liquidity needs.

### 2. Financing

To the extent material, a company must provide disclosure regarding its historical financing arrangements and their importance to cash flows, including, to the extent material, information that is not included in the financial statements. A company should discuss and analyze, to the extent material:

- its external debt financing;
- its use of off-balance sheet financing arrangements;
- its issuance or purchase of derivative instruments linked to its stock;
- its use of stock as a form of liquidity; and
- the potential impact of known or reasonably likely changes in credit ratings or ratings outlook (or inability to achieve changes).

In addition to these historical items, discussion and analysis of the types of financing that are, or that are reasonably likely to be, available (or of the types of financing that a company would want to use but that are, or are reasonably likely to be, unavailable) and the impact on the company's cash position and liquidity, should be considered and may be required. For example, where a company has decided to raise or seeks to raise material external equity or debt financing, or if it is reasonably likely to do so in the future, discussion and analysis of the amounts or ranges involved, the nature and the terms of the financing, other features of the financing and plans, and the impact on the company's cash position and liquidity (as well as results of operations in the case of matters such as interest payments) should be considered and may be required.<sup>54</sup>

### **C. Debt Instruments, Guarantees and Related Covenants**

There are at least two scenarios in which companies should consider whether discussion and analysis of material covenants related to their outstanding debt (or covenants applicable to the companies or third parties in respect of guarantees or other contingent obligations)<sup>55</sup> may be required.<sup>56</sup>

First, companies that are, or are reasonably likely to be, in breach of such covenants<sup>57</sup> must disclose material information about that breach and analyze the impact on the company if material. That analysis should include, as applicable and to the extent material:

- the steps that the company is taking to avoid the breach;
- the steps that the company intends to take to cure, obtain a waiver of or otherwise address the breach;
- the impact or reasonably likely impact of the breach (including the effects of any cross-default or cross-acceleration or similar provisions) on financial condition or operating performance; and
- alternate sources of funding to pay off resulting obligations or replace funding.

Second, companies should consider the impact of debt covenants on their ability to undertake additional debt or equity financing. Examples of these covenants include, but are not limited to, debt incurrence restrictions, limitations on interest payments, restrictions on dividend payments and various debt ratio limits. If these covenants limit, or are reasonably likely to limit, a company's ability to undertake financing to a material extent, the company is required to discuss the covenants in question and the consequences of the limitation to the company's financial condition and operating performance. Disclosure of alternate sources of funding and, to

the extent material, the consequences (including but not limited to the cost) of accessing them should also be considered and may be required.

#### **D. Cash Management**

Companies generally have some degree of flexibility in determining when and how to use their cash resources to satisfy obligations and make other capital expenditures. MD&A should describe known material trends or uncertainties relating to such determinations. For example, a decision by a company in a highly capital-intensive business to spend significantly less on plant and equipment than it has historically may result in long-term effects that should be disclosed if material. Material effects could include more cash, less interest expense and lower depreciation, but higher future repair and maintenance expenses or a higher cost base than the company would otherwise have.

#### **V. Critical Accounting Estimates**

Many estimates and assumptions involved in the application of GAAP have a material impact on reported financial condition and operating performance and on the comparability of such reported information over different reporting periods. Our December 2001 Release reminded companies that, under the existing MD&A disclosure requirements, a company should address material implications of uncertainties associated with the methods, assumptions and estimates underlying the company's critical accounting measurements.<sup>58</sup> In May 2002 we proposed rules, which remain under consideration, that would broaden the scope of disclosures beyond those currently required.<sup>59</sup>

When preparing disclosure under the current requirements, companies should consider whether they have made accounting estimates or assumptions where:

- the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimates and assumptions on financial condition or operating performance is material.

If so, companies should provide disclosure about those critical accounting estimates or assumptions in their MD&A.

Such disclosure should supplement, not duplicate, the description of accounting policies that are already disclosed in the notes to the financial statements. The disclosure should provide greater insight into the quality and variability of information regarding financial condition and operating performance. While accounting policy notes in the financial statements generally describe the method used to apply an accounting principle, the discussion in MD&A should present a company's analysis of the uncertainties involved in applying a principle at a given time or the variability that is reasonably likely to result from its application over time.

A company should address specifically why its accounting estimates or assumptions bear the risk of change. The reason may be that there is an uncertainty attached to the estimate or assumption, or it just may be

difficult to measure or value. Equally important, companies should address the questions that arise once the critical accounting estimate or assumption has been identified, by analyzing, to the extent material, such factors as how they arrived at the estimate, how accurate the estimate/assumption has been in the past, how much the estimate/assumption has changed in the past, and whether the estimate/assumption is reasonably likely to change in the future. Since critical accounting estimates and assumptions are based on matters that are highly uncertain, a company should analyze their specific sensitivity to change, based on other outcomes that are reasonably likely to occur and would have a material effect. Companies should provide quantitative as well as qualitative disclosure when quantitative information is reasonably available and will provide material information for investors.

For example, if reasonably likely changes in the long-term rate of return used in accounting for a company's pension plan would have a material effect on the financial condition or operating performance of the company, the impact that could result given the range of reasonably likely outcomes should be disclosed and, because of the nature of estimates of long-term rates of return, quantified.

### **Amendments to the Codification of Financial Reporting Policies**

The "Codification of Financial Reporting Policies" announced in Financial Reporting Release 1 (April 15, 1982) [47 FR 21028] is updated:

1. By adding to the following new sections to the Financial Reporting Codification from the release:

(III) Overall Approach to MD&A

(IV) Liquidity and Capital Resources

(V) Critical Accounting Estimates

2. By revising the footnotes from those sections of the release which contain a short form citation to include the complete citation form rather than the short form.

3. By renumbering the footnotes from those sections of the release to run in the Financial Reporting Codification consecutively from number 1 through number 37.

The Codification is a separate publication of the Commission. It will not be published in the Code of Federal Regulations System.

#### *List of Subjects*

17 CFR Part 211, 231 and 241

Securities.

### **Amendments to the Code of Federal Regulations.**

For the reasons set forth above, the Commission is amending title 17, chapter II of the Code of Federal Regulations as set forth below:

**PART 211 — INTERPRETATIONS RELATING TO FINANCIAL REPORTING MATTERS**

1. Part 211, Subpart A, is amended by adding Release No. FR-72 and the release date of December 19, 2003 to the list of interpretive releases.

**PART 231 — INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER**

2. Part 231 is amended by adding Release No. 33-8350 and the release date of December 19, 2003 to the list of interpretive releases.

**PART 241 — INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER**

3. Part 241 is amended by adding Release No. 34-48960 and the release date of December 19, 2003 to the list of interpretive releases.

By the Commission.

Margaret H. McFarland  
Deputy Secretary

Dated: December 19, 2003

**Endnotes**

<sup>1</sup> The requirements are set forth in Item 303 of Regulation S-K (Management's Discussion & Analysis of Financial Condition and Results of Operations) [17 CFR 229.303], Items 303(b) and (c) of Regulation S-B (Management's Discussion & Analysis of Financial Condition and Results of Operations, and Off-balance sheet arrangements) [17 CFR 228.303(b) and (c)], Item 5 of Form 20-F (Operating and Financial Review and Prospects) [17 CFR 249.220f], and General Instruction B.(11) of Form 40-F (Off-balance sheet arrangements) [17 CFR 249.240f].

Although the wording of the MD&A requirement in Form 20-F was revised in 1999, the Commission's adopting release noted that we interpret that Item as calling for the same disclosure as Item 303 of Regulation S-K. See Release No. 33-7745 (Sept. 28, 1999) [64 FR 53900 at 59304]. In addition, Instruction 1 to Item 5 in Form 20-F provides that issuers should refer to the Commission's 1989 interpretive release on MD&A disclosure under Item 303 of Regulation S-K (Interpretive Release: Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Release No. 33-6835 (May 18, 1989) [54 FR 22427] (the "1989 Release")) for guidance in preparing the discussion and analysis by management of the company's financial condition and results of operations required in Form 20-F. Therefore, although this release refers primarily to Item 303 of Regulation S-K, it also is intended to apply to MD&A drafted pursuant to Item 5 of Form 20-F.

In addition, the guidance in this release applies to small business issuers that are subject to the disclosure requirements of Items 303(b) and (c) of Regulation S-B. Small business issuers, like all other companies subject to SEC reporting obligations, should consider the interpretive guidance based

on their own particular facts and circumstances.

<sup>2</sup> Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

<sup>3</sup> See Commission Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33-8056 (Jan. 22, 2002) [67 FR 3746] ("January 2002 Release").

<sup>4</sup> See Summary by the Division of Corporation Finance of Significant Issues Addressed in the Review of the Periodic Reports of the Fortune 500 Companies (Feb. 27, 2003) ("Fortune 500 Summary") available at [www.sec.gov/divisions/corpfin/fortune500rep.htm](http://www.sec.gov/divisions/corpfin/fortune500rep.htm).

<sup>5</sup> In this release we sometimes use the term "financial condition and operating performance" to refer to the required subjects of MD&A of financial condition, liquidity and capital resources, changes in financial condition and results of operations (both in the context of profit and loss and cash flows).

<sup>6</sup> Note 27 to the 1989 Release states, "MD&A mandates disclosure of specified forward-looking information, and specifies its own standards for disclosure — i.e., reasonably likely to have a material effect. The specific standard governs the circumstances in which Item 303 requires disclosure. The probability/magnitude test for materiality approved by the Supreme Court in *Basic v. Levinson*, 108 S.Ct. 978 (1988), is inapposite to Item 303 disclosure."

<sup>7</sup> See, e.g., *Improving Business Reporting — A Customer Focus; Meeting the Information Needs of Investors and Creditors*, Comprehensive Report of the Special Committee on Financial Reporting, American Institute of Certified Public Accountants (AICPA) (1994) ("Jenkins Report").

<sup>8</sup> In Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 95, *Statement of Cash Flows* (Nov. 1987), the FASB allowed the indirect method of reporting net cash flow from operating activities by adjusting net income to reconcile it to net cash flow from operating activities. Under that method, the major classes of operating cash receipts and payments are determined indirectly by determining the change in asset and liability accounts that relate to operating income. However, in SFAS 95, the FASB encouraged companies to use the direct method of reporting net cash flow from operating activities rather than the indirect method. The direct method reports net cash flow from operations by summing major classes of gross cash receipts, such as customer payments, and gross cash payments, such as cash paid to employees. The direct method also requires a reconciliation of net income to net cash flow from operating activities. The FASB gave its opinion that the direct method is "the more comprehensive and presumably more useful approach."

While this release refers primarily to U.S. GAAP, the underlying events and circumstances described in the release ordinarily will be applicable to foreign private issuers and should be discussed to the extent material. Consistent with the Instructions to Form 20-F, however, companies using that form should focus on the primary financial statements in their discussion and analysis in Item 5 (Operative and Financial Review Prospects). Also, companies are required to discuss in Item 5 of Form 20-F any aspects of the differences between foreign and U.S. GAAP that they

believe are necessary for an understanding of the financial statements as a whole. See Instruction 2 to Item 5 of Form 20-F [17 CFR 249.220f].

<sup>9</sup> Final Rule: Amendments to Annual Report Form, Related Forms, Rules, Regulations, and Guides; Integration of Securities Acts Disclosure Systems, Release No. 33-6231 (Sept. 2, 1980) [45 FR 63630].

<sup>10</sup> Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 33-6349 (Sept. 28, 1981) 23 SEC Docket 962 [Release not published in the Federal Register].

<sup>11</sup> Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, Release No. 33-6711 (April 24, 1987) [52 FR 13715].

<sup>12</sup> 1989 Release.

<sup>13</sup> Fortune 500 Summary.

<sup>14</sup> *Id.*

<sup>15</sup> Cautionary Advice Regarding Disclosure About Critical Accounting Policies, Release No. 33-8040 (Dec. 12, 2001) [66 FR 65013] ("December 2001 Release").

<sup>16</sup> On December 31, 2001 the Commission received a petition from Arthur Andersen LLP, Deloitte and Touche, LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP. The American Institute of Certified Public Accountants endorsed the petition. A copy of the petition is available at [www.sec.gov/rules/petitions/petndiscl\\_12312001.htm](http://www.sec.gov/rules/petitions/petndiscl_12312001.htm).

<sup>17</sup> See January 2002 Release.

<sup>18</sup> *Id.*

<sup>19</sup> Proposed Rule: Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies, Release No. 33-8098 (May 10, 2002) [67 FR 35620] ("2002 Critical Accounting Policies Proposal").

<sup>20</sup> Final Rule: Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements and Aggregate Contractual Obligations, Release No. 33-8182 (Jan. 28, 2003) [68 FR 5982] ("2003 Off-Balance Sheet Release").

The overall guidance in this Interpretive Release is applicable to all MD&A discussions, including those related to off-balance sheet arrangements. As such, it should be applied to General Instruction B.(11) of Form 40-F and Item 303(c) of Regulation S-B, in addition to the other sections set out in note 1, above. We are not addressing specifically disclosures of off-balance sheet arrangements in this release, however, because we have little experience with companies' application of the new rules, which are effective for companies' registration statements, annual reports and proxy or information statements that are required to include financial statements for their fiscal years ending on or after June 15, 2003. Companies (other than small business issuers) must include the table of contractual obligations in

registration statements, annual reports, and proxy or information statements that are required to include financial statements for the fiscal years ending on or after December 15, 2003. In addition, Section 401(c) of the Sarbanes-Oxley Act requires us to complete a study and report to the President and Congress next year on these types of disclosures.

<sup>21</sup> The tabular disclosure is not required for small business issuers by Item 303 of Regulation S-B.

<sup>22</sup> See, e.g., *In the Matter of Edison Schools, Inc.*, Release No. 34-45925 (May 14, 2002); *In the Matter of Sony Corporation and Sumio Sano*, Release No. 34-40305 (Aug. 5, 1998); *In the Matter of Bank of Boston Corp.*, Initial Decision Release No. 81 (Dec. 22, 1995); *In the Matter of Gibson Greetings, Inc., Ward A. Cavanaugh, and James H. Johnsen*, Release No. 34-36357 (Oct. 11, 1995); *In the Matter of America West Airlines, Inc.*, Release No. 34-34047 (May 12, 1994); *In the Matter of Salant Corporation and Martin F. Tynan*, Release No. 34-34046 (May 12, 1994); *In the Matter of Shared Medical Systems Corporation*, Release No. 34-33632 (Feb. 17, 1994); *In the Matter of Caterpillar Inc.*, Release No. 34-30532 (Mar. 31, 1992); *In the Matter of American Express Company*, Release No. 34-23332 (June 17, 1986).

<sup>23</sup> See, e.g., Final Rule: Plain English Disclosure, Release No. 33-7497 (Jan. 28, 1998) [63 FR 6370 at 6375] (*citing Gould v. American Hawaiian Steamship Company*, 331 F. Supp. 981 (D. Del. 1971); *Kohn v. American Metal Climax, Inc.*, 322 F. Supp. 1331 (E.D. Pa. 1970), *modified*, 458 F.2d 255 (3d Cir. 1972).)

<sup>24</sup> See 1989 Release, Part III.A.

<sup>25</sup> See, e.g., Release No. 33-6711 (Apr. 24, 1987) [52 FR 13715 at 13717] ("an opportunity to look at the company through the eyes of management by providing both a short and long-term analysis of the business of the company.").

<sup>26</sup> 1989 Release, Part III.A (*citing* Release No. 33-6349 (Sept. 28, 1981) 23 SEC Docket 962 at 964 [Release not published in the Federal Register]).

<sup>27</sup> Examples of such other factors, depending on the circumstances of a particular company, can include manufacturing plant capacity and utilization, backlog, trends in bookings and employee turnover rates. See, e.g., *Quality, Transparency, Accountability*, Lynn E. Turner, Chief Accountant, Securities and Exchange Commission, Remarks before Financial Executives Institute (Apr. 26, 2001), available at [www.sec.gov/news/speech/spch485.htm](http://www.sec.gov/news/speech/spch485.htm).

Companies should also consider disclosing information that may be peripheral to the accounting function, but is integral to the business or operating activity. Examples of such measures, depending on the circumstances of a particular company, can include those based on units or volume, customer satisfaction, time-to-market, interest rates, product development, service offerings, throughput capacity, affiliations/joint undertakings, market demand, customer/vendor relations, employee retention, business strategy, changes in the managerial approach or structure, regulatory actions or regulatory environment, and any other pertinent macroeconomic measures. Because these measures are generally non-financial in nature, we do not believe that their disclosure generally will

raise issues under Item 10(e) of Regulation S-K [17 CFR 229.10(e)] or Item 10(h) of Regulation S-B [17 CFR 228.10(h)].

<sup>28</sup> See *Improving Business Reporting: Insights into Enhancing Voluntary Disclosures*, Steering Committee Report of the Business Reporting Research Project of the FASB (2001) available at [www.fasb.org](http://www.fasb.org); the Jenkins Report; Financial Accounting Series Special Report, *Business and Financial Reporting, Challenges from the New Economy* (FASB) (2001) ("Special Report on Improving Business Reporting").

<sup>29</sup> See Special Report on Improving Business Reporting.

<sup>30</sup> See, e.g., the Jenkins Report; the Special Report on Improving Business Reporting.

<sup>31</sup> See the Jenkins Report.

<sup>32</sup> See, e.g., Item 303(a)(1) of Regulation S-K [17 CFR 229.303(a)(1)] (requiring the identification of "known trends or known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way"). See also Item 303(a)(2)(i) of Regulation S-K [17 CFR 229.303(a)(2)(i)] (requiring a description of registrant's material commitments for capital expenditures).

<sup>33</sup> See Securities Act Rule 408 [17 CFR 230.408], Securities Exchange Act of 1934 Section 10(b) [15 U.S.C. §78j(b)], Exchange Act Rule 10b-5 [17 CFR 240.10b-5], and Exchange Act Rule 12b-20 [17 CFR 240.12b-20]. See also, *In the Matter of Edison Schools, Inc.*, Release No. 34-45925 (May 14, 2002) (finding, among other things, that the company failed to provide accurate and complete disclosure about its reported revenues); *In the Matter of Sony Corporation and Sumio Sano*, Release No. 34-40305 (Aug. 5, 1998) (finding that the company violated Section 13(a) of the Exchange Act by making inadequate disclosures about the nature and the extent of Sony Pictures' net losses and their impact on the consolidated results Sony was reporting); *In the Matter of Caterpillar Inc.*, Release No. 34-30532 (Mar. 31, 1992) (finding failure to disclose the impact of a subsidiary's foreign operations on the company's results of operations violated Section 13(a) of the Exchange Act).

<sup>34</sup> Instruction 3 to Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

<sup>35</sup> See, e.g., Instruction 4 to Item 303(a) of Regulation S-K (indicating that repetition and line-by-line analysis is not required nor is it appropriate when the causes for a change in one line item also relate to other line items and indicating that, to the extent the changes from year to year are readily computable from the financial statements, the changes need not be recited in the discussion). The 1989 Release also addressed these points directly. See 1989 Release, Part III.D.

Where companies believe that information from the face of financial statements is helpful to readers in MD&A, they should consider using a tabular presentation that shows the decimal percentages of components or year-over-year percentage changes of the financial statement line items. An appropriate analysis of this data, to the extent that it is material, should accompany the tabular presentation consistent with the guidance in Section III.B.3 of this Release.

<sup>36</sup> See 1989 Release, Part III.E.

<sup>37</sup> See January 2002 Release at 3748 ("two assessments management must make where a trend, demand, commitment, event or uncertainty is known: 1. Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required. 2. If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur" (citing the 1989 Release)).

<sup>38</sup> See 1989 Release, Part III.B.

<sup>39</sup> In connection with our adoption of the off-balance sheet arrangements disclosure requirements, we eliminated a portion of the instructions in Item 303 of Regulation S-K that stated that registrants were not required to provide forward-looking information. Deleting that portion of the instructions did not affect requirements to provide forward-looking information in other circumstances where required or reduce the availability of any safe harbor for forward-looking information. See also 2003 Off-Balance Sheet Release. See Securities Act Section 27A [15 U.S.C. §77z-2], Securities Act Rule 175 [17 CFR 230.175], Exchange Act Section 21E [17 U.S.C. §78u-5], and Exchange Act Rule 3b-6 [17 CFR 240.3b-6].

<sup>40</sup> See Item 303(a)(1) and (2) of Regulation S-K [17 CFR 229.303(a)(1) and (2)].

<sup>41</sup> See January 2002 Release; 2003 Off-Balance Sheet Release.

<sup>42</sup> See 1989 Release, Part III.C. See also Item 303(a)(1) and (2) of Regulation S-K [17 CFR 229.303(a)(1) and (2)], and Instructions 2 and 5 thereto.

<sup>43</sup> Short-term liquidity is defined as a period of twelve months or less and long-term is defined as a period in excess of twelve months. See 1989 Release, Part III.C. Note that the period of time over which a long-term discussion of liquidity is relevant is dependent upon the timing of the cash requirements of a company, as well as the period of time over which cash flows are managed. A vague reference to periods in excess of twelve months may not be sufficient.

<sup>44</sup> See Item 303(a)(2)(i) of Regulation S-K [17 CFR 229.303(a)(2)(i)].

<sup>45</sup> See Item 303(a)(5) of Regulation S-K [17 CFR 229.303(a)(5)].

<sup>46</sup> For example, the cash requirements for items such as interest, taxes or amounts to be funded to cover post-employment (including retirement) benefits may not be included in the tabular disclosure, but should be discussed if material.

<sup>47</sup> For example, debt may have been issued to fund the construction of a new plant, which will allow the company to expand its operations into a specific geographic area. Understanding that relationship and the expected

commencement date of plant operations puts the cash requirement for the debt into an appropriate context to understand liquidity.

<sup>48</sup> Companies are reminded of their related disclosure obligations under Item 504 (Use of Proceeds) of Regulation S-K [17 CFR 229.504] and the requirement to update this disclosure in Item 701(f) (Use of Proceeds) of Regulation S-K [17 CFR 229.701(f)].

<sup>49</sup> See Instruction 4 to Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

<sup>50</sup> See SFAS No. 95.

<sup>51</sup> Working capital is defined as current assets less current liabilities. See Chapter 3, AICPA Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins* (June 1953).

<sup>52</sup> To the extent that this change also materially impacts results of operations, discussion and analysis would also be required in that section, but companies should attempt to avoid unnecessary or confusing duplication.

<sup>53</sup> See Item 303(a) of Regulation S-K [17 CFR 229.303(a)].

<sup>54</sup> We believe that disclosure satisfying the requirements of MD&A can be made consistently with the restrictions of Section 5 of the Securities Act. See, e.g., Securities Act Rules 135c [17 CFR 230.135c].

<sup>55</sup> See FASB Interpretation No. (FIN) 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (Nov. 2002); 2003 Off-Balance Sheet Release; and the discussion *infra*, regarding off-balance sheet arrangements.

<sup>56</sup> See *In the Matter of America West Airlines, Inc.*, Release No. 34-34047 (May 12, 1994) (finding that the company failed to discuss uncertainties regarding its ability to comply with covenants).

<sup>57</sup> Companies also must take a similar approach to discussion and analysis with respect to mandatory prepayment provisions, "put" rights and other similar provisions.

<sup>58</sup> December 2001 Release.

<sup>59</sup> See 2002 Critical Accounting Policies Proposal.

<http://www.sec.gov/rules/final/33-8350.htm>

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Modified: 12/19/2003

**APPENDIX E-III**

**John W. White, *Executive Compensation Disclosure and the Important Role of CFOs*, Remarks Before the CFO Executive Board (Oct. 3, 2006)**



## U.S. Securities and Exchange Commission

### **Speech by SEC Staff: Executive Compensation Disclosure and the Important Role of CFO's**

*by*

**John W. White**

*Director, Division of Corporation Finance  
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CFO Executive Board  
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Thank you Silvio. I am very pleased to be here today at this dinner meeting of members from the CFO Executive Board. I very much appreciate your giving me a bit of your time to talk with you about an area of considerable current interest at the SEC — executive compensation disclosure. As I will explain in a moment, I am particularly focused this evening on the fact that each of you is the principal financial officer (as our rules at the SEC refer to you)<sup>1</sup> of a major public company, and I am hoping executive compensation disclosure is an area of interest for each of you. I certainly think it should be — perhaps even more so than you've realized thus far. CFO's play a very important role in America's businesses and in fact to our economy as a whole, as I have no doubt you all appreciate. The Commission's executive compensation disclosure rules also acknowledge this fact in multiple ways, as I will try to explain.

Before I go any further into my remarks, however, I need to share with you all the so-called "standard disclaimer" that applies to SEC staff remarks. As a matter of policy the SEC disclaims responsibility for any private comments or speeches from its staff. You should understand that my remarks this evening represent only my own views and not necessarily those of the Commission or of other members of the staff.

So my topic this evening is the Commission's recently adopted and significantly revised rules for executive compensation disclosure. The Commission adopted these final rules at an open meeting on July 26, 2006, and in the intervening two months, I have already had the opportunity to spend many hours addressing various groups of lawyers, compensation specialists, management, and last week even directors about what they should expect from the new rules and what the rules will be expecting of them. It is very important to me, and to the Commission, that all the necessary players are on board and on the team as these new rules go into effect for the next proxy season. All of you — as chief or principal financial officers — have a special place in that mix. Tonight, I would like to lay out briefly for you where I see some of the key intersections between the new rules and your own positions as CFO's.

First, however, I need to make one thing very clear and to delineate the SEC's role and place from various other voices that are being heard increasingly loudly about executive compensation. I have already used the word "disclosure" a couple of times this evening, and I really want to emphasize that the Commission's new rules are all about disclosure. I believe the Commission and its staff take very seriously the charge — as our Chairman, Chris Cox, has made clear<sup>2</sup> — that the Commission is not in the business of setting executive compensation. Not even in subtle ways. Nor is the Commission in the business of judging companies or boards about the decisions they make in this area. The Commission is, however, strongly committed to helping investors get the information they need (through required disclosures for public companies) about executive compensation so that shareholders and investors can judge that, how ever they choose and react how ever they like.

I also believe that the Commission is quite genuinely not trying to judge, change or affect the compensation of anyone in this room. That does not mean, of course, that our new rules will not have a substantial effect on all of you and on your colleagues in your companies' executive suites. I believe they will. I would like to look at three specific ways in which you can (and should, in my view) be involved in all of this:

1. Your involvement in the substance of your company's disclosure, particularly the new Compensation Discussion & Analysis;
2. Your involvement in refining and adjusting your company's disclosure controls and procedures; and
3. Your involvement with your board's compensation committee and its new Compensation Committee Report

### **CFO's and the Substance of Executive Compensation Disclosure**

So first of all, the substance of the new rules. I have no intention of getting into the weeds and taking you through the details of required disclosure going forward. I know you all have many others to help you on that score and who will be at the front lines for your companies in compiling the necessary information and preparing the company's disclosure. But there is one key point that you all should know — under the new rules, companies will be required to include disclosure in their proxy statements about their CFO's compensation. This is new, and it is irrelevant how much or how little any of you might make.

The old rules required compensation disclosure about the CEO (as a category) and the four other most highly compensated executives, calculated based on salary and bonus. The new rules, which become effective in December and for most of you will apply to your next proxy statement — will require disclosure about the compensation of the CEO and the CFO (by titles, or categories) as well as the next three most highly compensated executives. Under the new rules, the amount of compensation used to calculate the three highest is based on *everything* with a few limited exceptions. Importantly it is not just salary and bonus. So this figure includes the dollar value of option grants, the value of perquisites, and numerous other types of awards.

And if this thought horrifies you, please understand you won't be spared even by giving up your title or quitting your job. Disclosure will be required

about anyone who served as the CFO, or CEO, during any part of the year. And if you should leave, any severance you receive will be included in your compensation disclosure.

The release the SEC put out with its new rules is entitled "Executive Compensation and Related Person Disclosure" and covers substantially more than proxy disclosures of executive compensation (although that's critically important and is the central topic of the rulemaking). Just as a quick overview and summary, the final adopted rules cover:

- executive compensation disclosure, including, among other things,
  - new tabular disclosure (with a single compensation total)
  - a new Compensation Discussion & Analysis section, which I will turn to in just a minute
  - perquisites guidance
  - disclosure about post-termination (retirement or otherwise) or change-in-control payments
- disclosure of related party transactions
- disclosures about the compensation committee, about director independence determinations and other related corporate governance matters
- director compensation disclosure
- disclosure about security ownership of management and directors, including shares pledged by management
- new rules and guidance about disclosures of stock option grants and option grant programs, plans and practices

I'd be happy at the end of my remarks to talk about any of this in more detail if you have any questions. I also hope that perhaps some of you will be newly motivated after I stop talking to make sure someone at your company or on your team keeps talking and fills you in on what you should know and what you want to know.

### **Compensation Discussion & Analysis (CD&A)**

I do want to make one other last point under this broad "substance" umbrella. You may have heard that proxy statements under the new rules will be required to include a new "Compensation Discussion & Analysis", or CD&A, section. That section will also be deemed "filed" and will be incorporated into your company's annual reports on Form 10-K (more on the significance of that in a moment).

The new CD&A section is at the heart of the Commission's new rules. Given your CFO perspective, I know you are already very familiar with MD&A, or Management's Discussion & Analysis. CD&A will bear many similarities to MD&A, albeit covering a different subject matter. In the most summary terms, CD&A is designed to be a principles-based overview explaining — that is, "discussing and analyzing", or the "D&A" part — the policies and decisions related to executive compensation. And as CFO's, you should

particularly appreciate the meaning of principles-based disclosure, as it is not only central to MD&A but is also a close relative of the principles-based standards that are so much in focus lately in the accounting and financial reporting worlds.

The principles-based theme is critical to our recent rulemaking and one which I have been stressing in other forums when speaking on this topic and trying to explain how it works in the disclosure arena. When trying to explain how it works, I personally have found it useful to look at a 2002 speech on principles-based accounting that FASB Chairman Bob Herz gave.<sup>3</sup> If you are interested in this important element of the new rules and its intended impact on your company's disclosure, I would also refer you to a speech that I gave three weeks ago here in New York. In those remarks, I tried to lay out the meaning and significance of a principles-based approach and how embracing it can aid both investors and companies. Among other things, that speech, entitled "Principles Matter", takes a look at what "principles-based" means specifically with regard to the new CD&A. Those remarks are available on the SEC website.<sup>4</sup>

And, more importantly, in this compensation world which is often dominated by lawyers and compensation specialists of all types, you as CFO's bring a different perspective. As I have said, you are presumably familiar both with MD&A (and how it works) and with the principles-based theme from the accounting world. I hope you become involved and take a leadership role in this new and critically important disclosure that your company will be preparing and giving its investors for the first time in the coming months.

### **Disclosure Controls and Procedures**

I'd like to put the content of the new rules aside now and talk for a moment about process. I have to assume you all have spent much time in the world of internal control over financial reporting (the famous SOX 404). I also assume you are familiar with the related requirement that public companies maintain disclosure controls and procedures which apply to all information filed or submitted to the SEC. Among other things, I assume you're very familiar with these controls because they should be feeding into and contributing to your ability to make the certifications that are required of each of you, as a CFO, under Section 302 of the Sarbanes-Oxley Act.

I alluded earlier to the new and expanded types of compensation information required by the new rules. To my mind, a company needs to be reviewing and, where necessary, revamping its disclosure controls and procedures to make sure that those are up to this task. I imagine many of you already have done so, or hopefully have at least substantially started that process, since information from this year (all the way back to the start of the year) will be required to be disclosed in the next proxy. And remember there are two separate and distinct reasons, both related to your certifications, that you should especially care about disclosure controls and procedures.

- As I said earlier, your company's disclosure controls and procedures provide much of the support you need in making your required certifications (and don't forget your 906 certifications for that matter, on which you have personal criminal liability); but also
- Your Section 302 certification specifically speaks to your responsibility for disclosure controls and procedures and to you, as CFO and a

certifying officer, having evaluated those and disclosed your conclusions about them in your company's public filing — you cannot hide your head in the sand on this one.

So what kind of updating might your disclosure controls and procedures need? I cannot answer that question for you. For one thing, it's not my place — the answer depends on your company's specific facts and circumstances. For another thing, we don't possibly have enough time this evening to even scratch the surface. I would urge you all, however, to be actively involved in those updates and make sure you're satisfied with how they've been planned and how they're progressing. And make sure your team is thinking outside the box. Because of the new requirements in the executive compensation arena, you may need to include more people, different people who have never been involved in your public company disclosures in the past. You may need to set up new processes and circuits for gathering, compiling and analyzing information even before making disclosure determinations. Remember that the universe of people at the company for whom disclosures may be required has been expanded in many cases.

I am sorry I cannot provide you any definite or detailed answers but I would strongly urge each of you to make sure someone else does or, arguably even better, that you yourself are actively involved in coming up with these answers for your company. And please don't leave this task for another day. If it waits until the 11th hour, it is unlikely to get done right and it is unlikely to work effectively. You have a personal obligation under the securities laws as well as to your investors. Please plan ahead and if there is to be one take away for you from tonight, let this one be it. Get the processes and procedures going to your satisfaction — any compensation specialists, disclosure lawyers or other advisors you have should be on top of this — make sure they are and that you are as well.

### **Role of the Compensation Committee**

I am sure that countless compensation consultants and other specialists have a wealth of advice about how our new rules will be changing the landscape for the compensation committee. I believe that's true in at least some respects, and I think it's an important topic. But speaking with all of you tonight, I would just like to look at one narrow slice of the compensation committee pie — specifically, how does the Compensation Committee's changing role under the new rules relate to all of you and more specifically to your certifications and to those disclosure controls and procedures we were just discussing.

I imagine many, if not all, of you are familiar with the old "Board Compensation Committee Report on Executive Compensation" that used to appear in the proxy statement. As its name suggests, that one was a report by the compensation committee — not the company or management, and you did not certify to it. That report, however, has now been eliminated and replaced in some measure by the new CD&A section. In addition, a new and very different Compensation Committee Report will also be required going forward which I will describe shortly.

Perhaps we should step back just for a moment and return to a point I alluded to when talking about the new CD&A — it is filed company disclosure. Among other things, that means that it will be covered by your required SOX 302 certification. In some ways, the CD&A covers the same ground the old board compensation committee report covered. To my mind,

it also covers much more. It's also company disclosure, and you each are personally on the hook (through your certifications) for what it says. I can hear some of you saying, "How can that be fair?"

In response, I would make a couple of points. First of all, the CD&A really is company — not compensation committee — disclosure. Remember the analogy to MD&A — in this sense too, the two are in the same camp and they are part of your company's total disclosure. But to the extent the CD&A speaks to anything that you might feel you really can't assess the accuracy of, the Commission has mandated that the Compensation Committee supply a new report, which you will be able to look to as an important part of your process (your controls) of getting comfortable with the whole of your company's disclosure.

So if you'll allow me just a couple more minutes of your time, I would like to talk briefly about the new compensation committee report and how it relates to you. The Compensation Committee Report was modeled on the existing Audit Committee Report, and it must contain just 2 statements:

1. whether the compensation committee has reviewed and discussed the Compensation Discussion and Analysis with management, and
2. based on this review and discussions, whether the compensation committee recommended to the Board of Directors that the CD&A be included in the company's annual report on Form 10-K and proxy statement

The Compensation Committee Report will appear over the names of the compensation committee members and will be *furnished*, not filed — so even though it will be incorporated into your company's 10-K, your certification will not cover this report.

But this report, assuming your committee does recommend inclusion of the CD&A in your company's filings, should help you with the background and comfort you need in making your certifications. Similarly, if your company and your compensation committee do choose to engage in the review and discussions that the CD&A contemplates, I would think that should also help you as part of your disclosure controls and procedures. I should note that the SEC does not require those reviews and discussions (note the use of the word "whether" in the compensation committee report) but I imagine many companies will do so. I would also encourage all of you, individually, to think about what you feel you need and then to make sure you get it. Do you need the chairman of your compensation committee to be more involved, at an earlier stage? If you do, then I personally would urge you to try to get that started. In another speech I gave last week at the Practising Law Institute's Directors' Institute here in New York, I similarly urged directors, especially those serving on compensation committees, to have the same attitude and to understand what their companies, and their management, might need from them in light of the new rules.<sup>5</sup> Don't sit idly by between now and the date your proxy (or even your 10-K) gets filed. Do whatever you need to be prepared.

## Conclusion

In conclusion, I hope you are all convinced (if you weren't already) that the Commission's new executive compensation disclosure rules should be of fundamental interest to each of you individually. I acknowledged earlier the critical role you play to American business. And as I hope you know, you

also play a critical role under the securities laws — for your shareholders and for investors more generally. The certifications you sign are one reason for this but those certifications are, to my mind, even more importantly a reflection of all the other, more fundamental reasons that you are so key to your investors. In other words, your certifications are important because of your substantive contributions and your importance to your company and because of all the insights and understandings you have that investors will never be able to fully share. You can, however — precisely because of your critical role and your authority at your company — help investors get a little closer to your insights and your understanding. Do what you can — what you and your colleagues in the executive suite are probably uniquely qualified to do — to make sure your company's disclosures are the best they can be. I know each of you is an incredibly busy person, but I think you will find that the rewards of doing this are more than worth the time and effort.

Understanding and pursuing the principles of the new executive compensation disclosure rules is one way you can do that. If you appreciate and embrace the importance of this disclosure (and after all, it includes disclosure about your compensation), I imagine that attitude might go a long way toward inspiring and enlisting the others around you to share your sincerity and your commitment to the cause. You can also advance the needs and interests of your shareholders by structuring your company's disclosure controls and procedures so that they are aligned with these new disclosure tasks. And I hope you also understand how doing so is in your own best interest and can help serve your own needs. It truly is a complete circle, and I am convinced that if all the players on the team share the same understandings and the same commitment to the same goals, then you, your company and your investors will all reap the benefits. Thank you again for your time this evening.

## Endnotes

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<sup>1</sup> The Sarbanes-Oxley Act of 2002 and the Commission's rules that have followed the passage of that Act, including the new executive compensation disclosure rules, use the term "principal financial officer". For purposes of these remarks, "CFO" refers to exactly the same person or title as "principal financial officer".

<sup>2</sup> See, e.g., "Introductory Remarks at the SEC Open Meeting," Christopher Cox, Chairman, U.S. Securities and Exchange Commission, July 26, 2006, available at <http://www.sec.gov/news/speech/2006/spch072606cc.htm>.

<sup>3</sup> "Remarks before the Financial Executives International Current Financial Reporting Issues Conference," Robert H. Herz, November 4, 2002.

<sup>4</sup> "Principles Matter," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 6, 2006, available at <http://www.sec.gov/news/speech/2006/spch090606jww.htm>.

<sup>5</sup> "An Expansive View of Teamwork: Directors, Management and the SEC," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 25, 2006, available at <http://www.sec.gov/news/speech/2006/spch092506jww.htm>.

<http://www.sec.gov/news/speech/2006/spch100306jww.htm>

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**APPENDIX E-IV**

**John W. White, *The Principles Matter: Options Disclosure*,  
Remarks Before the Corporation Counsel Conference (Sept.  
11, 2006)**



**Speech by SEC Staff:  
The Principles Matter: Options Disclosure**

*by*

**John W. White**

*Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

Corporate Counsel Conference  
Washington, D.C.  
September 11, 2006

Thank you, Jesse (wherever you are) and Alan. A double introduction is a first for me — I am very appreciative.

I am very happy to be here this morning, as you start your two-day conference on the new executive compensation disclosure rules. You have assembled an impressive faculty and have set out an ambitious agenda for yourselves for the next two days.

Tomorrow, the Chief Counsel of my Division, David Lynn, will be joining you, and offering his insights as well. Dave and I, and other representatives of the Commission's staff, are signed up for quite a number of these programs, but we obviously will not be able to be at all the conferences about the new rules. And we will not be physically present at any of the countless presentations that lawyers and compensation specialists will be making to boards of directors and executive officers in the coming months. Nor will we participate in the ensuing disclosure discussions. Nonetheless, there is at least one theme that I hope will permeate all of the conferences, presentations and discussions. And that theme is where I would like to start my own remarks this morning — the meaning and significance of principles-based disclosure.

Before I turn to that, however, I must first remind you that the views I'm going to express today are solely my own, and do not necessarily reflect the views of the Securities and Exchange Commission, or of any members of its staff, other than myself.

In thinking about today's program, I have assumed that many in the audience are lawyers and other compensation and disclosure specialists who will be working diligently this upcoming proxy season to help companies comply with the new rules and to get their disclosures right. The Commission relied tremendously on the overwhelming and very constructive feedback we received from all quarters during the comment period on the rule proposal. And now that the rules have been finalized, we are relying on all of you to help make them work right in practice. Fortunately, in my opinion, the Commission's new rules are rather uniquely structured so that advisors, like you, will be able to make that critical

difference. The key to remember — as I articulated in a speech by the same name that I gave last week in New York — is two simple words: *principles matter*.

Principles, in my view, are an important thread running throughout the Commission's recent rulemaking. And I believe that looking at principles as they apply to various specific areas of the rulemaking is a useful learning tool. In last week's "Principles Matter" speech (which has been posted on the Commission website),<sup>1</sup> I looked at two different areas of the new rules — Compensation Discussion & Analysis and perquisites — each through the lens of principles. I also used those two examples in helping to show the critical role that disclosure counsel and advisors can play in a principles-based disclosure world. When you have a chance, I urge you to take a look at those remarks as they are very intertwined with my theme this morning.

This morning, I'd like to look specifically at how principles work in a third area in the recent rulemaking: that is, the disclosure of option grant practices. When I was studying the program that Jesse and his team have put together for this conference, it struck me that no separate panel seemed directly focused on the stock option angle of our new disclosure guidance. So hopefully if I spend a few minutes on that area this morning, I won't be stepping on anyone's toes later in the day. As you may know, this area was extremely important to the Commission, and I actually called it "a release within a release" when we were working on the final rulemaking.<sup>2</sup>

### **Principles-Based Disclosure and the New CD&A**

There are a wide variety of views on how to explain the term "principles-based". Although everyone seems to have the same general idea of what they're talking about, I think it's important, before we put the term into action, that we have a mutual understanding of what it means. For my part, I find the description that Robert Herz, chairman of the FASB, gave in 2002 to be very useful:

Under a principles-based approach, one starts with laying out the key objectives of good reporting in the subject area, and then provides guidance explaining the objective and relating it to some common examples. While rules are sometimes unavoidable, the intent is not to try to provide specific guidance, or rules, for every possible situation. Rather, if in doubt, the reader is directed back to the principles.<sup>3</sup>

Now, Bob was talking about accounting and financial reporting, of course, and that's often where we hear the phrase "principles-based". The Commission, however, has embraced it in numerous other places, including the recent executive compensation disclosure rulemaking.

Within this rulemaking, the new CD&A section is probably the place that most often gets tagged with the term "principles-based". Clearly, a solid understanding of principles-based disclosure is vital to preparing and providing investors with a high quality CD&A. If you have read the recent Release, you have been directed by the Commission to look to the existing MD&A (Management's Discussion & Analysis) as a model for understanding the function and operation of the new CD&A. I believe this analogy is very apt. Not only do they share similar acronyms, but more importantly MD&A and CD&A share a commitment to and provide a place for principles-based disclosure.

Last week, I referred to a speech that our former Commissioner Cyndi Glassman gave in March.<sup>4</sup> Commissioner Glassman was absolutely right in noting that "[o]f all of our disclosure rules, MD&A may be the most principles-based." So, when approaching the challenge of drafting your company's first CD&A, please don't forget the body of learning that companies already have from their experiences of drafting MD&A. The description of the term "principles-based" that I borrowed from Bob Herz, talks about starting with the "key objectives" of good reporting in a particular area. So what are the key objectives of good reporting (or more specifically, good disclosure) for executive compensation, and especially for the CD&A? CD&A is what gives context to the required tables and the numbers in them.

As the Commission stated in the Adopting Release:

The purpose of the Compensation Discussion and Analysis disclosure is to provide material information about the compensation objectives and policies for named executive officers without resorting to boilerplate disclosure. The Compensation Discussion and Analysis is intended to put into perspective for investors the numbers and narrative that follow it.<sup>5</sup>

The rules do provide six questions that CD&A *must* answer, as well as 15 examples of topics a company *might* consider addressing. Those examples are neither exhaustive nor mandatory. A company (and those drafting its disclosure) must determine what is material to the company. What do the company's investors need to know? They must then craft the appropriate disclosure that is responsive to those questions and is tailored to the company's particular facts and circumstances.

### **Disclosure of Options Practices**

So how does that broad description of the objectives of CD&A apply to options disclosure? Within the Release, right up front, the Commission took special care to talk about the application of its new rules for CD&A to option grant practices.<sup>6</sup> Principles clearly play a critical role here. In addition to detailed, new tabular disclosure requirements about option grants and their value (which you will be hearing more about in the panels later today that deal with the tables), the Commission is now requiring clear, principles-based narrative disclosure in the CD&A about a company's programs, plans and practices pertaining to option grants to executives.

As you all know, there has been a lot of media and other attention paid recently to various option grant practices, using labels like "backdating," "spring loading" and "bullet dodging". Those terms mean different things to different people. The Commission did not use any of them in the Release, and I will not be using them today. Rather, the Commission talked about two separate, general categories of options practices — (1) those relating to the timing of option grants and (2) those related to the pricing of option grants (or setting exercise prices).

Before looking at these practices, I believe it is important to note upfront that the Commission's new rules (and the guidance in the Release) are *prospective*. The Commission did not comment on past practices in the Release. I also believe it is important to remember that the Commission was very careful to highlight that it was not speaking to the substance of executive compensation, in either form or amount, in any way. As our

Chairman, Chris Cox, stated at the Open Meeting when the new rules were adopted, "It is not the job of the SEC to judge what constitutes the "right" level of compensation for an executive or to place limits on what executives are paid."<sup>7</sup> Our concern is with disclosure.

So let's turn now to the option practices and disclosure guidance in the Release. With regard to the first category of practices I mentioned a moment ago — timing practices — the Commission explained that these involve the granting of options in coordination with the release of material non-public information. Timing may be in coordination with the release of positive or negative material information, and it might take place by delaying or accelerating the information release, or by delaying or accelerating the option grant. There are a lot of different permutations and combinations there, but they all boil down to option grant "programs, plans or practices" that require appropriate disclosure and discussion under the new rules and the guidance in the Release.

The second general category of option grant practices relates to "pricing." Pricing practices involve establishing a strike price for an option grant that is different from the stock's closing market price on the date of grant. Generally speaking, the exercise price of an option grant is the closing market price of the underlying stock on the grant date. Companies may, however, establish different exercise prices provided they comply with the applicable disclosure requirements and follow the correct accounting. The Release provides guidance about two methods for establishing a different exercise price — by setting the exercise price based on (1) the stock's price on a date prior to the grant date, or (2) a formula, often using some combination of the stock's price at various times on the grant date or during a time window before (and sometimes after) the grant. As long as the option grants are properly disclosed and the company accounts for them correctly, there is nothing per se wrong with following one of those practices.

What does proper disclosure look like, then, if a company chooses to engage in either timing or pricing practices with regard to its option grants to its executives? As I said before, there are some fairly detailed new tabular disclosures that companies must provide. Moreover (and this is what I want to focus on today), in keeping with a principles-based system, the Commission provided in the Release several questions and examples in order to help companies craft the right disclosure in their CD&A specifically about option grants.

The very first question for special consideration that the Commission poses in the Release is, "Does a company have any program, plan or practice to time option grants to its executives in coordination with the release of material non-public information?"<sup>8</sup> This question is only a suggestion, and as I alluded to earlier, it should not be considered either mandatory or exhaustive. It does, however, deserve careful consideration. Think in principle about what it means to "time an option grant in coordination with the release of material non-public information."

The most obvious example of a timing practice might involve a company that times its options grants to precede the release of a positive earnings or new product announcement, with the expectation that the company's stock price will enjoy a boost when that announcement comes out and the option recipient will likewise benefit from his options being quickly, or more substantially, "in the money".

The principle also applies, though, to a company that delays an option grant, or accelerates a news release, to ensure that negative information is fully absorbed by the market before an option grant is awarded. People may assert that delaying an option grant until after all information is in the market (even if that means the stock price goes down) somehow "smells different" than accelerating an option grant to precede a positive news announcement (which would be anticipated to then boost the stock's price). But for the Commission's new disclosure rules and guidance, those two situations are really two sides of the same coin. If they exist, they both are "programs, plans or practices" related to option grants, and they both may need to be disclosed and discussed appropriately.

As another variant, the principle applies equally to a company that times its options grants to either precede or follow, as appropriate, a known (or anticipated) upcoming, material announcement from a third party — such as an FDA announcement that it has either approved or denied a critical drug application on which the company has pinned its hopes. In all these situations, remember the principle and don't let your analysis, or your disclosure, end with the most obvious example or overly simplistic answers.

Let's look at another question. The second illustrative question that the Commission posed in the Release is, "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?"<sup>9</sup> Our newest Commissioner, Kathy Casey, first raised the excellent point that the requisite context for understanding option grants to executives may go beyond the executive suite itself. While it's true that the Commission's disclosure rules pertain to *executive* compensation, it's not good enough to ask only the simple questions, to keep your blinders on, to not think outside the box. Does your company have a program, plan or practice for option grants which it follows with regard to all of its employees generally? Or is this a special situation that applies only to executives, or only to select executives? The answers to those questions may well inform or shine extra light on how a company follows such a practice, what benefits the company receives from it, or what effect it has on the executive recipients. Or, it may not. But the point of principles-based disclosure is that companies, and their advisors, need to figure that out, and to make sure they're disclosing the relevant, material information about their companies' particular facts and circumstances. Again, remember the key message here — *principles matter*. And give your investors the material disclosure they want, need and deserve.

The Release talks at length about timing and pricing practices with regard to options specifically. Those are two critical analytic elements, but please don't lose sight of the overarching principles in this sense either. If other practices relating to option grants are developed in the future — as they undoubtedly will be — they will also be covered by these principles-based disclosure requirements, even though the Release doesn't name them, and we may not (any of us) yet know what they are.

Similarly, the Release has an entire section that speaks about "options", but you should understand that the principles the Commission has promulgated undoubtedly apply to other equity awards, such as stock appreciation rights (SARs) and restricted stock that operate in the same field. Leaning again on my friend Mr. Herz, think about the key objectives of good reporting in this area, and the principles will guide your disclosure. As the Release expressly states, companies should consider their own facts and circumstances, and include all relevant material information in their

corresponding disclosures. The questions and guidance in the Release are only a start. Use your disclosure to provide the necessary context and perspective about your company, for your investors.

## Conclusion

Obviously we stand at a fairly unique juncture at which tremendous media and law enforcement attention is being paid to companies' option grant practices. It's not clear to me how the public, or history, will end up judging past practices. At the same time, the Commission has outlined a clear path for how these issues should be addressed going forward. No one has drafted a CD&A before, or crafted disclosure in light of the Commission's recent guidance on disclosure of option grant practices. I, at least, am not aware of any company that has otherwise used its proxy disclosure to provide its investors with a clear understanding of what the company is doing, and what it's achieving, with its option grants. I hope you will see your company's next proxy statement, therefore, as an opportunity "to get it right the first time." And I hope you will help America's public companies seize that opportunity. Each of you has an invaluable role to play in guiding and assisting your clients and your companies in answering that call. Remember, the two-word message of this morning: *principles matter*.

Thank you very much for giving me the opportunity today to share a few of my thoughts with you on the new rules. I hope you find the next two days to be both enjoyable and rewarding.

## Endnotes

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<sup>1</sup> "Principles Matter," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 6, 2006, available at <http://www.sec.gov/news/speech/2006/spch090606jww.htm>.

<sup>2</sup> SEC Release No. 33-8732A, "Executive Compensation and Related Party Disclosures," August 29, 2006, (the "Release"), available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.

<sup>3</sup> "Remarks before the Financial Executives International Current Financial Reporting Issues Conference," Robert H. Herz, November 4, 2002.

<sup>4</sup> "Remarks before the Tenth Annual Corporate Counsel Institute: Priorities and Concerns at the SEC," Cynthia A. Glassman, Commissioner, U.S. Securities and Exchange Commission, March 9, 2006, available at <http://www.sec.gov/news/speech/spch030906cag.htm>.

<sup>5</sup> Release at p. 29.

<sup>6</sup> Release at pp. 18-27.

<sup>7</sup> "Introductory Remarks at the SEC Open Meeting," Christopher Cox, Chairman, U.S. Securities and Exchange Commission, July 26, 2006, available at <http://www.sec.gov/news/speech/2006/spch072606cc.htm>.

<sup>8</sup> Release at p. 26.

<sup>9</sup> Id.

<http://www.sec.gov/news/speech/2006/spch091106jww.htm>

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Modified: 09/11/2006

**APPENDIX E-V**

**Letter from Council of Institutional Investors to Christopher  
Cox Re: Compensation Disclosure Compliance Review  
Process; Shareowner Perspective on Improving the  
Compensation Discussion and Analysis (*CD&A*) (Sep. 27, 2007)**

# COUNCIL OF INSTITUTIONAL INVESTORS

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September 27, 2007

The Honorable Christopher Cox  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

*RE: Compensation disclosure compliance review process; Shareowner  
perspective on improving the Compensation Discussion and Analysis  
(CD&A)*

Dear Chairman Cox:

I am writing on behalf of the Council of Institutional Investors, a not-for-profit association of more than 140 public, corporate and union pension funds with combined assets exceeding \$3 trillion. The Council commends the Securities and Exchange Commission for the recent actions it has taken as part of a larger review of companies' compliance with the new executive compensation disclosure rules. This initiative is an important step toward addressing the discernible lack of quality reporting in the Compensation Discussion and Analysis (CD&A) disclosures over the last proxy season. As the Commission moves forward with better reporting initiatives, the Council urges it to focus on the critical reporting items detailed below and to address such items in any future rulemaking.

Improving the quality of executive compensation disclosure has long been a top priority of the Council and its members. Council policy recommends that executive compensation programs tie pay tightly to company performance, promote sustainable long-term value creation and be structured in accordance with a company's strategic goals. Evaluating board-level compensation decisions requires that shareowners have complete and thorough information about compensation programs, the compensation committee's pay-setting process and the relationship between compensation decisions and the company's business objectives.

It is therefore critical that the new Compensation Discussion & Analysis section of the proxy statement fulfill the expectations of shareowners and those of the SEC and other interested parties. The CD&A is, in the SEC's words, a narrative "discussion and analysis of the material factors underlying compensation policies and decisions" intended to provide context for the tabular compensation disclosure.

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Council members are therefore encouraged by the SEC's recent efforts to remedy pay disclosure shortcomings through a targeted review project. Widely publicized reports note that the SEC has identified significant deficiencies in CD&As and has sent the first of several waves of comment letters—said to number 300—seeking improved disclosure and additional information. Details in these reports also indicate that SEC staff is focusing on many of the same disclosure areas that the Council views as inadequate. The Council is optimistic that the staff's actions now will result in marked improvements for the 2008 proxy season.

The Council supports the SEC's efforts to improve the quality of the CD&A disclosure and make it more useful for shareowners. To that end, it urges the SEC to continue to focus on the following issues:

- Overall clarity and use of plain English: A study released by Mercer Human Resource Consulting last spring found that the length of proxy statements increased overall in 2007, with the average proxy being comprised of about 30 pages and the average CD&A being comprised of 6,141 words. The study also noted that using various “readability metrics,” to measure proxy statements, it found that “disclosures were more difficult to read than the Bible, the U.S. Constitution and *The New York Times*.” Lengthy CD&As filled with jargon and legalese obfuscate the key analysis of executive compensation philosophies and practices that allow investors to make informed decisions. Companies should be required to strictly adhere to the requirement in the SEC disclosure rules that calls for the use of plain English and they should ensure that their CD&A disclosures answer the “how” and the “why” questions rather than merely those addressing “who, what, where and when.” The answers to “how” and “why” should include a discussion of the parties and the process involved in setting executive pay. The CD&A provides an opportunity for companies to disclose whether or not they have disgorgement policies in place requiring executives to surrender their bonuses in the event of financial restatements. Council policy endorses these clawback provisions.
- Disclosure of specific performance targets: Disclosure of performance targets enables shareowners to evaluate the design of incentive programs as well as the fit between objectives used to motivate executives and the company's business goals. A study released by Watson Wyatt Worldwide in April 2007 found that more than half of 100 large companies studied did not disclose the actual goals on which they based rewards under their 2006 annual incentive plans or their goals for long-term incentive plans, presumably relying on the exclusion for confidential trade secrets or confidential commercial or financial

information. The Council believes this exclusion should be construed narrowly to prevent it from swallowing the rule, and companies should be required to justify their entitlement to it with specificity. Companies that are deemed by the SEC to be entitled to withhold the specific targets should be required to provide adequate “degree of difficulty” disclosure, including describing past experience with similar target levels and disclosing any inconsistencies between compensation targets and targets set in other contexts. Phrases often found in CD&A disclosures related to these explanations such as “intended to encourage superior performance” and “designed to promote excellence and motivate management” are grossly inadequate.

- Peer group comparisons and benchmarking: Benchmarking pay at 50 percent or higher leads to ratcheting up executive compensation. Accordingly, companies should disclose all other companies against which pay is benchmarked. Moreover, if the companies used for benchmarking pay differ from those used in the performance comparison graph required in the 10-K, a company should explain the reason for the difference and the rationale for choosing the pay comparison companies.
- Disclosure of termination and change-in-control arrangements: More uniform, tabular disclosure of these arrangements with totals for each NEO under each different triggering scenario (including gross ups and all other taxes payable by the company) would make this information much more user-friendly for investors.
- Compensation consultant’s role in setting pay: Companies are now required to identify the board’s compensation consultant, but other key information about consultants is missing. Specifically, companies should disclose information about the role of the consultant in determining the amount and form of compensation, the scope of the consultants’ assignment including a description of other business performed for the company and the compensation committee’s assessment of the consultant’s independence.
- Disclosure of material differences in packages awarded to NEOs: The SEC rules specify that disclosure in the CD&A “should be sufficiently precise to identify material differences in compensation policies and decisions for named individual and executive officers, however, if the policies are sufficiently similar, the officers can be grouped together.” Providing collective information on named executive officers (NEOs) often is insufficient. Overly large gaps in compensation between the CEO and other

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NEOs suggest poor compensation program design, a weak board and inadequate succession planning. Companies should adequately disclose each NEO's compensation and explain the reasons for the differences in the amounts awarded to each. This part of the disclosure also should include a discussion of how the compensation committee evaluates the internal pay relationship among its executives in setting pay and a discussion of how specific forms of compensation are structured and implemented to reflect the individual performance of NEOs.

Thank you for your work to date in this area and for considering our comments. We look forward to improved executive compensation disclosure in companies' 2008 proxy statements.

We would be happy to meet with SEC staff to discuss these issues. Council members must have access to clear, concise, detailed information about executives' pay packages in order to make informed decisions regarding their investments.

Sincerely,



Ann Yerger  
Executive Director, Council of Institutional Investors

**APPENDIX E-VI**

**John W. White, *Executive Compensation Disclosure:  
Observations on Year Two and a Look Forward to the Changing  
Landscape for 2009 (Oct. 21, 2008)***



## Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009

by

John W. White

*Director, Division of Corporation Finance  
Securities and Exchange Commission*

New Orleans, Louisiana  
October 21, 2008

Thank you Jesse [Brill] and good afternoon. With companies now turning their attention to their 2009 disclosure, I am very pleased to be back with you to share my "second year" observations on executive compensation disclosure and provide you with my thoughts on what I hope we see in the coming proxy season. But first, I'd like to take a moment to touch on some important recent developments that I anticipate will impact the disclosure we see going forward in this area and that I think are simply too important not to address.

Of course, as I speak today, please keep in mind my disclaimer — the views I express today are my own and do not represent the views of the Commission or of any other member of the staff.

### **Current Market Events and the Emergency Economic Stabilization Act of 2008**

As you have no doubt seen, executive compensation has been pushed back into the spotlight (though I'm not sure it ever really left) with the current financial crisis. One of the themes you hear over and over again is the public's concern about the amount of compensation that executives at "Wall Street" firms earned over the years, as their companies were making decisions that ultimately contributed to the crisis we are currently experiencing. And this of course was reflected in the recently-enacted Emergency Economic Stabilization Act of 2008,<sup>1</sup> which establishes the Troubled Asset Relief Program. As you are aware, the TARP, as this program is known, contains various provisions requiring financial institutions to meet prescribed standards for executive compensation and corporate governance in the event they sell troubled assets to the U.S. Treasury or participate in the capital purchase program created under the TARP. Nine of our largest financial institutions have already said they will participate in the capital purchase program and sell \$125 billion of their senior preferred stock to Treasury, and more are likely to follow. Additional financial institutions will become subject to these executive compensation provisions as they sell troubled assets directly or through auctions to Treasury. Thus it is likely that many, and certainly the largest, of our financial institutions will soon be covered. The rules covering the capital

purchase program require that the new executive compensation provisions be in place, and existing executive compensation arrangements modified or terminated (to the extent necessary to comply with the new rules), prior to the closing of the senior preferred stock sales to Treasury. So this is all happening very fast.

These new provisions are substantive requirements applicable to participating companies and their senior executives. As this group well understands, and as I've noted on many other occasions, we at the SEC are focused not on affecting the substance of executive compensation determinations, but rather on the disclosure that is provided concerning that compensation. We are, of course, watching closely as market events and implementation of the program unfold, but I think it is already clear that the TARP and the unusual market events that led up to its enactment will introduce new compensation disclosure challenges. So this is certainly something that companies should, and no doubt are, beginning to gear up for, as are we in Corp Fin.

As this process begins, I would like to offer just a couple of preliminary — and they are truly preliminary — thoughts on the disclosure implications of the TARP, particularly with respect to its limits on executive compensation. For example, for participating financial institutions, the TARP requires the institution to have limits on compensation that exclude incentives for senior executive officers to take unnecessary and excessive risks that threaten the value of the financial institution. Last week, Treasury issued its regulations implementing this and the other executive compensation provisions in the Act.<sup>2</sup> For this particular provision, the regulations require the participating financial institution's compensation committee to meet with the senior risk officers of the institution to ensure that the incentive compensation arrangements do not encourage the senior executive officers to take "unnecessary and excessive risks that threaten the value of the financial institution." The committee will need to limit such arrangements if they do so. The committee also will need to meet with the senior risk officers annually. And, most relevant here, the committee will need to certify in the CD&A that it has done all of this. So, CD&A disclosure is the key communication vehicle for investors, as well as taxpayers, on whether and the extent to which the financial institution is complying with the conditions on taxpayer investment in that financial institution.

More generally, as the Commission noted in adopting the current executive compensation disclosure requirements, CD&A was designed "sufficiently broadly to continue operating effectively as future forms of compensation develop, without suggesting that items that do not fit squarely within a 'box' specified by the rules need not be disclosed."<sup>3</sup> Many of you have heard me emphasize, more than once, the principles-based nature of executive compensation disclosure under our new rules.<sup>4</sup> This approach of "utilizing a disclosure concept along with illustrative examples" also applies to other factors not specifically enumerated in the description of CD&A or elsewhere in Item 402 that may affect the company's compensation program. For example, the Emergency Economic Stabilization Act includes express limitations on executive compensation for participating companies — especially on golden parachutes, and on claiming tax deductions for executive compensation. As I am sure you will be discussing today, the limitation on claiming tax deductions has been expanded greatly, not just to reduce the \$1 million cap to \$500,000, but also to eliminate the exception for performance-based compensation. So if your company is a participating financial institution, you will need to carefully consider and reflect the new provisions and their ramifications in drafting your CD&A and

Item 402(j) disclosure.

Most of you are not from financial institutions, so let's talk for a moment about non-participating companies. This new Congressionally-mandated limitation on having compensation arrangements that could lead a financial institution's senior executive officers to take unnecessary and excessive risks that could threaten the value of the financial institution obviously applies on its face only to participants in the TARP. But, consider the broader implications and ask yourself this question: Would it be prudent for compensation committees, when establishing targets and creating incentives, not only to discuss how hard or how easy it is to meet the incentives, but also to consider the particular risks an executive might be incentivized to take to meet the target — with risk, in this case, being viewed in the context of the enterprise as a whole? I'll let you think about what Congress might want. We know what our rules require. That is, to the extent that such considerations are or become a material part of a company's compensation policies or decisions, a company would be required to discuss them as part of its CD&A. So please consider this carefully as you prepare your next CD&A.

Also, more broadly speaking, I expect that current market events are already affecting many companies' compensation decisions and thus should be affecting the drafting of their upcoming CD&A's. Regardless of whether your company participates in the TARP and consequently finds itself having to make new material disclosures, you should not merely be marking up last year's disclosure. Instead, you should be carefully considering if and how recent economic and financial events affect your company's compensation program. For example, have you modified outstanding awards or plans, or implemented new ones? Have you reconsidered the structure of your program, or the relative weighting of various compensation elements? Have you waived any performance conditions, or set new ones using different standards? Have you changed your processes and procedures for determining executive and director pay, triggering disclosure under Item 407? These questions and more should be addressed as you consider disclosure for 2008.

We also are looking at how we will shape our Corporation Finance review program for 2009 in light of recent market events, including the new executive compensation provisions in TARP and continued investor interest in executive compensation. As you know, our selective review program is guided by Section 408 of Sarbanes-Oxley, which requires that we review all public companies on a regular and systematic basis, but in no event less frequently than once every three years. The Act also sets out criteria for us to consider in scheduling these regular and systematic reviews, including considering companies that "experience significant volatility in their stock price," companies "with the largest market capitalizations," and companies "whose operations affect any material sector of the economy." As you also will recall, in 2007 we did a targeted review of the executive compensation disclosure under our then-new rules for 350 companies of all sizes.

Our plan for 2009 will be responsive to current conditions. In 2009 we will select for review and review the annual reports of all of the very largest financial institutions in the U.S. that are public companies. This group will include the nine large financial institutions that have already agreed to participate in the Treasury's capital purchase program. Our reviews will include both the financial statements and the executive compensation disclosures of these companies. We also intend to monitor the quarterly filings on Form 10-Q and current reports on Form 8-K of these companies.

And finally, though there is a lot to be focusing on in this area, I want to be certain that we don't lose sight of the role of interactive data in all of this, as it certainly is an important part of where the future lies for compensation disclosure.

## Second Year Disclosure

With that, let me return to what I thought I'd be talking about today when I accepted the invitation last spring to be here — that being to discuss what we saw in the second year of company disclosures under the new executive compensation disclosure requirements.

Last year when I was with you we were in the midst of our targeted reviews of 350 public companies' executive compensation disclosure and had just completed our report on what we saw in the first year of disclosures under the new rules.<sup>5</sup> This year, although we did not undertake a coordinated and targeted review of executive compensation and related disclosure, we did analyze companies' executive compensation disclosure in connection with the Division's traditional review program. Accordingly, where a filing containing executive compensation and related disclosure was selected for review, that material was examined and commented upon as appropriate during the course of our review. And this will continue to be the case. In this regard, there are many companies that did not receive comments in connection with our 2007 focused review or during our reviews in 2008, but this does not mean that their disclosure has been exempted from review or that Corp Fin has shifted priorities away from reviewing executive compensation disclosure in general. We are continuing to apply significant resources to ensuring that investors obtain quality disclosure about executive compensation and, to this end, the comment letters we most recently issued cover many of the themes and topics that were the subject of the October 2007 report.

So what did we see in 2008 and what did we comment on most? You will not be surprised when I tell you the primary areas of comment are familiar ones: (1) the need for more analysis, (2) disclosure of performance targets, and (3) disclosure relating to benchmarking.

The first of these, analysis, is of paramount importance and as such I want to both start with it and end with it. In short, our work here is not done. Last year the title of my remarks was "Where's the Analysis?" and this year, in far too many instances, we're still looking. This lack of analysis flows through companies' CD&As, including in their discussions of the two other areas I mentioned — performance targets and benchmarking. So let me talk about these for a moment and come back to the analysis point.

Performance Targets. Performance targets were a significant topic in our staff report and also in my remarks at this program last year. As you likely know, the disclosure requirements applicable to performance targets are principles-based. In preparing its disclosure, a company must determine whether performance targets are a material element of its compensation policies and decisions and, if they are material, provide disclosure in accordance with Item 402 of Regulation S-K. This was our largest area of comment in the first year, so it is not surprising that in our second year we continued to issue a very significant number of comments relating to the disclosure concerning, or omission of, performance objectives. For example, where companies omitted from their CD&A the performance objectives that are tied to a named executive officer's incentive compensation, we have continued to request that the filer justify the omission in light of the

appropriate standard set forth in Instruction 4 to Item 402(b). Although the Commission does not require formal requests for confidential treatment of this information under Exemption 4 of FOIA, we consistently ask filers to provide us with legal analysis setting forth the reasons why it believes competitive harm would ensue through disclosure. And we are reminding companies that these analyses should be tailored to the facts and circumstances surrounding the company and competitive environment of the industry in which it operates and should demonstrate the nexus between disclosure and the potential for competitive damage to result.

In putting together their disclosure in this area, companies must remember to return to the underlying principles-based standard — I cannot emphasize enough that rote disclosure based on a superficial reading of the rules will not carry the day here. We've all seen press over the past months suggesting that companies are still not providing the disclosure contemplated by the rules, and in many cases our reviews bear this out. So I urge companies to redouble their efforts, and to really learn from the guidance that is out there — and there is a great deal available to you in terms of applying the standards. In addition to our report and my remarks last year and today, I also would urge you to look to our updated and revised Compliance and Disclosure Interpretations (C&DIs),<sup>6</sup> which include some new interpretations. For example, C&DI 118.04<sup>7</sup> addresses how a company determines if it may omit disclosure of performance target levels under Instruction 4 to Item 402(b). If the performance targets are material in the context of the company's executive compensation policies or decisions, then the only basis for omission is a reasonable showing that disclosure would cause substantial competitive harm. We've made an attempt to distinguish qualitative/subjective individual performance goals from quantitative/objective performance goals and recognize the different disclosure issues associated with discretionary-type awards based on subjective criteria. Although there is no requirement to provide quantitative targets for what are inherently subjective or qualitative assessments, should a company determine that such disclosure is not required it should clearly lay out the way that qualitative inputs are ultimately translated into objective pay determinations.

If a company does conclude there is a sufficient basis to omit performance target disclosure because it determines that disclosure would result in competitive harm, then disclosure regarding the degree of difficulty associated with achievement or non-achievement of the omitted performance objective is mandatory. This disclosure should be as detailed as possible so as to clearly address the criteria for determining undisclosed target levels and it must directly establish the connection between the achievement of the performance objective and the characteristics of the incentive payment to which the goal applies. In other words, if a company advances a pay-for-performance philosophy, it should provide meaningful disclosure that describes the degree to which the performance goals or metrics were sufficiently challenging or appropriate in light of that compensation philosophy, and how achievement of the objectives actually rewarded performance. This may entail a discussion of the extent to which incentive amounts were determined based upon a historical review of the predictability of achievement of the performance objectives and possibly a discussion of the relationship between historical and future achievement of the performance standard. Investors should be provided with a clear impression of the arduousness or ease associated with achievement of the undisclosed target levels or other factors.

A final point on performance targets that I'd like to emphasize is the

importance of critically assessing, at the time disclosure decisions are being made, whether or not there is a sufficient legal basis for excluding the disclosure. I emphasize the need for sufficient preparation so that when Corp Fin asks, you have a solid response ready. Conducting a contemporaneous written analysis will help you to present a more persuasive case that competitive harm would result from disclosure. Moreover, a contemporaneous effort to construct your competitive harm analysis may better inform your conclusion as to whether you have a proper basis for omitting the disclosure. Making a general result-oriented conclusion at the time of filing and then later, only after an inquiry from the staff, asking your lawyers to perform a competitive harm analysis, is not an effective way to carry out your disclosure obligations. The staff has significant and substantive experience applying the analysis relating to the FOIA standard and we expect companies to substantiate a legitimate position rather than merely provide generalized support for a casual determination that some sort of harm might result from disclosure. Indeed, without making a reasonable determination that the company would suffer competitive harm, the company has no basis to omit the incentive target at the outset.

Benchmarking. Again, this was an important topic in our report and in my remarks last year, so it should not be a surprise to this group that I am returning to it. Where a company benchmarks a material element of compensation, we expect it to identify the companies that comprise the peer group used for benchmarking purposes. We also expect meaningful disclosure that provides insight into the basis for selecting the peer group, and the relationship between actual compensation and the data utilized in benchmarking or peer group studies. These were significant areas of comment again in 2008. In many cases, the benchmarking methodologies that companies are using still are not sufficiently clear nor have companies adequately explained how they are utilizing the data collected from their analyses of peer group pay. The composition of the comparison groups and the extent to which companies are setting their compensation levels to remain competitive with a peer group is essential disclosure and critical for many companies when describing how their compensation programs work or how they arrived at specific compensation decisions.

Over the past year we heard from a number of groups on the perceived difficulty in applying the benchmarking disclosure principles — particularly where a company may have looked at surveys that included data on hundreds of companies. In an effort to provide further clarity about our expectations in this area, the Division published C&DI 118.05,<sup>8</sup> which provides a general definition of benchmarking for purposes of Item 402(b)(2)(xiv). In that C&DI we clarify that benchmarking "generally entails using compensation data about other companies as a reference point on which — either wholly or in part — to base, justify or provide a framework for a compensation decision. It would not include a situation in which a company reviews or considers a broad-based third-party survey for a more general purpose, such as to obtain a general understanding of current compensation practices." Hopefully, looking forward, this guidance will facilitate a more transparent and robust discussion of competitive data, the companies against which companies compared compensation, and the extent to which peer group data was studied and reflected in the structuring of compensation practices and specific compensation decisions. And if not, we welcome your further thoughts in this area — as I noted, we issued this C&DI after hearing from companies and their advisors, so the goal here is to be responsive where there is a need for guidance.

Analysis. Returning to analysis. To start with the positive, we have seen

improvement in this area and it is clear that many companies have tried to provide meaningful disclosure explaining the rationale for their executive compensation policies and decisions. The most successful have implemented comprehensive overhauls of last year's disclosure model that effectively refocused their disclosure — in other words, they've started with the clean slate, the blank sheet of paper, that I suggested last year. Yet, many others have missed the opportunity to transform their presentation into the useful analytical discussion that should be the essence of the CD&A. Rather than moving forward toward better quality disclosure, they are merely treading water. Again, as was the case last year, the "how and the why" are missing in explaining the connection between the company's philosophies and processes and the numbers the company presents in its tabular disclosure.

The improvements we observed vary in scope depending on the size of the company and the complexity of the compensation arrangements and, while of course there is no one-size-fits-all disclosure model, it is evident that many filers of all sizes have accepted the challenge associated with improving the form and content of their executive compensation disclosure. For those that did choose to embrace the CD&A as an invitation to provide all categories of investors with the critical information necessary to understanding executive pay, we applaud your efforts. Through a more effective assessment of threshold materiality issues and a conscientious attempt to eliminate boilerplate and unnecessary narrative disclosure, these filers capitalized on the opportunity to convert their CD&As from an impenetrable disclosure document to the crisp and informative analytical discussion that is the centerpiece of this presentation.

Notwithstanding this improvement, we still commented heavily on the need for filers to concentrate their CD&A into an informative analytical discussion of:

- the material elements of compensation;
- how companies arrived at the varying levels of compensation; and
- why they believe their compensation practices and decisions fit within their overall objectives and philosophy.

In too many cases, companies failed to provide informative analysis on one or many levels, thereby depriving investors of critical information on fundamental compensation practices and decisions. This resulted in comments from Corp Fin seeking to elicit enhanced disclosure and redirect the filer's focus to the core analytical principles associated with faithful application of the disclosure provisions.

As we indicated in the October 2007 report, the disclosure principles require that filers provide the necessary links that allow investors to decipher the information contained in the compensation tables through a useful and readable description of the material factors underlying the compensation decisions for named executive officers. In an effort to emphasize the significance of this mandate, we continued to encourage companies to:

- explain and place in context each of the specific factors considered when approving particular pieces of each named executive officers' compensation package;
- analyze the reasons why the company believes that the amounts paid

are appropriate in light of the various factors it considered in making specific compensation decisions; and

- describe why or how determinations with respect to one element impacted other compensation decisions.

In many instances, we observed that filers were unable to effectively apply these concepts. Such shortcomings resulted in noticeable deficiencies when it came to providing concise quantitative or qualitative disclosure that captured how companies arrived at and why they paid the compensation awarded under a specific program or plan.

For example, if company performance was considered, we commonly encouraged filers to present a complete picture of the extent to which minimum, target, or maximum levels of performance goals were achieved and how achievement of the various company performance objectives resulted in specific payouts under the applicable compensation program or plan. To the extent that a discussion of the comparison between actual results and the performance objectives used to establish compensation does not correspond with actual payouts because pay was influenced by an exercise of discretion, we commonly requested companies to provide appropriate qualitative disclosure of the reasons for the use of such discretion and how it affected actual pay. We have learned that where pay-for-performance is at issue, there is no substitute for robust disclosure of actual results, evaluation of how those results translated into specific compensation, and why the compensation awarded was consistent with the company's overall compensation objectives.

As another example, where individual performance was a significant factor in determining compensation, we encouraged companies to identify specific contributions and to contextualize those achievements for purposes of demonstrating how they resulted in specific compensation decisions. While we do not require quantitative targets for what are inherently subjective or qualitative assessments, we expect insightful disclosure of how qualitative inputs are translated into objective pay determinations.

Finally, to the extent there is a relationship between payouts from different elements of compensation, we asked companies to provide clear descriptions of the correlation between each element of compensation and how compensation decisions regarding one element impacted levels of compensation derived from other elements. Unfortunately, I must repeat a refrain from my remarks to this audience last year. We continue to detect an absence of useful disclosure addressing the extent to which compensation committees are reviewing each element of compensation individually or whether committees are engaging in a collective evaluation of all components of executive pay when establishing the various forms and levels of compensation. The absence of such a discussion impairs the ability of investors to decipher the extent to which particular components of compensation are determined in a vacuum and which elements and levels of pay are linked to assessments of total compensation or amounts that remain realizable from prior compensation.

These are some of the most common shortfalls in analysis that we observed this year — and ones that we had hoped companies would have addressed after absorbing our guidance in this area. Of course, the analysis that we envision depends on many factors, including the nature of the company, the category of compensation being discussed, and the specific criteria considered for awarding the particular levels of compensation. So we

encourage all companies and their advisors to continue to work to develop improved disclosure strategies that will enhance the analysis that is their compensation story. And we will continue to remind companies to do this by seeking better analysis where we find that it is lacking.

So with that, let me close by emphasizing that we've really made a significant attempt to provide companies with clear expectations relating to the quality of executive compensation disclosure under the new disclosure requirements and I hope my observations today will again highlight the fact that, notwithstanding the number of comment letters, speeches, and published guidance that is out there, many companies have a long way to go before perfecting the disclosure that meaningfully conveys their compensation story. And in the coming year, many of you will also have the new challenge of crafting meaningful disclosure reflecting the effects of market turmoil and the new legislation. So I urge companies of all sizes and their advisors to reread our report from last year, my remarks from last year, the new C&DI's we published earlier this year, and these remarks. Then return to that blank sheet that I talked about last year and strive for ever-better disclosure in this important area. Thank you for your time and attention.

## Endnotes

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<sup>1</sup> Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

<sup>2</sup> See TARP Capital Purchase Program, Interim Final Rule, 73 FR 62205, October 20, 2008. See also, TARP Capital Purchase Program Summary Term Sheet, available at <http://www.ustreas.gov/press/releases/reports/document5hp1207.pdf>.

<sup>3</sup> See SEC Release No. 33-8732A, "Executive Compensation and Related Person Disclosure (conforming amendments)," August 29, 2006, available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.

<sup>4</sup> See "Principles Matter," John W. White, Director, Division of Corporation Finance, September 6, 2006, available at <http://www.sec.gov/news/speech/2006/spch090606jww.htm>; "Where's the Analysis?," John W. White, Director, Division of Corporation Finance, October 9, 2007, available at <http://www.sec.gov/news/speech/2007/spch100907jww.htm>.

<sup>5</sup> See "Staff Observations in the Review of Executive Compensation Disclosure, Division of Corporation Finance," available at <http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm>.

<sup>6</sup> Available on the SEC's website at <http://www.sec.gov/divisions/corpfin/cfguidance.shtml>.

<sup>7</sup> Compliance and Disclosure Interpretations, Regulation S-K, Question 118.04, available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>.

<sup>8</sup> Compliance and Disclosure Interpretations, Regulation S-K, Question 118.05, available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>.

<http://www.sec.gov/news/speech/2008/spch102108jww.htm>

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**APPENDIX E-VII**

**Shelley Parratt, *Speech by SEC Staff: Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010* (Nov. 9, 2009)**



## **Speech by SEC Staff: Executive Compensation Disclosure: Observations on the 2009 Proxy Season and Expectations for 2010**

*by*

**Shelley Parratt**

*Deputy Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

The 4th Annual Proxy Disclosure Conference: Tackling Your 2010  
Compensation Disclosures  
San Francisco, California  
November 9, 2009

Thank you, Jesse, for that kind introduction, and good morning. I'm very glad to be here with you today to share my thoughts on the current state of executive compensation disclosure under the Commission's rules and to talk about what we expect to see in the 2010 proxy season.

First, though, I need to remind you that the views I express today are my own, and do not necessarily represent the views of the Commission or other members of the staff.

Over the last several years, executive compensation has been subject to much debate. It seems that people from Main Street to Wall Street — and everywhere in between — have an intense interest in the topic. And with the ongoing challenges in the economy, there seems to be even more focus on executive compensation and its link to corporate accountability. Nearly every day there is a headline claiming that underperforming companies are overpaying their executives.

There is no reason to believe that the scrutiny of executive compensation practices at public companies will subside anytime soon. It is in a company's best interest to communicate clearly and effectively about its executive compensation and the Commission's disclosure requirements are designed to help you do that. While I'm not sure clear and transparent disclosure can trump emotion when it comes to money, it can't hurt.

The SEC's role in this area is not to regulate *how* companies compensate their executives, but rather to see that investors have the critical disclosure they need to make informed investment and voting decisions. The Compensation Discussion and Analysis is essential to providing investors with meaningful insight into the compensation policies and decisions of the companies in which they choose to invest. The CD&A is where a company tells its story about why it made the decisions it made.

### **The Division's Disclosure Program**

As a starting point, I thought it might be helpful to mention briefly the role of the Division's disclosure review program.

The Sarbanes-Oxley Act of 2002 requires that we review each reporting company at least once every three years.<sup>1</sup> It's a well-known fact that we review a substantial number of companies more frequently — and a large number of them every year. To place the scope of this program in context, in each of the last three fiscal years, we have reviewed the disclosure of more than 5,000 companies.

While many of our reviews are focused on a company's financial statements and related disclosure, we also remain focused on a company's non-financial disclosure, including its executive compensation disclosure. Our review of executive compensation disclosure is part of our normal review process and we continue to allocate significant resources to reviewing these disclosures. I'm sure many of you have received comments from us on your executive compensation disclosure during the past two years. If we have not reviewed your filings in either of the last two years, the chances are very good that we're planning to do so this year.

### **Observations on 2009 Executive Compensation Disclosure**

The Division has provided you with a report on the state of executive compensation disclosure at this conference over the past few years. When John White spoke to you in October 2007, he encouraged companies to start with a "clean slate" in drafting their CD&As<sup>2</sup> and take to heart the guidance the staff provided on executive compensation disclosure.<sup>3</sup> A year later, he reported that our comments on executive compensation disclosure mirrored those of the first year — companies needed to provide enhanced disclosure of their analyses and enhance their disclosure of performance targets and benchmarking.<sup>4</sup> Throughout this time, the Division has continued to provide companies with specific comments on their disclosure, reports on comment themes, and disclosure guidance in the form of Compliance and Disclosure Interpretations.

So, following what seems to have become a tradition, here I am in 2009 providing observations about executive compensation disclosure.

Following the end of the 2009 proxy season, we decided to take a look back at our comments and the state of issuers' disclosure. We wanted to identify common comment areas, understand how companies were responding to our comments, and evaluate whether we could improve the consistency of our comments and review of responses to those comments.

In looking back over the comments we issued, we noticed a couple of things. First, we found that we're pretty consistent in the comments we issued on executive compensation disclosure. Second, we noticed a pattern: companies we had previously reviewed continued to provide enhanced executive compensation disclosure and address the primary themes of comments as we identified in our 2007 report. Since 2007, these companies have enhanced their analyses and disclosure about performance targets and benchmarking, and as a result, we did not issue many comments to them. This doesn't mean that these companies couldn't improve their disclosure, but, for the most part, it appears that they have been paying attention to the disclosure requirements and our comment themes.

As for the companies we had not previously reviewed, we found that we issued a substantial number of comments addressing our common comment themes, even though we have made those themes public since October 2007.

Based on this review, we're left with one simple conclusion. The reason for

ongoing comments in these areas is not because companies do not understand the disclosure requirements — to the contrary, we believe that there is a general understanding of the rules. Rather, it seems that many are reluctant to address these comment themes until we provide specific comments requesting enhanced disclosure. Anecdotal evidence suggests the same — that companies may be disinclined to disclose detailed compensation information and prepare a rigorous analytical discussion of compensation practices until we ask them to do so in a review.

So where does that leave us? I hate to sound like a broken record, but once again, I must remind you to take a proactive approach to improving your CD&A disclosure. There's no need to wait for us to comment on your disclosure — after all, it is *your* disclosure. More importantly, your obligation to comply with our requirements is the same whether or not we review and comment on your disclosure. And even if we do not review your disclosure, your shareholders are reading it and are making voting and investment decisions based on it. That should be reason enough to motivate you to make your disclosure as good as it can possibly be.

That said, I'd like to mention two topics where companies should focus their attention in the coming year — analysis and performance targets.

### **Analysis**

In 2007, John White asked "Where's the Analysis?" and two years later, we often still can't find it. While many companies have improved their discussions of how and why they made the decisions they did, far too many companies continue to describe — in exhaustive detail — the framework in which they made the compensation decision, rather than the decision itself. The result is that the "how" and the "why" get lost in all the detail.

I'm not saying that you shouldn't provide a discussion of the framework. Our rules require a company to discuss how it determined compensation amounts for each material element of executive compensation, and the framework can be a useful tool to provide context for that disclosure. While the framework may provide context to investors, the CD&A should not be so technical and process-oriented that it obscures the explanation of what the compensation is designed to reward. A company's analysis of its compensation decisions should present shareholders with meaningful insight into its compensation policies and decisions, including the reasons behind them. Where analysis is lacking, shareholders are often left with a pages-long discussion that is heavy on process but does not explain the reasons why the named executive officers were compensated as they were.

I can't stress the "analysis" part of the Compensation Discussion and Analysis enough. Factual statements about what the company or compensation committee did or did not do are not enough. It isn't sufficient for a company to state that its compensation committee used tally sheets, wealth accumulation analyses, or internal pay equity analyses in making compensation decisions. The company should discuss how the committee used these tools to determine compensation amounts and structures, and explain why it reached its decisions. If a committee's pay determinations were simply subjective decisions, the company should say that. Otherwise, it isn't sufficient for a company to state simply that the committee made compensation decisions based on unspecified qualitative factors. A company should discuss the specific qualitative factors the committee considered and, as we put it back in 2007, "clearly lay out the way that qualitative inputs are ultimately translated into objective pay determinations."<sup>5</sup> Remember, your disclosure should tell your story and the story isn't complete without the analysis.

I don't want to leave you with the impression that the state of analysis in CD&A disclosure is abysmal. I do want to leave you with the impression that we think there are areas in which companies can and should improve. In the current economic environment, with the increased scrutiny on executive compensation, there is no better time to take a hard look at how you could improve your company's disclosure. This may be as simple as improving communications between the company's compensation decision-makers and the drafters of CD&A. Or it could be as simple as starting over with a blank sheet of paper.

We've heard that investors are becoming more and more frustrated by the increase in boilerplate language and CD&A length. We hear repeatedly that there is too much unnecessary bulk and we encourage you to see where you can shorten your disclosure by deleting unnecessary background and process-oriented information. The quality of your analysis is not measured by its length. We urge you to step back and make sure the real story is coming through loud and clear.

### **Performance Targets**

Those of you who have attended this program in the past know that a speech about executive compensation disclosure isn't complete without a discussion of performance targets. We issue more comments on performance targets than any other executive compensation disclosure item. When you say you pay for performance, we look for disclosure that will help your shareholders understand how your pay programs achieve that goal.

Investors feel strongly that companies should disclose performance targets and we want to make sure that companies understand our disclosure requirements on this critical topic. Let's start with the basics. When it comes to performance targets and disclosure, a company must first determine whether corporate or individual performance targets are material to its compensation policies and decisions. Making this determination often involves difficult judgment calls and, depending on the circumstances, we may question your conclusions.

In this regard, 2009 presented a host of public company compensation challenges. We saw instances where boards set performance targets that ultimately were not met, and as a result, bonuses were not awarded. We also saw instances where a board abandoned or ignored performance targets — the board awarded bonuses in an exercise of discretion rather than based on the established performance targets. These situations raised the question of whether the targets in question were material to the company's compensation policies and decisions.

The fact that a performance target was not met or was otherwise disregarded may be a factor to consider in the materiality determination, but it is not a dispositive one. Even where it does not result in an actual payout, a performance target may be material if, based on the company's specific facts and circumstances, it plays an important role in the way the company incentivizes its management.<sup>6</sup> Moreover, where a company pays its executives incentive compensation even though the relevant targets were not met, it can suggest that the targets, and compensation, are not sensitive to risk since the compensation is paid without regard to the risk outcome. In the absence of disclosure about those targets, we question whether shareholders are presented with the complete picture with which they can judge whether the board is acting in their best interests. Accordingly, in most cases, we would expect to see companies disclose and discuss such targets in their CD&A.

Where a company determines that certain performance targets are material, then it must specifically — and if applicable, quantitatively — disclose the targets, unless such disclosure would cause it substantial competitive harm.

Many companies use commercially-sensitive metrics in determining incentive compensation for their executive officers, and they are reluctant to disclose specific performance targets. They are concerned that competitors could use the information to harm the company's business. We do not want our rules to drive compensation committees to tie pay to the wrong measure simply to avoid competitive harm that would come from disclosure of the measure. To address these concerns, our rules seek to balance full disclosure with commercial realities. Companies may omit specific quantitative or qualitative performance-related targets, even where they are material to compensation policies and decisions, if disclosing them would likely cause competitive harm to the company.<sup>7</sup>

The standard that applies in this context is the same standard that would apply if a company were to file a formal request for confidential treatment of trade secrets or commercial or financial information contained in a material contract exhibit to a Securities Act or Exchange Act filing.<sup>8</sup> The touchstone of this standard is that the information must be confidential and disclosure of it would likely "cause substantial harm to the competitive position of the person from whom the information was obtained."<sup>9</sup> However, we've heard there is some confusion about the application of this standard to justify omitting a performance target. I'd like to try to clear up that confusion.

To justify omission of material performance targets based on the likelihood of competitive harm, a company must engage in the same analysis as it would in the context of a formal confidential treatment request. In our filing reviews, if a company's disclosure indicates that it uses performance targets in its compensation programs and it does not disclose those targets, we will likely ask it to explain its basis for omitting the targets. In a surprising number of instances, we find that companies failed to develop a thorough legal analysis prior to filing.

We understand that there's concern that we have applied a more rigorous competitive harm standard to compensatory arrangements than we have to material contracts. We have not intended for this to be the case. I'm not sure why people have the impression that the staff "goes easier" on confidential treatment requests relating to material contracts than on competitive harm arguments relating to performance targets. We apply the same standard to each analysis — even if we may review one kind of request more frequently than another. If you believe we are inappropriately concluding that your situation does not qualify for the exclusion, you should not hesitate to request reconsideration of your facts and circumstances. We include detailed instructions on how to seek this reconsideration on the SEC website.<sup>10</sup>

In our review of our comments on 2009 disclosure and the responses to those comments, we paid particular attention to competitive harm comments and responses. In a number of cases, the staff engaged in a thorough evaluation of competitive harm arguments in the comment and response process. When we reviewed those comments and responses, we found that where companies adequately explained the nexus between disclosure of the subject performance target and the potential for resulting competitive harm, we accepted the response and agreed with the omission of the specific target.

That said, it is often more difficult for companies to persuade us that disclosure of performance targets will result in competitive harm *after* the company has disclosed the amounts. This is especially true for targets that are tied to company-wide financial results that are publicly reported — such as targets tied to company-wide earnings per share. In this regard, we have yet to see any persuasive analyses explaining how competitors could pull together sufficiently-specific information about a company's future operations and strategy from the disclosure of these types of targets to cause the company competitive harm. Accordingly, absent highly unusual circumstances, companies should plan to disclose these kinds of performance targets if material to their compensation policies and decisions.

A final point I'd like to make on this topic is that when a company concludes that it may omit a performance target because disclosure would cause it competitive harm, it must disclose with meaningful specificity how difficult or likely it would be for the company or executive to achieve the undisclosed target.<sup>11</sup> A statement that the target is intended to be "challenging" is insufficient absent more detailed information. A company should provide support for the level of difficulty it asserts, which could include, for example, a discussion of the correlation between historical and future achievement of the relevant performance metric.

### What to Expect from the Comment Process in 2010

Now that I've told you what we found in our review of staff comments on 2009 executive compensation disclosures, let me turn to our expectations for 2010 disclosures.

To begin with, the Division is currently reviewing the comment letters submitted on the Commission's recent proposal to enhance proxy disclosure, including that related to compensation.<sup>12</sup> In the proposal, the Commission focuses on the current requirement to discuss how compensation relates to risk and proposes to expand CD&A to address how a company's overall compensation policies for its employees may create incentives that can affect the company's overall risk.<sup>13</sup> You should start thinking about how you would gather the additional information necessary to make the proposed disclosures because the proposed risk disclosure enhancements may well be in place for the coming proxy season. If this proposal is adopted, you can expect the new disclosure to be of interest to us in our reviews. Of course, the staff and Commission will carefully review the comment letters before the Commission decides on final rules.

In our first several years of reviewing disclosures under the existing rules, we wanted to encourage compliance generally by issuing futures comments<sup>14</sup> to give companies and their advisors time to understand and apply the new requirements to their circumstances and compensation practices. As companies have been digesting and applying the rules, we too have been enhancing our understanding of how they apply to various facts and circumstances. As we enter our fourth year of disclosure, our expectations for quality disclosure are heightened and we will reflect this in our comments.

What does that mean for you? It means that after three years of futures comments, we expect companies and their advisors to understand our rules and apply them thoroughly. So, any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules.

What should you focus on this year? Well, it's no secret where we think

companies can improve disclosure — I think we've been pretty clear about it in our comments, reports and speeches — but let me remind you one more time. First, please focus on making your disclosure more meaningful and understandable. When a company explains its compensation decision-making processes but does not explain why it made the compensation decisions it made, we will ask for enhanced disclosure of the analysis. When a company states that it determined a material element of compensation based on the achievement of performance targets, we will ask for specific disclosure of the targets and the actual achievement level against the targets, or for the company to provide us with an explanation of how such disclosure would cause it competitive harm. And if disclosure of material performance targets is not required, we will insist on meaningful degree of difficulty disclosure. When a company refers to a peer group used for benchmarking purposes, we'll ask for the names of the peer group companies and how you selected them, and where actual awards fell relative to the benchmark. Companies and their advisors should take care to address these themes as they draft next year's executive compensation disclosure. Now is the time to undertake an earnest attempt to prepare the best possible executive compensation disclosure consistent with the principles set forth in the rules.

As a principles-based disclosure requirement, the CD&A provides companies with wide discretion on how to address those principles. As such, companies should think broadly and not limit their disclosure to the non-exclusive examples the Commission provided in Item 402(b) of Regulation S-K. Where additional disclosure would be material to an understanding of a company's compensation policies or decisions, a company should provide that disclosure. While our principles-based disclosure requirement doesn't specifically require companies to disclose all aspects of their compensation programs, in these economic times with the attention shareholders are paying to executive compensation, a company should evaluate evolving materiality concerns with a view towards complete and transparent executive compensation disclosure.

## Closing

In closing, our goal in our review process is to help public companies provide investors with high-quality executive compensation disclosure that complies with both the letter and the spirit of the Commission's disclosure requirements. Don't wait for us to prod you into undertaking a good-faith effort to comply with the principles set forth in our disclosure requirements. Any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if we raise material comments. Now is the time to engage in a rigorous analysis to develop meaningful, coherent and comprehensive executive compensation disclosure.

While the SEC staff may appear to serve as your editor from time to time, the CD&A is your story to tell, not ours. Read our guidance. Read the publicly-available comment letters. Take a fresh look at the disclosure requirements. Pay attention to what the market is looking for. Your disclosure will be better if you do.

Thank you again for inviting me to join you today.

## Endnotes

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<sup>1</sup> See Sarbanes-Oxley Act of 2002, Pub. L. 107-204, Title IV, § 408, 116

Stat. 790 (July 30, 2002).

<sup>2</sup> See "Where's the Analysis?," John W. White, Director, Division of Corporation Finance, October 9, 2007, available at <http://www.sec.gov/news/speech/2007/spch100907jww.htm>.

<sup>3</sup> See, e.g., "Staff Observations in the Review of Executive Compensation Disclosure, Division of Corporation Finance," available at <http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm>.

<sup>4</sup> See "Executive Compensation Disclosure: Observations on Year Two and a Look Forward to the Changing Landscape for 2009," John W. White, Director, Division of Corporation Finance, October 21, 2008, available at <http://www.sec.gov/news/speech/2008/spch102108jww.htm>.

<sup>5</sup> "Staff Observations in the Review of Executive Compensation Disclosure, Division of Corporation Finance," *supra* note 3.

<sup>6</sup> See Item 402(b)(2)(vi) of Regulation S-K.

<sup>7</sup> See Instruction 4 to Item 402(b) of Regulation S-K.

<sup>8</sup> Formal confidential treatment requests can be made pursuant to Securities Act Rule 406 (17 C.F.R. § 230.406) or Exchange Act Rule 24b-2 (17 C.F.R. § 240.24b-2). Each of these rules incorporates the criteria for non-disclosure set forth in Exemption 4 of the Freedom of Information Act (5 U.S.C. § 552(b)(4)).

<sup>9</sup> Nat'l Parks & Conservation Ass'n v. Morton, 498 F.2d 765, 770 (D.C. Cir. 1974).

<sup>10</sup> See <http://www.sec.gov/divisions/corpfin/cffilingreview.htm>.

<sup>11</sup> See Instruction 4 to Item 402(b) of Regulation S-K.

<sup>12</sup> See Proxy Disclosure and Solicitation Enhancements, Release No. 33-9052 (July 10, 2009) ("Proxy Disclosure Enhancements Proposing Release"), available at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>.

<sup>13</sup> See Proxy Disclosure Enhancements Proposing Release, footnote 31.

<sup>14</sup> "Futures comments" are comments issued by the staff that ask companies to provide information or required disclosures in their response letters and/or in future filings, as opposed to in an amendment to the filing under review.

<http://www.sec.gov/news/speech/2009/spch110909sp.htm>

## F. SUMMARY COMPENSATION TABLE

The rules retain the requirement to include a summary compensation table in the annual proxy statement. Additionally, the rules require narrative disclosure to accompany the table.

### Rules

The summary compensation table requirement is located in Item 402(c) of Regulation S-K. Note a registrant that qualifies as a “smaller reporting company” may provide the scaled disclosure called for by paragraph (n) of Item 402 instead of paragraph (c) of such Item.

- See Part T. Smaller Reporting Companies.

Item 402(c) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

(c) *Summary Compensation Table.* (1) *General.* Provide the information specified in paragraph (c)(2) of this Item, concerning the compensation of the named executive officers for each of the registrant’s last three completed fiscal years, in a Summary Compensation Table in the tabular format specified below:

### 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									

(2) The Table shall include:

- (i) The name and principal position of the named executive officer (column (a));

- (ii) The fiscal year covered (column (b));
- (iii) The dollar value of base salary (cash and non-cash) earned by the named executive officer during the fiscal year covered (column (c));
- (iv) The dollar value of bonus (cash and non-cash) earned by the named executive officer during the fiscal year covered (column (d));

**Instructions to Item 402(c)(2)(iii) and (iv).**

1. If the amount of salary or bonus earned in a given fiscal year is not calculable through the latest practicable date, a footnote shall be included disclosing that the amount of salary or bonus is not calculable through the latest practicable date and providing the date that the amount of salary or bonus is expected to be determined, and such amount must then be disclosed in a filing under Item 5.02(f) of Form 8-K (17 CFR 249.308).

2. Registrants shall include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based or other forms of non-cash compensation instead have been received by the named executive officer. However, the receipt of any such form of non-cash compensation instead of salary or bonus must be disclosed in a footnote added to the salary or bonus column and, where applicable, referring to the Grants of Plan-Based Awards Table (required by paragraph (d) of this Item) where the stock, option or non-equity incentive plan award elected by the named executive officer is reported.

- (v) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (e));
- (vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (f));

**Instruction 1 to Item 402(c)(2)(v) and (vi).**

For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

**Instruction 2 to Item 402(c)(2)(v) and (vi).**

If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means ("repriced"), or otherwise has materially modified such awards, the registrant shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718, with respect to that repriced or modified award.

**Instruction 3 to Item 402(c)(2)(v) and (vi).**

For any awards that are subject to performance conditions, report the value at the grant date based upon the probable outcome of such conditions. This amount should be consistent with the estimate of aggregate compensation cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures. In a footnote to the table, disclose the value of the award at the grant date assuming that the highest level of performance conditions will be achieved if an amount less than the maximum was included in the table.

- (vii) The dollar value of all earnings for services performed during the fiscal year pursuant to awards under non-equity incentive plans as defined in paragraph (a)(6)(iii) of this Item, and all earnings on any outstanding awards (column (g));

**Instructions to Item 402(c)(2)(vii).**

1. If the relevant performance measure is satisfied during the fiscal year (including for a single year in a plan with a multi-year performance measure), the earnings are reportable for that fiscal year, even if not payable until a later date, and are not reportable again in the fiscal year when amounts are paid to the named executive officer.

2. All earnings on non-equity incentive plan compensation must be identified and quantified in a footnote to column (g), whether the earnings were paid during the fiscal year, payable during the period but deferred at the election of the named executive officer, or payable by their terms at a later date.

- (viii) The sum of the amounts specified in paragraphs (c)(2)(viii)(A) and (B) of this Item (column (h)) as follows:

- (A) The aggregate change in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans) from the pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the prior completed fiscal year to the pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the covered fiscal year; and
- (B) Above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans;

**Instructions to Item 402(c)(2)(viii).**

1. The disclosure required pursuant to paragraph (c)(2)(viii)(A) of this Item applies to each plan that provides for the payment of retirement benefits, or benefits that will be paid primarily following retirement, including but not limited to tax-qualified defined benefit plans and supplemental executive retirement plans, but excluding taxqualified defined contribution plans and

nonqualified defined contribution plans. For purposes of this disclosure, the registrant should use the same amounts required to be disclosed pursuant to paragraph (h)(2)(iv) of this Item for the covered fiscal year and the amounts that were or would have been required to be reported for the executive officer pursuant to paragraph (h)(2)(iv) of this Item for the prior completed fiscal year.

2. Regarding paragraph (c)(2)(viii)(B) of this Item, interest on deferred compensation is above-market only if the rate of interest exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under section 1274(d) of the Internal Revenue Code, (26 U.S.C. 1274(d))) at the rate that corresponds most closely to the rate under the registrant's plan at the time the interest rate or formula is set. In the event of a discretionary reset of the interest rate, the requisite calculation must be made on the basis of the interest rate at the time of such reset, rather than when originally established. Only the above-market portion of the interest must be included. If the applicable interest rates vary depending upon conditions such as a minimum period of continued service, the reported amount should be calculated assuming satisfaction of all conditions to receiving interest at the highest rate. Dividends (and dividend equivalents) on deferred compensation denominated in the registrant's stock ("deferred stock") are preferential only if earned at a rate higher than dividends on the registrant's common stock. Only the preferential portion of the dividends or equivalents must be included. Footnote or narrative disclosure may be provided explaining the registrant's criteria for determining any portion considered to be above-market.

3. The registrant shall identify and quantify by footnote the separate amounts attributable to each of paragraphs (c)(2)(viii)(A) and (B) of this Item. Where such amount pursuant to paragraph (c)(2)(viii)(A) is negative, it should be disclosed by footnote but should not be reflected in the sum reported in column (h).

- (ix) All other compensation for the covered fiscal year that the registrant could not properly report in any other column of the Summary Compensation Table (column (i)). Each compensation item that is not properly reportable in columns (c) - (h), regardless of the amount of the compensation item, must be included in column (i). Such compensation must include, but is not limited to:
  - (A) Perquisites and other personal benefits, or property, unless the aggregate amount of such compensation is less than \$10,000;
  - (B) All "gross-ups" or other amounts reimbursed during the fiscal year for the payment of taxes;
  - (C) For any security of the registrant or its subsidiaries purchased from the registrant or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally, either to all security holders or to all salaried employees of the registrant, the compensation cost, if any, computed in accordance with FASB ASC Topic 718;
  - (D) The amount paid or accrued to any named executive officer pursuant to a plan or arrangement in connection with:

- (1) Any termination, including without limitation through retirement, resignation, severance or constructive termination (including a change in responsibilities) of such executive officer's employment with the registrant and its subsidiaries; or
- (2) A change in control of the registrant;
- (E) Registrant contributions or other allocations to vested and unvested defined contribution plans;
- (F) The dollar value of any insurance premiums paid by, or on behalf of, the registrant during the covered fiscal year with respect to life insurance for the benefit of a named executive officer; and
- (G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (e) or (f).

**Instructions to Item 402(c)(2)(ix).**

1. Non-equity incentive plan awards and earnings on stock and options, except as specified in paragraph (c)(2)(ix)(G) of this Item, are required to be reported elsewhere as provided in this Item and are not reportable as All Other Compensation in column (i).
2. Benefits paid pursuant to defined benefit and actuarial plans are not reportable as All Other Compensation in column (i) unless accelerated pursuant to a change in control; information concerning these plans is reportable pursuant to paragraphs (c)(2)(viii)(A) and (h) of this Item.
3. Any item reported for a named executive officer pursuant to paragraph (c)(2)(ix) of this Item that is not a perquisite or personal benefit and whose value exceeds \$10,000 must be identified and quantified in a footnote to column (i). This requirement applies only to compensation for the last fiscal year. All items of compensation are required to be included in the Summary Compensation Table without regard to whether such items are required to be identified other than as specifically noted in this Item.
4. Perquisites and personal benefits may be excluded as long as the total value of all perquisites and personal benefits for a named executive officer is less than \$10,000. If the total value of all perquisites and personal benefits is \$10,000 or more for any named executive officer, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a named executive officer pursuant to this rule, then each perquisite or personal benefit that exceeds the greater of \$25,000 or 10% of the total amount of perquisites and personal benefits for that officer must be quantified and disclosed in a footnote. The requirements for identification and quantification apply only to compensation for the last fiscal year. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the registrant. With respect to the perquisite or other personal benefit for which footnote quantification is required, the registrant shall describe in the footnote its methodology for computing the aggregate incremental cost. Reimbursements of taxes owed with respect to perquisites or other personal benefits must be included in column (i) and are subject to

separate quantification and identification as tax reimbursements (paragraph (c)(2)(ix)(B) of this Item) even if the associated perquisites or other personal benefits are not required to be included because the total amount of all perquisites or personal benefits for an individual named executive officer is less than \$10,000 or are required to be identified but are not required to be separately quantified.

5. For purposes of paragraph (c)(2)(ix)(D) of this Item, an accrued amount is an amount for which payment has become due.

- (x) The dollar value of total compensation for the covered fiscal year (column (j)). With respect to each named executive officer, disclose the sum of all amounts reported in columns (c) through (i).

**Instructions to Item 402(c).**

1. Information with respect to fiscal years prior to the last completed fiscal year will not be required if the registrant was not a reporting company pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) at any time during that year, except that the registrant will be required to provide information for any such year if that information previously was required to be provided in response to a Commission filing requirement.

2. All compensation values reported in the Summary Compensation Table must be reported in dollars and rounded to the nearest dollar. Reported compensation values must be reported numerically, providing a single numerical value for each grid in the table. Where compensation was paid to or received by a named executive officer in a different currency, a footnote must be provided to identify that currency and describe the rate and methodology used to convert the payment amounts to dollars.

3. If a named executive officer is also a director who receives compensation for his or her services as a director, reflect that compensation in the Summary Compensation Table and provide a footnote identifying and itemizing such compensation and amounts. Use the categories in the Director Compensation Table required pursuant to paragraph (k) of this Item.

4. Any amounts deferred, whether pursuant to a plan established under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), or otherwise, shall be included in the appropriate column for the fiscal year in which earned.

**Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

The requirement to provide narrative disclosure accompanying the summary compensation table requirement is located in Item 402(e) of Regulation S-K which reads as follows:

**Regulation S-K, Item 402 (Executive Compensation).**

*(e) Narrative disclosure to summary compensation table and grants of plan-based awards table.*

- (1) Provide a narrative description of any material factors necessary to an understanding of the information disclosed in the tables required by paragraphs (c) and (d) of this Item. Examples of such factors may include, in given cases, among other things:
  - (i) The material terms of each named executive officer's employment agreement or arrangement, whether written or unwritten;
  - (ii) If at any time during the last fiscal year, any outstanding option or other equity-based award was repriced or otherwise materially modified (such as by extension of exercise periods, the change of vesting or forfeiture conditions, the change or elimination of applicable performance criteria, or the change of the bases upon which returns are determined), a description of each such repricing or other material modification;
  - (iii) The material terms of any award reported in response to paragraph (d) of this Item, including a general description of the formula or criteria to be applied in determining the amounts payable, and the vesting schedule. For example, state where applicable that dividends will be paid on stock, and if so, the applicable dividend rate and whether that rate is preferential. Describe any performance-based conditions, and any other material conditions, that are applicable to the award. For purposes of the Table required by paragraph (d) of this Item and the narrative disclosure required by paragraph (e) of this Item, performance-based conditions include both performance conditions and market conditions, as those terms are defined in FASB ASC Topic 718; and
  - (iv) An explanation of the amount of salary and bonus in proportion to total compensation.

**Instructions to Item 402(e)(1).**

1. The disclosure required by paragraph (e)(1)(ii) of this Item would not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.
2. Instructions 4 and 5 to Item 402(b) apply regarding disclosure pursuant to paragraph (e)(1) of this Item of target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant.

## Adopting Release Excerpts

Excerpts from the adopting releases include:

- As we noted in the Proposing Release, by more clearly organizing the compensation tables to explain how the elements relate to each other, we may in some situations be requiring disclosure of both amounts earned (or potentially earned) and amounts subsequently paid out. This approach raises the possible perception of “double counting” some elements of compensation in multiple tables. However, a particular item of compensation only appears once in the Summary Compensation Table. In order to explain the item of compensation, it may also appear in one or more of the other tables. We believe the possible perception of double disclosure is outweighed by the clearer and more complete picture the disclosure in the additional tables will provide to investors. We strongly encourage companies to use the narrative following the tables (and where appropriate the Compensation Discussion and Analysis) to explain how disclosures relate to each other in their particular circumstances.
- We are modifying the Summary Compensation Table to provide a clearer picture of total compensation. As we proposed, we are requiring that all compensation be disclosed in dollars and that a total of all compensation be provided. The new “Total” column aggregates the total dollar value of each form of compensation quantified in the other columns (revised columns (c) through (i)). This column responds to concerns that investors, analysts and other users of Item 402 disclosure have not been able to compute aggregate amounts of compensation using the disclosure in the table as specified prior to these amendments in a manner that was accurate or comparable across years or companies.
- As we proposed, compensation that is earned, but for which payment will be deferred, must be included in the salary, bonus or other column, as appropriate. A new instruction, applicable to the entire Summary Compensation Table, provides that if receipt of any amount of compensation is currently payable but has been deferred for any reason, the amount so deferred must be included in the appropriate column. This treatment is no longer limited to salary and bonus, as it was prior to these amendments, and under the amended rules this treatment applies regardless of the reason for the deferral.
- As proposed and adopted, the Stock Awards column (column (e)) discloses stock-related awards that derive their value from the company’s equity securities or permit settlement by issuance of the company’s equity securities and, as we have clarified, are thus within the scope of [FASB Accounting Standards Codification Topic 718 (“FASB ASC 718”)] for financial reporting, such as restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or other similar instruments that do not have option-like features. Stock awards granted pursuant to an equity incentive plan are also included in this column to ensure consistent reporting of stock awards and to ensure their inclusion in the revised Summary Compensation Table.
- After considering the comments received, we are adopting the proposed amendments to revise Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant date fair value of awards computed in accordance with FASB ASC Topic 718, with a special instruction for awards

subject to performance conditions as described below. We agree with commenters that aggregate grant date fair value disclosure better reflects the compensation committee's decision with regard to stock and option awards. We remain of the view that it is more meaningful to shareholders if company compensation decisions—including decisions to grant large “one time” multi-year awards—cause the named executive officers to change. In circumstances where such a large “new hire” or “retention” grant results in the omission from the Summary Compensation Table of another executive officer whose compensation otherwise would have been subject to reporting, the company can consider including compensation disclosure for that executive officer to supplement the required disclosures.

- We are persuaded that the value of performance awards reported in the Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table should be computed based upon the probable outcome of the performance condition(s) as of the grant date because that value better reflects how compensation committees take performance- contingent vesting conditions into account in granting such awards. We are adopting new Instructions to these tables to clarify that this amount will be consistent with the grant date estimate of compensation cost to be recognized over the service period, excluding the effect of forfeitures. To provide investors additional information about an award’s potential maximum value subject to changes in performance outcome, we will also require in the Summary Compensation Table and Director Compensation Table footnote disclosure of the maximum value assuming the highest level of performance conditions is probable. Such footnote disclosure will permit investors to understand an award’s maximum value without raising the concerns associated with requiring its tabular disclosure.
- We are requiring disclosure of awards granted during the year, as proposed. A number of commenters responded to our request for comment by indicating that they would prefer disclosure of the aggregate grant date fair value of equity awards granted for services in the relevant fiscal year, even if granted after fiscal year end, rather than awards granted during the relevant fiscal year, as proposed. Other commenters expressed concern that revising the proposal in this way would result in a lack of uniformity that would confuse investors, would be inconsistent with the FASB ASC Topic 718 grant date, and could invite manipulated reporting. We recognize that a “performance year” standard for reporting equity awards in securities in the relevant fiscal year may sometimes better align compensation disclosure with compensation decision making, and may be more consistent with Summary Compensation Table salary and bonus disclosure. However, because it appears that multiple subjective factors, which could vary significantly from company to company, influence equity awards granted after fiscal year end, we are concerned that changing the approach to reporting could result in inconsistencies that would erode comparability. One commenter noted that many companies make equity awards after the end of the fiscal year based on executive performance during the last completed fiscal year, but determining whether an equity award was granted primarily for services performed during the last completed fiscal year can be a highly subjective determination and the factors that influence the decision of when to report an equity award may vary significantly from company to company. Companies should continue to analyze in CD&A their decisions to grant post-fiscal year end equity awards where those decisions could affect a fair understanding of named executive officers’ compensation for the last fiscal year, and consider including supplemental tabular disclosure where it facilitates understanding the CD&A.

- We also revise the instruction to the Summary Compensation Table Salary and Bonus columns regarding salary or bonus forgone at the election of a named executive officer in favor of receiving a non-cash form of compensation. Reporting such forgone amounts in the Stock Awards or Option Awards columns after salary or bonus is earned is inconsistent with the original terms of the award that would have compensated the named executive officer in cash. Accordingly, the revised instruction requires the forgone amount to be reported in the Salary or Bonus column, with footnote disclosure of the receipt of non-cash compensation that refers to the Grants of Plan-Based Awards Table where the stock, option or non-equity incentive plan award elected is reported.
- The Non-Equity Incentive Plan Compensation column (column (g)) will report, as proposed, the dollar value of all amounts earned during the fiscal year pursuant to nonequity incentive plans. This column includes all other incentive plan awards not included in the stock awards and option awards columns.
  - Compensation awarded under an incentive plan that is not within the scope of [FASB ASC 718] will be disclosed in the Summary Compensation Table in the year when the relevant specified performance criteria under the plan are satisfied and the compensation earned, whether or not payment is actually made to the named executive officer in that year.
  - The grant of an award under a non-equity incentive plan will be disclosed in the supplemental Grants of Plan-Based Awards Table in the year of grant, which may be some year prior to the year in which compensation under the non-equity incentive plan is reported in the Summary Compensation Table.
  - Once the disclosure has been provided in the Summary Compensation Table when the specified performance criteria have been satisfied and the compensation earned, and the grant of the award has been disclosed in the Grants of Plan-Based Awards Table, no further disclosure will be specifically required when payment is actually made to the named executive officer.
  - Some commenters objected to Summary Compensation Table reporting of awards for which the relevant performance condition has been satisfied that remain subject to forfeiture conditions (such as conditions requiring continued service or conditions that provide for forfeiture based on future company performance). We continue to believe that satisfaction of the relevant performance condition (including an interim performance condition in a long term plan) is the event that is material to investors for Summary Compensation Table reporting purposes. We encourage companies to use the related narrative section to disclose material features that are not reflected in the tabular disclosure including, for example, subsequent forfeitures of amounts reported in the table with respect to previous fiscal years.
- As proposed and adopted, the amendments define an “incentive plan” as any plan providing compensation intended to serve as incentive for performance to occur over a specified period. The related definition of “incentive plan award” as an award provided under an incentive plan is also adopted as proposed.

- Noting that companies formerly reported as “bonuses” awards that would be short-term incentive plan awards under this definition, commenters requested guidance as to what distinguishes items reportable as non-equity incentive plan compensation from those reportable as bonuses under the amended rules. An award would be considered “intended to serve as an incentive for performance to occur over a specified period” if the outcome with respect to the relevant performance target is substantially uncertain at the time the performance target is established and the target is communicated to the executive. Compensation pursuant to such a non-equity award would be reported in the Summary Compensation Table as non-equity incentive plan compensation and the grant of the award would be reported as a non-equity incentive plan award in the Grants of Plan-Based Awards Table. In contrast, a cash award based on satisfaction of a performance target that was not pre-established and communicated, or the outcome of which is not substantially uncertain, would be reportable in the Summary Compensation Table as a bonus.
- We confirm that disclosure of all compensation is clearly required under the rules.
  - The only exception, as discussed below, is for perquisites and personal benefits if they aggregate less than \$10,000 for a named executive officer. The 1992 Release, at Section II.A.4., also noted “the revised item includes an express statement that it requires disclosure of all compensation to the named executive officers and directors for services rendered in all capacities to the registrant and its subsidiaries.” See also Item 402(a)(2) as stated prior to these amendments. Further, as described above, Summary Compensation Table disclosure of nonqualified deferred compensation earnings is limited to the above-market or preferential portion of earnings. As was previously the case before these amendments, companies may omit information regarding group life, health, hospitalization and medical reimbursement plans that do not discriminate in scope, terms or operation in favor of executive officers or directors of the company and that are available generally to all salaried employees. See Item 402(a)(6)(ii).
- Where perquisites are subject to identification, they must be described in a manner that identifies the particular nature of the benefit received. For example, it is not sufficient to characterize generally as “travel and entertainment” different company-financed benefits, such as clothing, jewelry, artwork, theater tickets and housekeeping services.
- As was formerly the case, tax “gross-ups” or other reimbursement of taxes owed with respect to any compensation, including but not limited to perquisites and other personal benefits, must be separately quantified and identified in the tax reimbursement category described below, even if the associated perquisites or other personal benefits are eligible for exclusion or would not require identification or footnote quantification under the rule.
- In response to commenters’ concerns about double counting pension benefits, we have not retained the aspect of proposed Instruction 2 to this column that would have required disclosure of pension benefits paid to the named executive officer during the period covered by the table. As adopted, an instruction provides that benefits paid pursuant to defined benefit and actuarial plans are not reportable as All Other Compensation unless accelerated pursuant to a change in control. Similarly, distributions of nonqualified deferred compensation are not reportable as All Other Compensation.

- Unlike the Compensation Discussion and Analysis, which focuses on broader topics regarding the objectives and implementation of executive compensation policies, the narrative disclosures following the Summary Compensation Table and other tables focus on and provide specific context to the quantitative disclosure in the tables. For example, narrative disclosure following a table might explain material aspects of a plan that are not evident from the quantitative tabular disclosure and are not addressed in the Compensation Discussion and Analysis.

## Practice Pointers

### NEO Determination

- *See Part C. Determination of Named Executive Officers* for information concerning how the named executive officers are determined.

### All Compensation Covered

- Other than a few very narrowly defined exceptions specifically discussed in the adopting release (*e.g.*, perquisites for a named executive officer below \$10,000 in total value and benefits under non-discriminatory group life, health, hospitalization and medical reimbursement plans), the Summary Compensation Table is required to disclose all elements of compensation.
  - *See* John W. White, *Principles Matter*, Address at the Practising Law Institute Conference (September 6, 2006), a copy of which is located at [Appendix B-VI](#).
  - *See Part B. The New Rules*.

### Report Salary or Bonus Not Determined as of Proxy Statement Date on Form 8-K

- If a named executive officer's salary or bonus was not determinable when the registrant filed its proxy statement (or Form 10-K), when such officer's salary or bonus becomes determinable the registrant must file a Form 8-K disclosing under Item 5.02(e) the amount awarded as salary or bonus.
  - *See Part S. Amendments to Form 8-K*.

### Report Deferred Compensation

- Compensation that is earned during a fiscal year is reportable in the Summary Compensation Table for the year earned, even if deferred.

### Do Not Report Compensation for Years Prior to NEO Status

- If a named executive officer was not a named executive officer in a prior fiscal year, compensation information for such prior fiscal year is not required to be included in the Summary Compensation Table.

- See *Appendix B-III, SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.01.*

### **Distinction Between Bonus and Non-Equity Incentive Plan Compensation**

- The Summary Compensation Table distinguishes between bonus (reported in column (d)) and non-equity incentive plan compensation (reported in column (g)). In general, annual cash awards that are based on the achievement of pre-determined performance goals must now be reported in the Summary Compensation Table as non-equity incentive plan compensation for the year earned and in the Grants of Plan Based Awards table as of the date of grant. Guaranteed or discretionary cash bonuses must be reported in the bonus column of the Summary Compensation Table for the year earned.
  - See adopting release (excerpted above) for a discussion of how to distinguish between a bonus and a non-equity incentive plan award.
  - See also *Part D. Definitions.*

### **Distinction Between Stock Awards and Option Awards**

- The Summary Compensation Table distinguishes between stock awards (reported in column (e)) and option awards (reported in column (f)).
  - See *Part D. Definitions.*

### **Report Stock and Option Awards in Dollars Based on Grant Date Fair Value**

- The rule changes adopted by the SEC in December 2009 (the “Amendments”) changed the way compensation related to stock options, restricted stock and other equity grants is reported in the Summary Compensation Table. Equity awards must now be reflected in the year awarded based on their full aggregate grant date fair value computed in accordance with FASB Accounting Standards Codification Topic 718 (“FASB ASC 718”), rather than based on the expense attributable to them in the applicable fiscal year.
  - Also, the Amendments require that the value of performance-based awards be based on the “probable outcome of such conditions(s).” Footnote disclosure is required to show the value of the performance-based award assuming that the highest level of performance will be achieved if an amount less than the maximum was included in the table.
  - This new manner of disclosure applies to all disclosures made after December 20, 2009 and will be required for awards made in prior years. That is, amounts in the Summary Compensation Table will need to be recomputed for prior years, but the recomputations are for informational purposes only and do not require the company to change the individuals reported as its named executive officers for any preceding year or amend any earlier filing.
  - The grant date fair value amounts included in the Summary Compensation Table will also appear, on a grant-by-grant basis, in the Grant of Plan Based Awards table.

- Amounts are included in the Summary Compensation Table in the year of grant, even if the equity award was part of annual compensation awarded for performance in the year prior to grant (a common practice at many companies). The timing of reporting grant date values for equity awards thus differs from cash incentive awards, which are reported for the year earned, even if the award is not determined until the following year (as is typical). Consequently, the Summary Compensation Table may not accurately reflect compensation decisions made for the year. For example, if a large cash incentive award and equity award are granted in early 2009 based on 2008 performance, the cash award will appear in the 2008 row of the Summary Compensation Table but the grant date fair value of the equity award will be included in the 2009 row. In this case, supplemental disclosure in the CD&A should be considered.

### **Reporting Equity Taken in Lieu of Salary or Bonus**

- Generally companies are to include in the Salary column or the Bonus column any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based, or other forms of non-cash compensation have been received instead by the named executive officer. Any equity or other non-cash award accepted in lieu of salary or bonus should be reported in the Grants of Plan-Based Awards Table and the Summary Compensation Table should include footnote disclosure regarding the receipt of non-cash compensation in lieu of salary or bonus that refers to the Grants of Plan-Based Awards Table where the award is reported.
- However, if the amount of salary or bonus foregone at the election of the named executive officer was less than the value of the equity-based compensation received, the incremental value of an equity award would be reported in the Stock Awards or Option Awards columns. If the agreement pursuant to which the named executive officer had the option to elect settlement in stock or equity-based compensation was within the scope of FASB ASC 718 (e.g., the right to stock settlement is embedded in the terms of the award) the award would be reported in the Stock Awards or Option Awards columns.
  - See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.03.*

### **Earnings on Equity Awards**

- The right to receive dividends or other earnings on equity awards is generally factored into the grant date fair value of the awards computed under FASB ASC 718, and therefore included in the FASB ASC 718 expense. As a result, in most circumstances, dividends or other earnings on equity awards are not required to be reported in the Summary Compensation Table. However, in cases where the right to receive dividends is not factored into the grant date fair value of an equity award, any earnings on such award must be reported in the All Other Compensation column of the Summary Compensation Table.

### **Change in Pension Value “No Negative Number” Rule**

- Where the amount of the change in the actuarial present value of the accumulated pension benefit is negative, the amount should be disclosed by footnote but should not be reflected in

the sum reported in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column. However, when a company aggregates all of the decreases and increases in the value of a named executive officer's individual pension plans, a company may subtract negative values when aggregating the changes in the actuarial present values of the accumulated benefits under the plans, and apply the "no negative number" rule for the final number after aggregating all plans.

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.06.*

### **Treat a Pension Plan Distribution as an Increase in Pension Value**

- An in-service pension plan distribution should be treated as an increase in pension value in the Change in Pension Value and Nonqualified Deferred Compensation Earnings column of the Summary Compensation Table.

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Interpretive Responses Regarding Particular Situations, Section 219, Item 219.04.*

### **Use of Supplemental Table to Report Elements of "All Other Compensation"**

- If the "All Other Compensation" provided to the executive officers is comprised of a number of different items, companies may want to disclose the items in a separate table accompanying the Summary Compensation Table.

- See *Appendix F-I. Sample Table Disclosing Components of All Other Compensation.*
- See also *Part R. Plain English Requirement.*

### **Disclosure of Accrued Severance**

- The amount accrued to a named executive officer in connection with termination of such executive officer's employment or a change in control is reportable in the "All Other Compensation" column. An amount is accrued, and thus reportable, if the named executive officer's performance necessary to earn the amount is complete.
  - For example, if the named executive officer has completed all performance to earn an amount, but payment is subject to a six-month deferral in order to comply with Internal Revenue Code Section 409A, the amount would be an accrued amount required to be disclosed.
  - In contrast, if an amount will be payable two years after termination if the named executive officer cooperates with (or complies with a covenant not to compete with) the company during that period, the amount is not reportable because the executive officer's performance is still necessary for the payment to become due.
- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.13.*

## Perquisites

- For information regarding the disclosure of perquisites and personal benefits in the Summary Compensation Table, *see Part G Perquisites.*

## Narrative Disclosure

- Per Item 402(e) of Regulation S-K, the Summary Compensation Table and Grants of Plan-Based Awards tables are required to be accompanied by a narrative discussion describing any material factors necessary to an understanding of the information disclosed in the table. Examples would include a discussion of:
  - the material terms of employment agreements; and
  - the material terms of equity and non-equity incentive plan awards, including a description of the vesting schedules and formulas for determining the amounts payable.
    - As with CD&A, performance targets are not required to be disclosed if such targets qualify for non-disclosure under the SEC’s existing standards for confidential treatment requests. For additional information *see Part E. Compensation Discussion and Analysis, “Potential Disclosure of Performance Targets.”*
    - Using this narrative text to describe the material terms of agreements/awards can help “unclutter” the CD&A; the CD&A should focus on a crisp analysis of the reasons for the agreements/awards without getting bogged down on the details of the agreements/awards.
- In addition, companies should consider explaining the amount of salary and bonus paid to named executive officers in proportion to total compensation if other items of compensation significantly influenced the determination of the named executive officers salary and bonus.
- As discussed in the adopting release, to avoid “double counting” in light of the fact that some items disclosed in the Summary Compensation Table are also disclosed in other required tables, companies should use the narrative following the tables to explain how disclosures relate to each other in their particular circumstances.

## Smaller Reporting Companies

- A registrant that qualifies as a “smaller reporting company” may provide the scaled disclosure called for by paragraph (n) of Item 402 instead of paragraphs (c) of such Item.
  - *See Part T. Smaller Reporting Companies.*

**APPENDIX F-I**

**Sample Table Disclosing Components of All Other  
Compensation**

### Components of All Other Compensation

[In the All Other Compensation column of the Summary Compensation Table, all compensation for the covered fiscal year that could not properly be reported in any other column of the Summary Compensation Table is required to be reported. Any item so reported that is not a perquisite or personal benefit and whose value exceeds \$10,000, and any perquisite or personal benefit that exceeds the greater of \$25,000 or 10% of the total amount of perquisites and personal benefits for a named executive officer, must be identified and quantified in a footnote. The new rules do not require this disclosure to be made in tabular format; however, consideration should be given to disclosing the information in tabular format similar to the below.]

For fiscal year 2006, the amounts set forth under All Other Compensation consisted of the following

<b>Benefits and Perquisites</b>	<b>Mr. W</b>	<b>Ms. X</b>	<b>Mr. Y</b>	<b>Ms. Z</b>
Company contributions to Retirement Plan	\$ 6,000	\$ 6,000	\$ 6,000	\$ -
Company contributions to 401(k) Plan	8,600	6,000	8,600	-
Term life insurance premiums	1,500	1,500	1,500	1,200
Country club membership dues	22,000	10,000	-	-
Dividends on Restricted Stock	14,000	7,000	-	-
Automobile allowance	10,000	10,000	8,000	8,000
Commuting expenses	-	17,166	-	19,101
Tax gross-up payments	-	6,866	-	7,640
Relocation expenses	-	-	-	18,000
<b>Total</b>	<b>\$ 62,100</b>	<b>\$ 64,532</b>	<b>\$ 24,100</b>	<b>\$ 53,941</b>

## **G. PERQUISITES**

### **Rules**

The rules specifically require disclosure of perquisites and personal benefits for both named executive officers and directors.

- See Item 402(c)(2)(ix)(A) requiring perquisite disclosure in the Summary Compensation Table.
  - *See Part F. Summary Compensation Table.*
- See Item 402(j)(1) requiring disclosure of perquisites payable to named executive officers upon termination or change-in-control.
  - *See Part M. Potential Payments Upon Termination or Change-in-Control.*
- See Item 402(k)(2)(vii)(A) requiring perquisite disclosure in the Director Compensation Table.
  - *See Part N. Director Compensation Table.*

### **Adopting Release**

The rules do not define “perquisites and personal benefits.” However, the adopting release contains the following interpretive guidance regarding how to determine whether an item is a perquisite:

- We continue to believe that it is not appropriate for Item 402 to define perquisites or personal benefits, given that different forms of these items continue to develop, and thus a definition would become outdated. As stated in the Proposing Release, we are concerned that sole reliance on a bright line definition in our rules might provide an incentive to characterize perquisites or personal benefits in ways that would attempt to circumvent the bright lines.
- Among the factors to be considered in determining whether an item is a perquisite or other personal benefit are the following:
  - An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive’s duties.
  - Otherwise, an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.
- We believe the way to approach this is by initially evaluating the first prong of the analysis. If an item is integrally and directly related to the performance of the executive’s duties, that is the end of the analysis – the item is not a perquisite or personal benefit and no

compensation disclosure is required. Moreover, if an item is integrally and directly related to the performance of an executive's duties under this analysis, there is no requirement to disclose any incremental cost over a less expensive alternative. For example, with respect to business travel, it is not necessary to disclose the cost differential between renting a mid-sized car over a compact car.

- Because of the integral and direct connection to job performance, the elements of the second part of the analysis (*e.g.*, whether there is also a personal benefit or whether the item is generally available to other employees) are irrelevant. An example of such an item could be a “Blackberry” or a laptop computer if the company believes it is an integral part of the executive's duties to be accessible by e-mail to the executive's colleagues and clients when out of the office. Just as these devices represent advances over earlier technology (such as voicemail), we expect that as new technology facilitates the extent to which work is conducted outside the office, additional devices may be developed that will fall into this category.
- The concept of a benefit that is “integrally and directly related” to job performance is a narrow one. The analysis draws a critical distinction between an item that a company provides because the executive needs it to do the job, making it integrally and directly related to the performance of duties, and an item provided for some other reason, even where that other reason can involve both company benefit and personal benefit. Some commenters objected that “integrally and directly related” is too narrow a standard, suggesting that other business reasons for providing an item should not be disregarded in determining whether an item is a perquisite. We do not adopt this suggested approach. As we stated in the Proposing Release, the fact that the company has determined that an expense is an “ordinary” or “necessary” business expense for tax or other purposes or that an expense is for the benefit or convenience of the company is not responsive to the inquiry as to whether the expense provides a perquisite or other personal benefit for disclosure purposes. Whether the company should pay for an expense or it is deductible for tax purposes relates principally to questions of state law regarding use of corporate assets and of tax law; our disclosure requirements are triggered by different and broader concepts.
- As we noted in the Proposing Release, business purpose or convenience does not affect the characterization of an item as a perquisite or personal benefit where it is not integrally and directly related to the performance by the executive of his or her job. Therefore, for example, a company's decision to provide an item of personal benefit for security purposes does not affect its characterization as a perquisite or personal benefit. A company policy that for security purposes an executive (or an executive and his or her family) must use company aircraft or other company means of travel for personal travel, or must use company or company-provided property for vacations, does not affect the conclusion that the item provided is a perquisite or personal benefit.
- If an item is not integrally and directly related to the performance of the executive's duties, the second step of the analysis comes into play. Does the item confer a direct or indirect benefit that has a personal aspect (without regard to whether it may be provided for some business reason or for the convenience of the company)? If so, is it generally available on a non-discriminatory basis to all employees? For example, a company's provision of helicopter

service for an executive to commute to work from home is not integrally and directly related to job performance (although it would benefit the company by getting the executive to work faster), clearly bestows a benefit that has a personal aspect, and is not generally available to all employees on a non-discriminatory basis. As we have noted, business purpose or convenience does not affect the characterization of an item as a perquisite or personal benefit where it is not integrally and directly related to the performance by the executive of his or her job.

- A company may reasonably conclude that an item is generally available to all employees on a non-discriminatory basis if it is available to those employees to whom it lawfully may be provided. For this purpose, a company may recognize jurisdictionally based legal restrictions (such as for foreign employees) or the employees' "accredited investor" status. In contrast, merely providing a benefit consistent with its availability to employees in the same job category or at the same pay scale does not establish that it is generally available on a non-discriminatory basis to all employees.
- Applying the concepts that we outline above, examples of items requiring disclosure as perquisites or personal benefits under Item 402 include, but are not limited to: club memberships not used exclusively for business entertainment purposes, personal financial or tax advice, personal travel using vehicles owned or leased by the company, personal travel otherwise financed by the company, personal use of other property owned or leased by the company, housing and other living expenses (including but not limited to relocation assistance and payments for the executive or director to stay at his or her personal residence), security provided at a personal residence or during personal travel, commuting expenses (whether or not for the company's convenience or benefit), and discounts on the company's products or services not generally available to employees on a non-discriminatory basis.
- Beyond the examples provided, we assume that companies and their advisors, who are more familiar with the detailed facts of a particular situation and who are responsible for providing materially accurate and complete disclosure satisfying our requirements, can apply the two-step analysis to assess whether particular arrangements require disclosure as perquisites or personal benefits. In light of the importance of the subject to many investors, all participants should approach the subject of perquisites and personal benefits thoughtfully.

## Practice Pointers

### Disclosure of Perquisites in Summary Compensation Table

- Perquisites and personal benefits must be included in the All Other Compensation columns of the Summary Compensation Table and Director Compensation Table, as applicable.
  - Perquisites and personal benefits for a named executive officer or director may be excluded if the total value of perquisites and personal benefits for such individual is less than \$10,000.

- If the total value of all perquisites and personal benefits is \$10,000 or more for a named executive officer or director, then each perquisite or personal benefit provided to such individual must be identified by type in a footnote.
  - Note that this may require disclosure of some perquisites even if the incremental cost of the perquisites is zero.
- If the total value of a particular perquisite or personal benefit exceeds the greater of \$25,000 or 10% of the total value of all perquisites and personal benefits for a named executive officer or director, then such perquisite or personal benefit must also be quantified in a footnote.

### **Disclosure Based on Incremental Cost**

- The rules continue to require that perquisites be measured based on their incremental cost and now require companies to disclose, for each perquisite or personal benefit that is required to be quantified in a footnote, the methodology used in determining incremental cost.
  - Of particular note in this regard, in the adopting release the SEC reaffirmed its position that the incremental cost of perquisites, including corporate aircraft, is not linked to any rates used for tax purposes (such as SIFL).
  - If a perquisite or other personal benefit has no aggregate incremental cost, it must still be separately identified by type if the total amount of perquisites provided to the individual exceeds \$10,000. Any item for which an executive officer has actually fully reimbursed the company for its total cost should not be considered a perquisite or other personal benefit and therefore need not be separately identified by type. In this regard, for example, an executive officer would have “fully reimbursed” the company for a meal at a country club if she reimbursed not only the cost of the meal, but also a proportional amount of the country club dues paid by the company.
    - *See Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.07.*

### **Description of Perquisites**

- Companies must carefully craft their disclosure related to perquisites, paying special attention to the description of individual perquisites to ensure that each item is described in a manner that adequately conveys the benefit received (*i.e.*, companies should avoid overly broad titles and descriptions for perquisites).

### **Controls and Procedures**

- Companies should confirm that they have adequate controls and procedures in place to identify perquisites under the new rules, given the new guidance regarding the identification of perquisites and the reduction in the threshold in aggregate value requiring disclosure from \$50,000 to \$10,000.

- Further, companies may wish to revise their D&O questionnaires to include questions to specifically elicit information related to perquisites; it may also be helpful for companies to list in their questionnaires examples of what is and is not a perquisite.

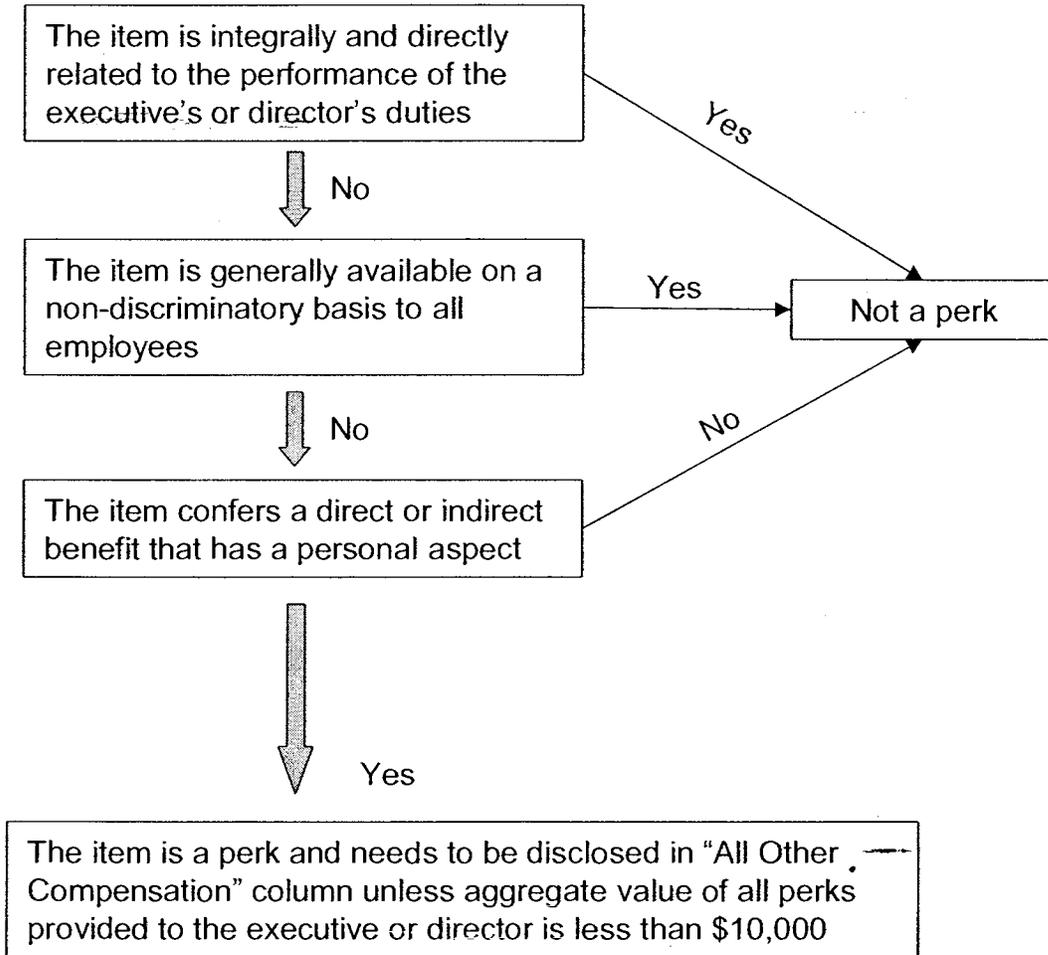
### **Perk Determination Flow Chart**

- See Appendix G-I. *Perk Determination Flow Chart*.

**APPENDIX G-I**

**Perk Determination Flow Chart**

## Perk Determination Flow Chart



## H. GRANTS OF PLAN-BASED AWARDS TABLE

The rules require the inclusion of a grants of plan-based awards table in the annual proxy statement. Additionally, the rules require narrative disclosure to accompany the table.

### Rules

The grants of plan-based awards table requirement is located in Item 402(d) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to prepare a grants of plan-based awards table.

- See Part T. Smaller Reporting Companies.

Item 402(d) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

(d) *Grants of plan-based awards table.* (1) Provide the information specified in paragraph (d)(2) of this Item, concerning each grant of an award made to a named executive officer in the last completed fiscal year under any plan, including awards that subsequently have been transferred, in the following tabular format:

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)	Grant Date Fair Value of Stock and Option Awards (\$)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)				
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)
PEO											
PFO											
A											
B											
C											

(2) The Table shall include:

- (i) The name of the named executive officer (column (a));

- (ii) The grant date for equity-based awards reported in the table (column (b)). If such grant date is different than the date on which the compensation committee (or a committee of the board of directors performing a similar function or the full board of directors) takes action or is deemed to take action to grant such awards, a separate, adjoining column shall be added between columns (b) and (c) showing such date;
- (iii) The dollar value of the estimated future payout upon satisfaction of the conditions in question under non-equity incentive plan awards granted in the fiscal year, or the applicable range of estimated payouts denominated in dollars (threshold, target and maximum amount) (columns (c) through (e));
- (iv) The number of shares of stock, or the number of shares underlying options to be paid out or vested upon satisfaction of the conditions in question under equity incentive plan awards granted in the fiscal year, or the applicable range of estimated payouts denominated in the number of shares of stock, or the number of shares underlying options under the award (threshold, target and maximum amount) (columns (f) through (h));
- (v) The number of shares of stock granted in the fiscal year that are not required to be disclosed in columns (f) through (h) (column (i));
- (vi) The number of securities underlying options granted in the fiscal year that are not required to be disclosed in columns (f) through (h) (column (j));
- (vii) The per-share exercise or base price of the options granted in the fiscal year (column (k)). If such exercise or base price is less than the closing market price of the underlying security on the date of the grant, a separate, adjoining column showing the closing market price on the date of the grant shall be added after column (k); and
- (viii) The grant date fair value of each equity award computed in accordance with FASB ASC Topic 718 (column (l)). If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise or base price of options, SARs or similar option-like instruments previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means (“repriced”), or otherwise has materially modified such awards, the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718, with respect to that repriced or modified award, shall be reported.

**Instructions to Item 402(d).**

1. Disclosure on a separate line shall be provided in the Table for each grant of an award made to a named executive officer during the fiscal year. If grants of awards were made to a named executive officer during the fiscal year under more than one plan, identify the particular plan under which each such grant was made.

2. For grants of incentive plan awards, provide the information called for by columns (c), (d) and (e), or (f), (g) and (h), as applicable. For columns (c) and (f), *threshold* refers to the minimum amount payable for a certain level of performance under the plan. For columns (d) and (g), *target* refers to the amount payable if the specified performance target (s) are reached. For columns (e) and (h), *maximum* refers to the maximum payout possible under the plan. If the award provides only for a single estimated payout, that amount must be reported as the *target* in columns (d) and (g). In columns (d) and (g), registrants must provide a representative amount based on the previous fiscal year's performance if the target amount is not determinable.
3. In determining if the exercise or base price of an option is less than the closing market price of the underlying security on the date of the grant, the registrant may use either the closing market price as specified in paragraph (a)(6)(v) of this Item, or if no market exists, any other formula prescribed for the security. Whenever the exercise or base price reported in column (k) is not the closing market price, describe the methodology for determining the exercise or base price either by a footnote or accompanying textual narrative.
4. A tandem grant of two instruments, only one of which is granted under an incentive plan, such as an option granted in tandem with a performance share, need be reported only in column (i) or (j), as applicable. For example, an option granted in tandem with a performance share would be reported only as an option grant in column (j), with the tandem feature noted either by a footnote or accompanying textual narrative.
5. Disclose the dollar amount of consideration, if any, paid by the executive officer for the award in a footnote to the appropriate column.
6. If non-equity incentive plan awards are denominated in units or other rights, a separate, adjoining column between columns (b) and (c) shall be added quantifying the units or other rights awarded.
7. Options, SARs and similar option-like instruments granted in connection with a repricing transaction or other material modification shall be reported in this Table. However, the disclosure required by this Table does not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.
8. For any equity awards that are subject to performance conditions, report in column (l) the value at the grant date based upon the probable outcome of such conditions. This amount should be consistent with the estimate of aggregate compensation cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures.

The requirement to provide narrative disclosure accompanying the grants of plan-based awards table requirement is located in Item 402(e)(1) of Regulation S-K which reads as follows:

## **Regulation S-K, Item 402 (Executive Compensation).**

*(e) Narrative disclosure to summary compensation table and grants of plan-based awards table.*

- (1) Provide a narrative description of any material factors necessary to an understanding of the information disclosed in the tables required by paragraphs (c) and (d) of this Item. Examples of such factors may include, in given cases, among other things:
  - (i) The material terms of each named executive officer's employment agreement or arrangement, whether written or unwritten;
  - (ii) If at any time during the last fiscal year, any outstanding option or other equity-based award was repriced or otherwise materially modified (such as by extension of exercise periods, the change of vesting or forfeiture conditions, the change or elimination of applicable performance criteria, or the change of the bases upon which returns are determined), a description of each such repricing or other material modification;
  - (iii) The material terms of any award reported in response to paragraph (d) of this Item, including a general description of the formula or criteria to be applied in determining the amounts payable, and the vesting schedule. For example, state where applicable that dividends will be paid on stock, and if so, the applicable dividend rate and whether that rate is preferential. Describe any performance-based conditions, and any other material conditions, that are applicable to the award. For purposes of the Table required by paragraph (d) of this Item and the narrative disclosure required by paragraph (e) of this Item, performance-based conditions include both performance conditions and market conditions, as those terms are defined in FASB ASC Topic 718; and
  - (iv) An explanation of the amount of salary and bonus in proportion to total compensation.

### **Instructions to Item 402(e)(1).**

1. The disclosure required by paragraph (e)(1)(ii) of this Item would not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.
2. Instructions 4 and 5 to Item 402(b) apply regarding disclosure pursuant to paragraph (e)(1) of this Item of target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or the board of directors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant.

**Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

## Adopting Release Excerpts

Excerpts from the adopting releases include:

- As proposed, the Grants of All Other Equity Awards Table would have permitted aggregation of option grants with the same exercise or base price. We have not adopted such an instruction for this table, based on our belief that grant-by-grant disclosure is the most appropriate approach, particularly given our particular disclosure concerns regarding option grants.
- The amendments revise the Grants of Plan-Based Awards Table to add column (I), showing the full grant date fair value of each equity award, computed in accordance with FASB ASC Topic 718. Presenting this information on a grant-by-grant basis is consistent with the presentation of other information in the Grants of Plan-Based Awards Table. This presentation should continue to provide investors a clear picture of the value of options when granted, including in-the-money awards.
- The interim final rules further amend the Grants of Plan-Based Awards Table to include information concerning repriced or materially modified options, stock appreciation rights and similar option-like instruments, disclosing the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718. Consistent with the presentation of other information in the Grants of Plan-Based Awards Table, this disclosure will be made on a grant-by-grant basis.
  - Consistent with FASB ASC Topic 718, this disclosure does not apply to any modification that equalizes the fair value of an award before and after the modification, such as a modification made pursuant to an antidilution provision that requires adjustment in the event of a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs. Similarly, this disclosure does not apply to a repricing that occurs through a pre-existing formula or mechanism in the terms of the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, as the adjustment feature would have been reflected in the grant date fair value of the award.
- Unlike the Compensation Discussion and Analysis, which focuses on broader topics regarding the objectives and implementation of executive compensation policies, the narrative disclosures following the Summary Compensation Table and other tables focus on and provide specific context to the quantitative disclosure in the tables. For example, narrative disclosure following a table might explain material aspects of a plan that are not evident from the quantitative tabular disclosure and are not addressed in the Compensation Discussion and Analysis.
- Narrative text accompanying the tables will also describe, to the extent material and necessary to an understanding of the tabular disclosure, award terms relating to disclosure provided in the Grants of Plan-Based Awards Table. This could include, for example, a general description of the formula or criteria to be applied in determining the amounts payable, the vesting schedule, a description of the performance-based conditions and any

other material conditions applicable to the award, whether dividends or other amounts would be paid, the applicable rate and whether that rate is preferential.

- We are persuaded that the value of performance awards reported in the Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table should be computed based upon the probable outcome of the performance condition(s) as of the grant date because that value better reflects how compensation committees take performance-contingent vesting conditions into account in granting such awards. We are adopting new Instructions to these tables to clarify that this amount will be consistent with the grant date estimate of compensation cost to be recognized over the service period, excluding the effect of forfeitures. To provide investors additional information about an award's potential maximum value subject to changes in performance outcome, we will also require in the Summary Compensation Table and Director Compensation Table footnote disclosure of the maximum value assuming the highest level of performance conditions is probable. Such footnote disclosure will permit investors to understand an award's maximum value without raising the concerns associated with requiring its tabular disclosure.

## Practice Pointers

### Grant-by-Grant Disclosure

- Grant-by-grant disclosure is required in the grants of plan-based awards table.

### "Non-Equity Incentive Plan" vs. "Equity Incentive Plan"

- An equity incentive plan is an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of FASB ASC Topic 718. A non-equity incentive plan is an incentive plan or portion of an incentive plan that is not an equity incentive plan.
  - The scope of FASB ASC Topic 718 is broad and includes both stock and liability awards (as defined in FASB ASC Topic 718).
  - *See Part D. Definitions.*

### Potential Need to Add Column Regarding Grant Date

- If the grant date of an award as determined in accordance with FASB ASC Topic 718 is different than the date the compensation committee takes action or is deemed to take action to grant such award, a separate column must be added to reflect such date.

### Potential Need to Add Column Disclosing Stock Price on Grant Date

- Companies that determine the exercise price for options based on any method other than the closing market price of the underlying security on the date of the grant (*e.g.*, the closing price of the underlying security on the date preceding the grant), will be required to include a

separate column in the table showing the closing market price on the date of grant if the exercise price is less than the closing market price of the underlying security on the date of grant.

- Any such company will be required to indicate by footnote or narrative disclosure how the exercise price was determined.
- To avoid having to make these disclosures, a company with a plan that sets the exercise price for options based on anything other than the closing price of the underlying security on the date of grant should consider amending the plan to use the closing price on the date of grant instead.

### **Awards Payable in Stock But Denominated in Dollars**

If an equity incentive plan award is denominated in dollars, but payable in stock, the award should be disclosed in the Grants of Plan-Based Awards Table by including the dollar value and a footnote to explain that it will be paid out in stock in the form of whatever number of shares that amount translates into at the time of the payout. In this limited circumstance, and if all the awards are structured in this manner, it is acceptable to change the captions for columns (f) through (g) to of the Grants of Plan-Based Awards Table to show “(\$)” instead of “(#).”

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 120.01.*

### **Reporting Annual Non-equity Incentive Plan Awards that Have Been Earned**

If all of a company’s non-equity incentive plan awards were made for annual plans, where the awards have already been earned and therefore disclosed in the Summary Compensation Table, the heading over columns (c), (d) and (e) of the Grants of Plan-Based Awards Table may be changed to “Estimated possible payouts under Non-equity incentive plan awards.”

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 120.02.*

### **No Need to Assume Arbitrary Thresholds or Maximums**

If plans do not include thresholds or maximums (or equivalent items), it is not necessary to include arbitrary sample threshold and maximum amounts. For example, for a non-equity incentive plan that does not specify threshold or maximum payout amounts (for example, a plan in which each unit entitles the executive to \$1.00 of payment for each \$.01 increase in earnings per share during the performance period), threshold and maximum levels need not be shown as “0” and “N/A” because the payouts theoretically may range from nothing to infinity. Rather, an appropriate footnote should state that there are no thresholds or maximums (or equivalent items).

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Interpretive Responses Regarding Particular Situations, Section 219, Item 220.02.*

## Value of Performance-Based Equity Awards

- Note that although the value of performance-based equity awards presented in the Grants of Plan-Based Awards Table should be computed based on the probable outcome of the performance conditions as of the grant date, companies are required to make footnote disclosures in the Summary Compensation Table and Director Compensation Table of the maximum value assuming achievement of the highest level of performance conditions

## Narrative Disclosure

- The Summary Compensation Table and Grants of Plan-Based Awards tables are required to be accompanied by a narrative discussion describing any material factors necessary to an understanding of the information disclosed in the table. Examples would include a discussion of:
  - the material terms of employment agreements; and
  - the material terms of equity and non-equity incentive plan awards, including a description of the vesting schedules and formulas for determining the amounts payable.
    - As with CD&A, performance targets are not required to be disclosed if such targets qualify for non-disclosure under the SEC’s existing standards for confidential treatment requests. For additional information *see Part E. Compensation Discussion and Analysis, “Potential Disclosure of Performance Targets.”*
- In addition, companies should consider explaining the amount of salary and bonus paid to named executive officers in proportion to total compensation if other items of compensation significantly influenced the determination of the named executive officers salary and bonus.
- As discussed in the adopting release, to avoid “double counting” in light of the fact that some items disclosed in the Summary Compensation Table are also disclosed in other required tables, companies should use the narrative following the tables to explain how disclosures relate to each other in their particular circumstances.

## Smaller Reporting Companies

A registrant that qualifies as a “smaller reporting company” is not required to prepare a grants of plan-based awards table.

- *See Part T. Smaller Reporting Companies.*

## I. OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END TABLE

The rules require the inclusion of an outstanding equity awards at fiscal year-end table in the annual proxy statement.

### Rules

The outstanding equity awards at fiscal year-end table requirement is located in Item 402(f) of Regulation S-K which reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

(f) *Outstanding Equity Awards at Fiscal Year-End Table.* (1) Provide the information specified in paragraph (f)(2) of this Item, concerning unexercised options; stock that has not vested; and equity incentive plan awards for each named executive officer outstanding as of the end of the registrant's last completed fiscal year in the following tabular format:

### 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 Unearned 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 Unearned Shares, Units or Other Rights That Have Not Vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
PFO									
A									
B									
C									

(2) The Table shall include:

- (i) The name of the named executive officer (column (a));
- (ii) On an award-by-award basis, the number of securities underlying unexercised options, including awards that have been transferred other than for value, that are exercisable and that are not reported in column (d) (column (b));
- (iii) On an award-by-award basis, the number of securities underlying unexercised options, including awards that have been transferred other than for value, that are unexercisable and that are not reported in column (d) (column (c));
- (iv) On an award-by-award basis, the total number of shares underlying unexercised options awarded under any equity incentive plan that have not been earned (column (d));
- (v) For each instrument reported in columns (b), (c) and (d), as applicable, the exercise or base price (column (e));
- (vi) For each instrument reported in columns (b), (c) and (d), as applicable, the expiration date (column (f));
- (vii) The total number of shares of stock that have not vested and that are not reported in column (i) (column (g));
- (viii) The aggregate market value of shares of stock that have not vested and that are not reported in column (j) (column (h));
- (ix) The total number of shares of stock, units or other rights awarded under any equity incentive plan that have not vested and that have not been earned, and, if applicable the number of shares underlying any such unit or right (column (i)); and
- (x) The aggregate market or payout value of shares of stock, units or other rights awarded under any equity incentive plan that have not vested and that have not been earned (column (j)).

**Instructions to Item 402(f)(2).**

1. Identify by footnote any award that has been transferred other than for value, disclosing the nature of the transfer.
2. The vesting dates of options, shares of stock and equity incentive plan awards held at fiscal-year end must be disclosed by footnote to the applicable column where the outstanding award is reported.
3. Compute the market value of stock reported in column (h) and equity incentive plan awards of stock reported in column (j) by multiplying the closing market price of the registrant's stock at the end of the last completed fiscal year by the number of shares or units of stock or the amount

of equity incentive plan awards, respectively. The number of shares or units reported in columns (d) or (i), and the payout value reported in column (j), shall be based on achieving threshold performance goals, except that if the previous fiscal year's performance has exceeded the threshold, the disclosure shall be based on the next higher performance measure (target or maximum) that exceeds the previous fiscal year's performance. If the award provides only for a single estimated payout, that amount should be reported. If the target amount is not determinable, registrants must provide a representative amount based on the previous fiscal year's performance.

4. Multiple awards may be aggregated where the expiration date and the exercise and/or base price of the instruments is identical. A single award consisting of a combination of options, SARs and/or similar option-like instruments shall be reported as separate awards with respect to each tranche with a different exercise and/or base price or expiration date.

5. Options or stock awarded under an equity incentive plan are reported in columns (d) or (i) and (j), respectively, until the relevant performance condition has been satisfied. Once the relevant performance condition has been satisfied, even if the option or stock award is subject to forfeiture conditions, options are reported in column (b) or (c), as appropriate, until they are exercised or expire, or stock is reported in columns (g) and (h) until it vests.

#### **Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

### **Practice Pointers**

#### **Award-by-Award Disclosure**

- Because the outstanding equity awards at fiscal year-end table requires awards to be reported on an award-by-award basis, this table may be lengthy for many companies.
  - Multiple awards, however, may be aggregated if they have the same expiration date and exercise price or base price.

#### **Equity Incentive Plan Awards**

- As noted in the instructions, options or stock awarded under an equity incentive plan should be reported under the equity incentive plan awards columns (columns (d), (i) and (j)) until the related performance conditions are satisfied.
  - Once the performance conditions are satisfied, even if the award remains subject to non-performance based forfeiture conditions, (1) options should be reported in columns (b) or (c), as appropriate, until they are exercised or expire and (2) stock should be reported in columns (g) and (h) until it vests.

- The number of shares reported for equity incentive plan awards should be based on achieving the threshold performance goals under the plan, except if the previous year's performance has exceeded the threshold, the disclosure should be based on the next higher performance measure (*e.g.*, target or maximum).
  - If the award provides only for a single estimated payout, that amount should be reported.
  - If the target amount is not determinable, a representative amount should be reported based on the previous year's performance.

### **Report Out-of-the-Money Grants**

- Option awards must be included in the outstanding equity awards at fiscal year-end table whether or not they are in-the-money.

### **Report Awards Assuming Higher of Threshold and Actual Achievement To Date**

The number of shares or units reported and the payout value should be based on achieving threshold performance goals, except that if performance during the last completed fiscal year (or, if the payout is based on performance to occur over more than one year, the last completed fiscal years over which performance is measured) has exceeded the threshold, the disclosure shall be based on the next higher performance measure (target or maximum) that exceeds the last completed fiscal year's performance (or, if the payout is based on performance to occur over more than one year, the last completed fiscal years over which performance is measured)

- *See Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 120.04.*

## J. OPTION EXERCISES AND STOCK VESTED TABLE

The rules require the inclusion of an option exercises and stock vested table in the annual proxy statement.

### Rules

The option exercises and stock vested table requirement is located in Item 402(g) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to prepare an option exercises and stock vested table.

- *See Part T. Smaller Reporting Companies.*

Item 402(g) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

*(g) Option Exercises and Stock Vested Table.* (1) Provide the information specified in paragraph (g)(2) of this Item, concerning each exercise of stock options, SARs and similar instruments, and each vesting of stock, including restricted stock, restricted stock units and similar instruments, during the last completed fiscal year for each of the named executive officers on an aggregated basis in the following tabular format:

<b>OPTION EXERCISES AND STOCK VESTED</b>				
	<b>Option Awards</b>		<b>Stock Awards</b>	
<b>Name</b>	<b>Number of Shares Acquired on Exercise (#)</b>	<b>Value Realized on Exercise (\$)</b>	<b>Number of Shares Acquired on Vesting (#)</b>	<b>Value Realized on Vesting (\$)</b>
<b>(a)</b>	<b>(b)</b>	<b>(c)</b>	<b>(d)</b>	<b>(e)</b>
PEO				
PFO				
A				
B				
C				

(2) The Table shall include:

- (i) The name of the executive officer (column (a));
- (ii) The number of securities for which the options were exercised (column (b));
- (iii) The aggregate dollar value realized upon exercise of options, or upon the transfer of an award for value (column (c));
- (iv) The number of shares of stock that have vested (column (d)); and
- (v) The aggregate dollar value realized upon vesting of stock, or upon the transfer of an award for value (column (e)).

**Instruction to Item 402(g)(2).**

Report in column (c) the aggregate dollar amount realized by the named executive officer upon exercise of the options or upon the transfer of such instruments for value. Compute the dollar amount realized upon exercise by determining the difference between the market price of the underlying securities at exercise and the exercise or base price of the options. Do not include the value of any related payment or other consideration provided (or to be provided) by the registrant to or on behalf of a named executive officer, whether in payment of the exercise price or related taxes. (Any such payment or other consideration provided by the registrant is required to be disclosed in accordance with paragraph (c)(2)(ix) of this Item.) Report in column (e) the aggregate dollar amount realized by the named executive officer upon the vesting of stock or the transfer of such instruments for value. Compute the aggregate dollar amount realized upon vesting by multiplying the number of shares of stock or units by the market value of the underlying shares on the vesting date. For any amount realized upon exercise or vesting for which receipt has been deferred, provide a footnote quantifying the amount and disclosing the terms of the deferral.

**Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

**Practice Pointers**

**Disclose Gross Shares Received**

- In reporting a cashless exercise of options or the exercise of a stock appreciation right, the total number of shares underlying the exercised option or stock appreciation right should be reported. A footnote or accompanying narrative could explain and quantify the net number of shares received.

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 123.01.*

### **Smaller Reporting Companies**

A registrant that qualifies as a “smaller reporting company” is not required to prepare an option exercises and stock vested table.

- See *Part T. Smaller Reporting Companies.*

## K. PENSION BENEFITS TABLE

The rules require the inclusion of a pension benefits table in the annual proxy statement.

### Rules

The pension benefits table requirement is located in Item 402(h) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to prepare a pension benefits table.

- See Part T. *Smaller Reporting Companies*.

Item 402(h) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

*(h) Pension Benefits.* (1) Provide the information specified in paragraph (h)(2) of this Item with respect to each plan that provides for payments or other benefits at, following, or in connection with retirement, in the following tabular format:

#### PENSION BENEFITS

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

(2) The Table shall include:

- (i) The name of the executive officer (column (a));
- (ii) The name of the plan (column (b));

- (iii) The number of years of service credited to the named executive officer under the plan, computed as of the same pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the last completed fiscal year (column (c));
- (iv) The actuarial present value of the named executive officer's accumulated benefit under the plan, computed as of the same pension plan measurement date used for financial statement reporting purposes with respect to the registrant's audited financial statements for the last completed fiscal year (column (d)); and
- (v) The dollar amount of any payments and benefits paid to the named executive officer during the registrant's last completed fiscal year (column (e)).

**Instructions to Item 402(h)(2).**

1. The disclosure required pursuant to this Table applies to each plan that provides for specified retirement payments and benefits, or payments and benefits that will be provided primarily following retirement, including but not limited to tax-qualified defined benefit plans and supplemental executive retirement plans, but excluding tax-qualified defined contribution plans and nonqualified defined contribution plans. Provide a separate row for each such plan in which the named executive officer participates.

2. For purposes of the amount(s) reported in column (d), the registrant must use the same assumptions used for financial reporting purposes under generally accepted accounting principles, except that retirement age shall be assumed to be the normal retirement age as defined in the plan, or if not so defined, the earliest time at which a participant may retire under the plan without any benefit reduction due to age. The registrant must disclose in the accompanying textual narrative the valuation method and all material assumptions applied in quantifying the present value of the current accrued benefit. A benefit specified in the plan document or the executive's contract itself is not an assumption. Registrants may satisfy all or part of this disclosure by reference to a discussion of those assumptions in the registrant's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

3. For purposes of allocating the current accrued benefit between tax qualified defined benefit plans and related supplemental plans, apply the limitations applicable to tax qualified defined benefit plans established by the Internal Revenue Code and the regulations thereunder that applied as of the pension plan measurement date.

4. If a named executive officer's number of years of credited service with respect to any plan is different from the named executive officer's number of actual years of service with the registrant, provide footnote disclosure quantifying the difference and any resulting benefit augmentation.

- (3) Provide a succinct narrative description of any material factors necessary to an understanding of each plan covered by the tabular disclosure required by this paragraph.

While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:

- (i) The material terms and conditions of payments and benefits available under the plan, including the plan's normal retirement payment and benefit formula and eligibility standards, and the effect of the form of benefit elected on the amount of annual benefits. For this purpose, normal retirement means retirement at the normal retirement age as defined in the plan, or if not so defined, the earliest time at which a participant may retire under the plan without any benefit reduction due to age;
- (ii) If any named executive officer is currently eligible for early retirement under any plan, identify that named executive officer and the plan, and describe the plan's early retirement payment and benefit formula and eligibility standards. For this purpose, early retirement means retirement at the early retirement age as defined in the plan, or otherwise available to the executive under the plan;
- (iii) The specific elements of compensation (*e.g.*, salary, bonus, etc.) included in applying the payment and benefit formula, identifying each such element;
- (iv) With respect to named executive officers' participation in multiple plans, the different purposes for each plan; and
- (v) Registrant policies with regard to such matters as granting extra years of credited service.

**Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

## Adopting Release Excerpts

Excerpts from the adopting release include:

- The table we adopt today requires disclosure of the actuarial present value of the named executive officer's accumulated benefit under the plan and the number of years of service credited to the named executive officer under the plan reported in the table, each computed as of the same pension plan measurement date for financial statement reporting purposes with respect to the audited financial statements for the company's last completed fiscal year. This disclosure applies without regard to the particular form(s) of benefit payment available under the plan.

## Practice Pointers

### No Disclosure Required Concerning Defined Contribution Plans

- Note the pension benefits table does not require any disclosures concerning tax-qualified or non-qualified defined contribution plans.

### Coordinate with Actuaries and Accountants

- Companies may need to coordinate with their plan actuaries and accountants to calculate the actuarial present value of each named executive officer's accumulated benefit under each covered plan. Such values must be computed as of the same pension plan measurement date used for financial statement reporting purposes for the last completed fiscal year.
- Companies will also need to calculate, for inclusion in the Summary Compensation Table, the aggregate change in the actuarial present value of each named executive officer's accumulated benefit under each covered plan for the completed fiscal year.
  - *See Part F. Summary Compensation Table.*

### Interpretive Guidance

- For interpretive guidance regarding preparation of the Pension Benefits Table *see Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Questions 124.01 to 124.05.*

### Smaller Reporting Companies

A registrant that qualifies as a "smaller reporting company" is not required to prepare a pension benefits table.

- *See Part T. Smaller Reporting Companies.*

**L. NONQUALIFIED DEFERRED COMPENSATION TABLE**

The rules require the inclusion of a non-qualified deferred compensation table in the annual proxy statement.

**Rules**

The non-qualified deferred compensation table requirement is located in Item 402(i) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to prepare a non-qualified deferred compensation table.

- See Part T. Smaller Reporting Companies.

Item 402(i) of Regulation S-K reads as follows:

**Regulation S-K, Item 402 (Executive Compensation).**

- (i) *Nonqualified defined contribution and other nonqualified deferred compensation plans.* (1) Provide the information specified in paragraph (i)(2) of this Item with respect to each defined contribution or other plan that provides for the deferral of compensation on a basis that is not tax-qualified in the following tabular format:

**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					

(2) The Table shall include:

- (i) The name of the executive officer (column (a));
- (ii) The dollar amount of aggregate executive contributions during the registrant's last fiscal year (column (b));
- (iii) The dollar amount of aggregate registrant contributions during the registrant's last fiscal year (column (c));
- (iv) The dollar amount of aggregate interest or other earnings accrued during the registrant's last fiscal year (column (d));
- (v) The aggregate dollar amount of all withdrawals by and distributions to the executive during the registrant's last fiscal year (column (e)); and
- (vi) The dollar amount of total balance of the executive's account as of the end of the registrant's last fiscal year (column (f)).

**Instruction to Item 402(i)(2).**

Provide a footnote quantifying the extent to which amounts reported in the contributions and earnings columns are reported as compensation in the last completed fiscal year in the registrant's Summary Compensation Table and amounts reported in the aggregate balance at last fiscal year end (column (f)) previously were reported as compensation to the named executive officer in the registrant's Summary Compensation Table for previous years.

- (3) Provide a succinct narrative description of any material factors necessary to an understanding of each plan covered by tabular disclosure required by this paragraph. While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:
  - (i) The type(s) of compensation permitted to be deferred, and any limitations (by percentage of compensation or otherwise) on the extent to which deferral is permitted;
  - (ii) The measures for calculating interest or other plan earnings (including whether such measure(s) are selected by the executive or the registrant and the frequency and manner in which selections may be changed), quantifying interest rates and other earnings measures applicable during the registrant's last fiscal year; and
  - (iii) Material terms with respect to payouts, withdrawals and other distributions.

**Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

## Adopting Release Excerpts

Excerpts from the adopting release include:

- As noted above, we are requiring disclosure in the Summary Compensation Table only of the above-market or preferential portion of earnings on compensation that is deferred on a basis that is not tax-qualified. To provide investors with disclosure of the full amount of nonqualified deferred compensation accounts that the company is obligated to pay named executive officers, including the full amount of earnings for the last fiscal year, we are also requiring new tabular and narrative disclosure of nonqualified deferred compensation, as we proposed.
- [In terms of describing plan earnings,] where plan earnings are calculated by reference to actual earnings of mutual funds or other securities, such as company stock, it is sufficient to identify the reference security and quantify its return. This disclosure may be aggregated to the extent the same measure applies to more than one named executive officer.

## Practice Pointers

### Applies Only to Nonqualified Deferred Compensation

- Tax qualified plans that provide for deferral of compensation, such as 401(k) plans and qualified profit-sharing plans, are not covered by the table.

### Footnote Regarding Amounts Previously Reported in Summary Compensation Table

- The instructions to Item 402(i) require a footnote quantifying the extent to which amounts reported in the “Contributions” and “Earnings” columns were reported as compensation in the last completed fiscal year in the Summary Compensation Table and amounts reported in the “Aggregate Balances at Last Fiscal Year End” column previously were reported as compensation in the Summary Compensation Table for previous years.
  - This requirement may require companies to review proxy statements from many previous years.

### Earnings on Nonqualified Deferred Compensation

- “Earnings” include dividends, stock price appreciation (or depreciation), and other similar items. The purpose of the table is to show changes in the aggregate account balance at fiscal year end for each named executive office. Thus, “earnings” should encompass any increase or decrease in the account balance during the last completed fiscal year that is not attributable to contributions, withdrawals or distributions during the year.
  - *See Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 125.02.*

## **Smaller Reporting Companies**

A registrant that qualifies as a “smaller reporting company” is not required to prepare a non-qualified deferred compensation table.

- *See Part T. Smaller Reporting Companies.*

## **M. POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE-IN-CONTROL**

The rules require significant disclosures regarding termination and change-in-control arrangements.

### **Rules**

The requirement to describe termination and change-in-control arrangements is located in Item 402(j) of Regulation S-K.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to describe termination and change-in-control arrangements.

- *See Part T. Smaller Reporting Companies.*

Item 402(j) of Regulation S-K reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

(j) *Potential payments upon termination or change-in-control.* Regarding each contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) to a named executive officer at, following, or in connection with any termination, including without limitation resignation, severance, retirement or a constructive termination of a named executive officer, or a change in control of the registrant or a change in the named executive officer’s responsibilities, with respect to each named executive officer:

- (1) Describe and explain the specific circumstances that would trigger payment(s) or the provision of other benefits, including perquisites and health care benefits;
- (2) Describe and quantify the estimated payments and benefits that would be provided in each covered circumstance, whether they would or could be lump sum, or annual, disclosing the duration, and by whom they would be provided;
- (3) Describe and explain how the appropriate payment and benefit levels are determined under the various circumstances that trigger payments or provision of benefits;
- (4) Describe and explain any material conditions or obligations applicable to the receipt of payments or benefits, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, including the duration of such agreements and provisions regarding waiver of breach of such agreements; and
- (5) Describe any other material factors regarding each such contract, agreement, plan or arrangement.

#### **Instructions to Item 402(j).**

1. The registrant must provide quantitative disclosure under these requirements, applying the assumptions that the triggering event took place on the last business day of the registrant’s last

completed fiscal year, and the price per share of the registrant's securities is the closing market price as of that date. In the event that uncertainties exist as to the provision of payments and benefits or the amounts involved, the registrant is required to make a reasonable estimate (or a reasonable estimated range of amounts) applicable to the payment or benefit and disclose material assumptions underlying such estimates or estimated ranges in its disclosure. In such event, the disclosure would require forward-looking information as appropriate.

2. Perquisites and other personal benefits or property may be excluded only if the aggregate amount of such compensation will be less than \$10,000. Individual perquisites and personal benefits shall be identified and quantified as required by Instruction 4 to paragraph (c)(2)(ix) of this Item. For purposes of quantifying health care benefits, the registrant must use the assumptions used for financial reporting purposes under generally accepted accounting principles.

3. To the extent that the form and amount of any payment or benefit that would be provided in connection with any triggering event is fully disclosed pursuant to paragraph (h) or (i) of this Item, reference may be made to that disclosure. However, to the extent that the form or amount of any such payment or benefit would be enhanced or its vesting or other provisions accelerated in connection with any triggering event, such enhancement or acceleration must be disclosed pursuant to this paragraph.

4. Where a triggering event has actually occurred for a named executive officer and that individual was not serving as a named executive officer of the registrant at the end of the last completed fiscal year, the disclosure required by this paragraph for that named executive officer shall apply only to that triggering event.

5. The registrant need not provide information with respect to contracts, agreements, plans or arrangements to the extent they do not discriminate in scope, terms or operation, in favor of executive officers of the registrant and that are available generally to all salaried employees.

### **Adopting Release Excerpts**

Excerpts from the adopting release include:

- The Commission has long recognized that “termination provisions are distinct from other plans in both intent and scope and, moreover, are of particular interest to shareholders.” Prior to today’s amendments, disclosure did not in many cases capture material information regarding these plans and potential payments under them. We therefore proposed and are adopting disclosure of specific aspects of written or unwritten arrangements that provide for payments at, following, or in connection with the resignation, severance, retirement or other termination (including constructive termination) of a named executive officer, a change in his or her responsibilities, or a change in control of the company.
- The item contemplates disclosure of the duration of non-compete and similar agreements, and provisions regarding waiver of breach of these agreements, and disclosure of tax gross-up payments.

- A company will be required to provide quantitative disclosure under these requirements even where uncertainties exist as to amounts payable under these plans and arrangements. We clarify that in the event uncertainties exist as to the provision of payments and benefits or the amounts involved, the company is required to make a reasonable estimate (or a reasonable estimated range of amounts), and disclose material assumptions underlying such estimates or estimated ranges in its disclosure. In such event, the disclosure will be considered forward-looking information as appropriate that falls within the safe harbors for disclosure of such information.

## Practice Pointers

### Use of Tables

- Because Item 402(j) requires companies to quantify payments and benefits payable under all the various triggering events that could apply, for many companies it may be necessary to include a table in the proxy statement for each named executive officer detailing the payments and benefits under the relevant scenarios.
  - See *Appendix M-I. Sample Table Disclosing Potential Payments Upon Termination Or Change-In-Control.*

### Disclose Important Defined Terms

- Because of nuances inherent in change-in-control and severance agreements, companies should include definitions for terms such as “Cause,” “Good Reason” and “Change of Control.”

### Disclose Acceleration Provisions Even if Provided to All Optionholders

- Instruction 5 to Item 402(j) provides that a company need not provide information with respect to contracts, agreements, plans, or arrangements to the extent they are available generally to all salaried employees and do not discriminate in scope, terms, or operation, in favor of executive officers of the company. Notwithstanding this instruction, the effects of acceleration provisions benefiting named executive officers generally will need to be disclosed even if acceleration is provided for all optionholders.
  - This is the case because the Instruction 5 standard that the “scope” of arrangements not discriminate in favor of executive officers would not be satisfied where the option awards to executives are in amounts greater than those provided to all salaried employees.
  - See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 126.02*

### Smaller Reporting Companies

A registrant that qualifies as a “smaller reporting company” is not required to describe termination and change-in-control arrangements.

- See *Part T. Smaller Reporting Companies.*

**APPENDIX M-I**

**Sample Table Disclosing Potential Payments Upon  
Termination or Change-in-Control**

**POTENTIAL PAYMENTS UPON TERMINATION  
OR CHANGE IN CONTROL**

[The new rules require narrative disclosure regarding each agreement, plan or arrangement that provides for payments to a named executive officer at, following, or in connection with any termination (including resignation, severance, retirement or constructive termination) or change in control. This disclosure must quantify the estimated payments and benefits that would be provided under each covered circumstance assuming that each triggering event took place on the last business day of the fiscal year. The new rules do not require this disclosure to be made in tabular format; however, given its complexity, consideration should be given to disclosing the information in tabular format similar to the below.]

<b>Benefits and Payments</b>	<b>Termination Without Cause or For Good Reason</b>	<b>Termination Without Cause or For Good Reason Following Change-in- Control</b>	<b>Change-in- Control (No Termination)</b>	<b>Any Other Reason, including Death, Voluntary Termination, Retirement or For Cause</b>
Compensation:				
Severance Pay	\$ 500,000 <sup>(1)</sup>	\$ 1,000,000 <sup>(2)</sup>	\$ -	\$ -
Annual Incentive Award <sup>(3)</sup>	250,000	250,000	-	-
Unvested Stock Options <sup>(4)</sup>	1,000,000	1,000,000	1,000,000	-
Benefits:				
Health and Dental Insurance <sup>(5)</sup>	14,000	14,000	-	-
Outplacement Consulting <sup>(6)</sup>	10,000	10,000	-	-
Excise Tax Gross-Up <sup>(7)</sup>	-	750,000	750,000	-
<b>Total:</b>	<b>\$ 1,774,000</b>	<b>\$ 3,024,000</b>	<b>\$ 1,750,000</b>	<b>\$ -</b>

(1) Represents 12 months salary continuation.

(2) Represents 24 months salary continuation.

(3) Represents 2006 target annual incentive award.

(4) Represents the value of 200,000 unvested options held at December 31, 2006, based upon the amount by which the closing market price on December 31, 2006 (\$25.00) of the shares of Common Stock underlying those options exceeded the exercise price (\$20.00).

(5) Represents the estimated incremental cost to the Company of health and dental plan continuation coverage. Such estimate is based on the same assumptions used by the Company for financial reporting purposes under U.S. GAAP.

(6) Reflects the maximum amount of outplacement services required to be provided.

(7) Reflects estimated tax gross-up payment.

[The above example assumes that:

- under the CEO's employment agreement, following termination without cause or for good reason the CEO is entitled to:
  - continued salary and health and dental insurance for 12 months, unless the termination follows a change-in-control in which case the CEO is entitled to 24 months continuation;
  - a pro-rated target bonus;
  - automatic vesting of unvested stock options; and
  - up to \$10,000 of outplacement consulting services; and
- The CEO has 200,000 unvested options that automatically accelerate upon a change-in-control.

For most companies, there will be more potential scenarios and benefits that will need to be included. Also note a separate table would need to be provided for each of the named executive officers.

The new rules will also require a narrative discussion of the provisions of the agreements, including a discussion of any material factors necessary to an understanding of the agreements, the definitions of the triggering events (e.g., cause, disability, change in control) and any material obligations or conditions applicable to the receipt of the payments, such as confidentiality or non-compete provisions.]

## N. DIRECTOR COMPENSATION TABLE

The rules add a requirement to include a director compensation table in the annual proxy statement. Additionally, the rules require narrative disclosure to accompany the table.

### Rules

The director compensation table and related narrative disclosure requirements are located in Item 402(k) of Regulation S-K which reads as follows:

#### **Regulation S-K, Item 402 (Executive Compensation).**

(k) *Compensation of Directors.* (1) Provide the information specified in paragraph (k)(2) of this Item, concerning the compensation of the directors for the registrant's last completed fiscal year, in the following tabular format:

### 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)
A							
B							
C							
D							
E							

(2) The Table shall include:

- (i) The name of each director unless such director is also a named executive officer under paragraph (a) of this Item and his or her compensation for service as a director is fully reflected in the Summary Compensation Table pursuant to paragraph (c) of this Item and otherwise as required pursuant to paragraphs (d) through (j) of this Item (column (a));

- (ii) The aggregate dollar amount of all fees earned or paid in cash for services as a director, including annual retainer fees, committee and/or chairmanship fees, and meeting fees (column (b));
- (iii) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (c));
- (iv) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (d));

**Instruction to Item 402(k)(2)(iii) and (iv).**

For each director, disclose by footnote to the appropriate column: the grant date fair value of each equity award computed in accordance with FASB ASC Topic 718; for each option, SAR or similar option like instrument for which the registrant has adjusted or amended the exercise or base price during the last completed fiscal year, whether through amendment, cancellation or replacement grants, or any other means (“repriced”), or otherwise has materially modified such awards, the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718; and the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end. However, the disclosure required by this Instruction does not apply to any repricing that occurs through a preexisting formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.

- (v) the dollar value of all earnings for services performed during the fiscal year pursuant to non-equity incentive plans as defined in paragraph (a)(6)(iii) of this Item, and all earnings on any outstanding awards (column (e));
- (vi) The sum of the amounts specified in paragraphs (k)(2)(vi)(A) and (B) of this Item (column (f)) as follows:
  - (A) The aggregate change in the actuarial present value of the director’s accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans) from the pension plan measurement date used for financial statement reporting purposes with respect to the registrant’s audited financial statements for the prior completed fiscal year to the pension plan measurement date used for financial statement reporting purposes with respect to the registrant’s audited financial statements for the covered fiscal year; and
  - (B) Above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans;

- (vii) All other compensation for the covered fiscal year that the registrant could not properly report in any other column of the Director Compensation Table (column (g)). Each compensation item that is not properly reportable in columns (b) – (f), regardless of the amount of the compensation item, must be included in column (g). Such compensation must include, but is not limited to:
- (A) Perquisites and other personal benefits, or property, unless the aggregate amount of such compensation is less than \$10,000;
  - (B) All “gross-ups” or other amounts reimbursed during the fiscal year for the payment of taxes;
  - (C) For any security of the registrant or its subsidiaries purchased from the registrant or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally, either to all security holders or to all salaried employees of the registrant, the compensation cost, if any, computed in accordance with FASB ASC Topic 718;
  - (D) The amount paid or accrued to any director pursuant to a plan or arrangement in connection with:
    - (1) The resignation, retirement or any other termination of such director;  
or
    - (2) A change in control of the registrant;
  - (E) Registrant contributions or other allocations to vested and unvested defined contribution plans;
  - (F) Consulting fees earned from, or paid or payable by the registrant and/or its subsidiaries (including joint ventures);
  - (G) The annual costs of payments and promises of payments pursuant to director legacy programs and similar charitable award programs;
  - (H) The dollar value of any insurance premiums paid by, or on behalf of, the registrant during the covered fiscal year with respect to life insurance for the benefit of a director; and
  - (I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d);  
and

### **Instructions to Item 402(k)(2)(vii).**

1. Programs in which registrants agree to make donations to one or more charitable institutions in a director's name, payable by the registrant currently or upon a designated event, such as the retirement or death of the director, are charitable awards programs or director legacy programs for purposes of the disclosure required by paragraph (k)(2)(vii)(G) of this Item. Provide footnote disclosure of the total dollar amount payable under the program and other material terms of each such program for which tabular disclosure is provided.
2. Any item reported for a director pursuant to paragraph (k)(2)(vii) of this Item that is not a perquisite or personal benefit and whose value exceeds \$10,000 must be identified and quantified in a footnote to column (g). All items of compensation are required to be included in the Director Compensation Table without regard to whether such items are required to be identified other than as specifically noted in this Item.
3. Perquisites and personal benefits may be excluded as long as the total value of all perquisites and personal benefits for a director is less than \$10,000. If the total value of all perquisites and personal benefits is \$10,000 or more for any director, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a director pursuant to this rule, then each perquisite or personal benefit that exceeds the greater of \$25,000 or 10% of the total amount of perquisites and personal benefits for that director must be quantified and disclosed in a footnote. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the registrant. With respect to the perquisite or other personal benefit for which footnote quantification is required, the registrant shall describe in the footnote its methodology for computing the aggregate incremental cost. Reimbursements of taxes owed with respect to perquisites or other personal benefits must be included in column (g) and are subject to separate quantification and identification as tax reimbursements (paragraph (k)(2)(vii)(B) of this Item) even if the associated perquisites or other personal benefits are not required to be included because the total amount of all perquisites or personal benefits for an individual director is less than \$10,000 or are required to be identified but are not required to be separately quantified.

- (viii) The dollar value of total compensation for the covered fiscal year (column (h)).  
With respect to each director, disclose the sum of all amounts reported in columns (b) through (g).

### **Instruction to Item 402(k)(2).**

Two or more directors may be grouped in a single row in the Table if all elements of their compensation are identical. The names of the directors for whom disclosure is presented on a group basis should be clear from the Table.

#### *(3) Narrative to director compensation table.*

Provide a narrative description of any material factors necessary to an understanding of the director compensation disclosed in this Table. While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:

- (i) A description of standard compensation arrangements (such as fees for retainer, committee service, service as chairman of the board or a committee, and meeting attendance); and
- (ii) Whether any director has a different compensation arrangement, identifying that director and describing the terms of that arrangement.

#### **Instruction to Item 402(k).**

In addition to the Instruction to paragraphs (k)(2)(iii) and (iv) and the Instructions to paragraph (k)(2)(vii) of this Item, the following apply equally to paragraph (k) of this Item: Instructions 2 and 4 to paragraph (c) of this Item; Instructions to paragraphs (c)(2)(iii) and (iv) of this Item; Instructions to paragraphs (c)(2)(v) and (vi) of this Item; Instructions to paragraph (c)(2)(vii) of this Item; Instructions to paragraph (c)(2)(viii) of this Item; and Instructions 1 and 5 to paragraph (c)(2)(ix) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (k) of this Item that correspond to analogous disclosures provided for in paragraph (c) of this Item to which they refer.

#### **Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

### **Adopting Release Excerpts**

Excerpts from the adopting release include:

- As with the Summary Compensation Table, the new rules make clear that all compensation must be included in the [director compensation table].
- Following the table, narrative disclosure will describe any material factors necessary to an understanding of the table. Such factors may include, for example, a breakdown of types of fees. In addition, as noted in Section II.A., disclosure regarding option timing or dating practices may be necessary under this narrative disclosure requirement when the recipients of the stock option grants are directors of the company.

### **Practice Pointers**

#### **Report Stock and Option Awards in Dollars Based on Grant Date Fair Value**

- The rule changes adopted by the SEC in December 2009 (the “Amendments”) changed the way compensation related to stock options, restricted stock and other equity grants is reported in the Director Compensation Table. Equity awards must now be reflected in the year awarded based on their full aggregate grant date fair value computed in accordance with FASB Accounting Standards Codification Topic 718 (“FASB ASC 718”), rather than based on the expense attributable to them in the applicable fiscal year.

- Also, the Amendments require that the value of performance-based awards be based on the “probable outcome of such conditions(s).” Footnote disclosure is required to show the value of the performance-based award assuming that the highest level of performance will be achieved if an amount less than the maximum was included in the table. This requirement is likely not relevant for most director compensation programs.

### **Disclosure of Outstanding Stock Awards and Option Awards**

- Note the aggregate number of outstanding stock awards and option awards held by each director at fiscal year end is required to be disclosed in footnotes accompanying the director compensation table.

### **All Directors During Year Covered**

- Any person serving as a director during the last completed fiscal year must be included in the Director Compensation Table, even if the person was no longer a director at the end of the last completed fiscal year.
  - See *Appendix B-III, SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Questions 127.01 and 127.02.*

### **Report All Compensation**

- All compensation paid to directors must be reported whether or not the compensation was paid for services as a director or other services (e.g. consulting services).
  - See *Appendix B-III, SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Section 227, Item 217.01.*

### **Pension Plan Payouts Generally Not Reportable**

- It is not necessary to report pension payments to a director earned for services as a former employee of the company if payment of the pension is not conditioned on his or her service as a director and director service does not generate new accruals.
  - See *Appendix B-III, SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Section 227, Item 227.04.*

## O. RELATED PERSON TRANSACTIONS

The rules impose a principles-based disclosure regime for reporting related person transactions.

The SEC has published Compliance & Disclosure Interpretations regarding Regulation S-K, including Item 404.

### Rules

The related person disclosure requirements are located in Item 404 of Regulation S-K which reads as follows:

#### **Regulation S-K, Item 404 (Transactions with related persons, promoters and certain control persons).**

(a) *Transactions with related persons.* Describe any transaction, since the beginning of the registrant's last fiscal year, or any currently proposed transaction, in which the registrant was or is to be a participant and the amount involved exceeds \$120,000, and in which any related person had or will have a direct or indirect material interest. Disclose the following information regarding the transaction:

- (1) The name of the related person and the basis on which the person is a related person.
- (2) The related person's interest in the transaction with the registrant, including the related person's position(s) or relationship(s) with, or ownership in, a firm, corporation, or other entity that is a party to, or has an interest in, the transaction.
- (3) The approximate dollar value of the amount involved in the transaction.
- (4) The approximate dollar value of the amount of the related person's interest in the transaction, which shall be computed without regard to the amount of profit or loss.
- (5) In the case of indebtedness, disclosure of the amount involved in the transaction shall include the largest aggregate amount of principal outstanding during the period for which disclosure is provided, the amount thereof outstanding as of the latest practicable date, the amount of principal paid during the periods for which disclosure is provided, the amount of interest paid during the period for which disclosure is provided, and the rate or amount of interest payable on the indebtedness.
- (6) Any other information regarding the transaction or the related person in the context of the transaction that is material to investors in light of the circumstances of the particular transaction.

#### **Instructions to Item 404(a).**

1. For the purposes of paragraph (a) of this Item, the term *related person* means:

- a. Any person who was in any of the following categories at any time during the specified period for which disclosure under paragraph (a) of this Item is required:
    - i. Any director or executive officer of the registrant;
    - ii. Any nominee for director, when the information called for by paragraph (a) of this Item is being presented in a proxy or information statement relating to the election of that nominee for director; or
    - iii. Any immediate family member of a director or executive officer of the registrant, or of any nominee for director when the information called for by paragraph (a) of this Item is being presented in a proxy or information statement relating to the election of that nominee for director, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of such director, executive officer or nominee for director, and any person (other than a tenant or employee) sharing the household of such director, executive officer or nominee for director; and
  - b. Any person who was in any of the following categories when a transaction in which such person had a direct or indirect material interest occurred or existed:
    - i. A security holder covered by Item 403(a) (§229.403(a)); or
    - ii. Any immediate family member of any such security holder, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of such security holder, and any person (other than a tenant or employee) sharing the household of such security holder.
2. For purposes of paragraph (a) of this Item, a *transaction* includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships.
  3. The amount involved in the transaction shall be computed by determining the dollar value of the amount involved in the transaction in question, which shall include:
    - a. In the case of any lease or other transaction providing for periodic payments or installments, the aggregate amount of all periodic payments or installments due on or after the beginning of the registrant's last fiscal year, including any required or optional payments due during or at the conclusion of the lease or other transaction providing for periodic payments or installments; and
    - b. In the case of indebtedness, the largest aggregate amount of all indebtedness outstanding at any time since the beginning of the registrant's last fiscal year and all amounts of interest payable on it during the last fiscal year.
  4. In the case of a transaction involving indebtedness:

- a. The following items of indebtedness may be excluded from the calculation of the amount of indebtedness and need not be disclosed: amounts due from the related person for purchases of goods and services subject to usual trade terms, for ordinary business travel and expense payments and for other transactions in the ordinary course of business;
  - b. Disclosure need not be provided of any indebtedness transaction for the related persons specified in Instruction 1.b. to paragraph (a) of this Item; and
  - c. If the lender is a bank, savings and loan association, or broker-dealer extending credit under Federal Reserve Regulation T (12 CFR part 220) and the loans are not disclosed as nonaccrual, past due, restructured or potential problems (see Item III.C.1. and 2. of Industry Guide 3, Statistical Disclosure by Bank Holding Companies (17 CFR 229.802(c))), disclosure under paragraph (a) of this Item may consist of a statement, if such is the case, that the loans to such persons:
    - i. Were made in the ordinary course of business;
    - ii. Were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the lender; and
    - iii. Did not involve more than the normal risk of collectibility or present other unfavorable features.
5. a. Disclosure of an employment relationship or transaction involving an executive officer and any related compensation solely resulting from that employment relationship or transaction need not be provided pursuant to paragraph (a) of this Item if:
- i. The compensation arising from the relationship or transaction is reported pursuant to Item 402 (§229.402); or
  - ii. The executive officer is not an immediate family member (as specified in Instruction 1 to paragraph (a) of this Item) and such compensation would have been reported under Item 402 (§229.402) as compensation earned for services to the registrant if the executive officer was a named executive officer as that term is defined in Item 402(a)(3) (§229.402(a)(3)), and such compensation had been approved, or recommended to the board of directors of the registrant for approval, by the compensation committee of the board of directors (or group of independent directors performing a similar function) of the registrant.
- b. Disclosure of compensation to a director need not be provided pursuant to paragraph (a) of this Item if the compensation is reported pursuant to Item 402(k) (§229.402(k)).
6. A person who has a position or relationship with a firm, corporation, or other entity that engages in a transaction with the registrant shall not be deemed to have an indirect material interest within the meaning of paragraph (a) of this Item where:
- a. The interest arises only:

- i. From such person's position as a director of another corporation or organization that is a party to the transaction; or
    - ii. From the direct or indirect ownership by such person and all other persons specified in Instruction 1 to paragraph (a) of this Item, in the aggregate, of less than a ten percent equity interest in another person (other than a partnership) which is a party to the transaction; or
    - iii. From both such position and ownership; or
  - b. The interest arises only from such person's position as a limited partner in a partnership in which the person and all other persons specified in Instruction 1 to paragraph (a) of this Item, have an interest of less than ten percent, and the person is not a general partner of and does not hold another position in the partnership.
7. Disclosure need not be provided pursuant to paragraph (a) of this Item if:
- a. The transaction is one where the rates or charges involved in the transaction are determined by competitive bids, or the transaction involves the rendering of services as a common or contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority;
  - b. The transaction involves services as a bank depository of funds, transfer agent, registrar, trustee under a trust indenture, or similar services; or
  - c. The interest of the related person arises solely from the ownership of a class of equity securities of the registrant and all holders of that class of equity securities of the registrant received the same benefit on a pro rata basis.

*(b) Review, approval or ratification of transactions with related persons.*

- (1) Describe the registrant's policies and procedures for the review, approval, or ratification of any transaction required to be reported under paragraph (a) of this Item. While the material features of such policies and procedures will vary depending on the particular circumstances, examples of such features may include, in given cases, among other things:
  - i. The types of transactions that are covered by such policies and procedures;
  - ii. The standards to be applied pursuant to such policies and procedures;
  - iii. The persons or groups of persons on the board of directors or otherwise who are responsible for applying such policies and procedures; and
  - iv. A statement of whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced.

- (2) Identify any transaction required to be reported under paragraph (a) of this Item since the beginning of the registrant's last fiscal year where such policies and procedures did not require review, approval or ratification or where such policies and procedures were not followed.

**Instruction to Item 404(b).**

Disclosure need not be provided pursuant to this paragraph regarding any transaction that occurred at a time before the related person became one of the enumerated persons in Instruction 1.a.i., ii., or iii. to Item 404(a) if such transaction did not continue after the related person became one of the enumerated persons in Instruction 1.a.i., ii., or iii. to Item 404(a).

*(c) Promoters and certain control persons.*

- (1) Registrants that are filing a registration statement on Form S-1 under the Securities Act (§239.11 of this chapter) or on Form 10 under the Exchange Act (§249.210 of this chapter) and that had a promoter at any time during the past five fiscal years shall:
  - i. State the names of the promoter(s), the nature and amount of anything of value (including money, property, contracts, options or rights of any kind) received or to be received by each promoter, directly or indirectly, from the registrant and the nature and amount of any assets, services or other consideration therefore received or to be received by the registrant; and
  - ii. As to any assets acquired or to be acquired by the registrant from a promoter, state the amount at which the assets were acquired or are to be acquired and the principle followed or to be followed in determining such amount, and identify the persons making the determination and their relationship, if any, with the registrant or any promoter. If the assets were acquired by the promoter within two years prior to their transfer to the registrant, also state the cost thereof to the promoter.
- (2) Registrants shall provide the disclosure required by paragraphs (c)(1)(i) and (c)(1)(ii) of this Item as to any person who acquired control of a registrant that is a shell company, or any person that is part of a group, consisting of two or more persons that agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of a registrant, that acquired control of a registrant that is a shell company. For purposes of this Item, shell company has the same meaning as in Rule 405 under the Securities Act (17 CFR 230.405) and Rule 12b-2 under the Exchange Act (17 CFR 240.12b-2).

*(d) Smaller reporting companies.* A registrant that qualifies as a "smaller reporting company," as defined by § 229.10(f)(1), must provide the following information in order to comply with this Item:

- (1) The information required by paragraph (a) of this Item for the period specified there for a transaction in which the amount involved exceeds the lesser of \$120,000 or one percent of the average of the smaller reporting company's total assets at year end for the last two completed fiscal years;

- (2) The information required by paragraph (c) of this Item; and
- (3) A list of all parents of the smaller reporting company showing the basis of control and as to each parent, the percentage of voting securities owned or other basis of control by its immediate parent, if any.

#### **Instructions to Item 404(d)**

1. Include information for any material underwriting discounts and commissions upon the sale of securities by the smaller reporting company where any of the persons specified in paragraph (a) of this Item was or is to be a principal underwriter or is a controlling person or member of a firm that was or is to be a principal underwriter.
2. For smaller reporting companies information shall be given for the period specified in paragraph (a) of this Item and, in addition, for the fiscal year preceding the small reporting company's last fiscal year.

#### **Instructions to Item 404.**

1. If the information called for by this Item is being presented in a registration statement filed pursuant to the Securities Act or the Exchange Act, information shall be given for the periods specified in the Item and, in addition, for the two fiscal years preceding the registrant's last fiscal year, unless the information is being incorporated by reference into a registration statement on Form S-4 (17 CFR 239.25), in which case, information shall be given for the periods specified in the Item.
2. A foreign private issuer will be deemed to comply with this Item if it provides the information required by Item 7.B. of Form 20-F (17 CFR 249.220f) with more detailed information provided if otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded.

### **Adopting Release and Interpretive Guidance**

A copy of the SEC's Compliance & Disclosure Interpretations dated July 8, 2011 regarding Regulation S-K, including Item 404, is located at [Appendix B-III](#).

- An electronic copy of the compliance & disclosure interpretations which is intended to be updated from time to time can be found at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>

Excerpts from the adopting release include:

- As we explained in the Proposing Release, we believe that, in addition to disclosure regarding executive compensation, a materially complete picture of financial relationships with a company involves disclosure regarding related party transactions. Therefore, we are also adopting significant revisions to Item 404 of Regulation S-K, previously titled "Certain Relationships and Related Transactions." In 1982, various provisions that had been adopted in a piecemeal fashion and had been subject to frequent amendment were consolidated into

Item 404 of Regulation S-K. Today we are amending Item 404 of Regulation S-K and S-B to streamline and modernize this disclosure requirement, while making it more principles-based. Although the amendments significantly modify this disclosure requirement, its purpose - to elicit disclosure regarding transactions and relationships, including indebtedness, involving the company and related persons and the independence of directors and nominees for director and the interests of management - remains unchanged.

- We are adopting amendments to Item 404 to make the certain relationships and related transactions disclosure requirements clearer and easier to follow. The revisions retain the principles for disclosure of related person transactions that were previously specified in Item 404(a), but no longer include all of the instructions that served to delineate what transactions are reportable or excludable from disclosure based on bright lines that can depart from a more appropriate materiality analysis. Instead, Item 404(a) as amended consists of a general statement of the principle for disclosure, followed by specific disclosure requirements and instructions.
- The materiality standard for disclosure embodied in Item 404(a) prior to these amendments is retained; a company must disclose based on whether the related person had or will have a direct or indirect material interest in the transaction. The materiality of any interest will continue to be determined on the basis of the significance of the information to investors in light of all the circumstances. As was the case before adoption of amended Item 404(a), the relationship of the related persons to the transaction, and with each other, the importance of the interest to the person having the interest and the amount involved in the transaction are among the factors to be considered in determining the materiality of the information to investors.
- One commenter questioned whether changing the test of company involvement from being a “party” to a transaction to being a “participant” in a transaction is intended to be a substantive change. The purpose of this change is to more accurately connote the company’s involvement in a transaction by clarifying that being a “participant” encompasses situations where the company benefits from a transaction but is not technically a contractual “party” to the transaction.
- The term “transaction” has a broad scope in Item 404(a). This term is not to be interpreted narrowly, but rather broadly includes, but is not limited to, any financial transaction, arrangement or relationship or any series of similar transactions, arrangements or relationships.
- The definition of “related person” that we have adopted will require disclosure of related person transactions involving the company and a person (other than a significant shareholder or immediate family member of such shareholder) that occurred during the last fiscal year, if the person was a “related person” during any part of that year. A person who had a position or relationship giving rise to the person being a “related person” during only part of the last fiscal year may have had a material interest in a transaction with the company during that year. While prior to these amendments Item 404(a) did not indicate whether disclosure was required for the transaction in this situation, the history of Item 404 suggests that disclosure was required if the requisite relationship existed at the time of the transaction, even if the

person was no longer a related person at the end of the year. We believe that, because of the potential for abuse and the close proximity in time between the transaction and the person's status as a "related person," it is appropriate to require disclosure for transactions in which the person had a material interest occurring at any time during the fiscal year. For example, it is possible that a material interest of a person in a transaction during this timeframe could influence the person's performance of his or her duties.

- We believe that transactions with persons who have been or who will become significant shareholders (or their immediate family members), but are not at the time of the transaction, raise different considerations and are harder to track, and thus we are excluding them as proposed. Disclosure will be required, however, regarding a transaction that begins before a significant shareholder becomes a significant shareholder, and continues (for example, through the on-going receipt of payments) on or after the time that the person becomes a significant shareholder.

## Practice Pointers

### Principles-Based Disclosure

- As the adopting release notes, revised Item 404 is more principles-based than the previous Item 404 and therefore requires more rigorous analysis of the materiality of the transaction to the related person.
  - As was the case under the prior rules, materiality is determined on the basis of the significance of the information to investors in light of all the circumstances.
  - See John W. White, *Principles Matter: Related Person Transactions Disclosure and Disclosure Controls and Procedures, Remarks Before the Society of Corporate Secretaries and Governance Professionals* (Oct. 12, 2006), a copy of which is located at [Appendix O-I](#).

### Potential Disclosure of Compensation Not Approved by Compensation Committee

- The new rules require disclosure of compensation to executive officers not reported under Item 402 (*i.e.*, compensation paid to executive officers other than the named executive officers) unless the compensation was approved or recommended by the compensation committee. Therefore, companies need to either ensure that all elements of compensation paid to all executive officers are approved or recommended by the compensation committee or be prepared to disclose compensation not so approved in its related person transaction disclosures.

### Disclosure of Related Person Transaction Approval Procedures

- Given that Item 404 now requires detailed disclosures concerning a company's policies and procedures for the review, approval or ratification of related party transactions (potentially including the standards to be applied pursuant to such policies and procedures and a statement of whether such policies are in writing), if a company does not already have

detailed policies and procedures for reviewing related party transactions, it should consider implementing such policies.

### **Definition of “Immediate Family Member”**

- The term “any immediate family member” is defined to include, among others, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and stepchildren and stepparents. However, such relatives are deemed to be:
    - only those persons who are currently related to the primary reporting person (e.g., a person who is divorced from a director’s daughter would no longer be a son-in-law whose transactions must be reported); and
    - only those persons who are related by blood or step relationship to the primary reporting person or his spouse (e.g., the sister of a director’s spouse is considered a sister-in-law; the sister’s husband, however, is not considered a brother-in-law for purposes of this item).
- *See Appendix B-III. SEC Compliance & Disclosure Interpretations regarding Regulation S-K, Section 230.01.*

### **Amount Involved Not Limited to Related Person’s Interest**

- For purposes of determining whether the amount involved in a transaction exceeds the \$120,000 disclosure threshold it may be necessary to look beyond the amount of the related person’s economic interest in the transaction.
- *See Appendix B-III. SEC Compliance & Disclosure Interpretations regarding Regulation S-K, Section 230.03* which gives the following example:
  - A corporation enters into a lease in an amount substantially in excess of \$120,000 with a lessor unaffiliated with the corporation. The lease, however, is negotiated through a related person who is paid a commission that is less than \$120,000 for those services. Since the amount of that person’s commission is dependent upon the value of the lease, that person is considered to have an interest in the lease transaction, and the transaction, together with the commission, should be reported if the interest is determined to be a direct or indirect material interest.

### **Employment Arrangements are Considered Transactions**

- Employment arrangements are considered reportable transactions under Item 404.
  - *See Appendix B-III. SEC Compliance & Disclosure Interpretations regarding Regulation S-K, Section 230.07* stating that if a child of a director is employed by a company and receives yearly compensation exceeding \$120,000, the child’s compensation should be disclosed as a transaction in which the director has a material interest.

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations regarding Regulation S-K, Section 230.12* stating that when the transaction under consideration is an employment arrangement, “the amount involved in the transaction,” includes all compensation, not just the salary of the employee.

### **Smaller Reporting Companies**

- A registrant that qualifies as a “smaller reporting company” is required provide the disclosure called for by paragraph (d) of Item 404.
  - Note, unlike Item 404(a) which only covers the last fiscal year, Item 404(d) covers the prior two fiscal years.
  - See *Part T. Smaller Reporting Companies*.

**APPENDIX O-I**

**John W. White, *Principles Matter: Related Person Transactions Disclosure and Disclosure Controls and Procedures*, Remarks Before the Society of Corporate Secretaries and Governance Professionals (Oct. 12, 2006)**



## U.S. Securities and Exchange Commission

**Speech by SEC Staff:  
"Principles Matter: Related Person Transactions  
Disclosure and Disclosure Controls and Procedures"  
Remarks Before the Society of Corporate Secretaries  
and Governance Professionals  
New York Chapter**

*by*

**John W. White**

*Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

Newport, Rhode Island  
October 12, 2006

Thank you Shelley. I am happy to be here today. With my time during lunch, I would like to speak with you all about a topic that has been occupying a lot of my time in the past few months—the revisions to the SEC's executive compensation and related party disclosure rules that the Commission adopted in late July. I imagine the topic is now occupying much of your time. I should first remind you all, however, of the so-called "standard disclaimer". As a matter of policy the SEC disclaims responsibility for any private comments or speeches from its staff, and you should understand that my remarks today represent only my own views and not necessarily those of the Commission or of other members of the staff.

I am assuming that many if not all of you are closely involved with your companies' responses and preparations for the new rules. I have spoken with some of you about a series of speeches I have given in the past month or so which have focused on various aspects of the new rules. Since those remarks are available to you on the Commission's website, I am not going to repeat those comments today. I do, however, want to stick closely to a very important theme that has appeared in many of my prior remarks and is critical to the new disclosure rules—that this rulemaking was a truly principles-based exercise and, as I have said numerous times before, the *principles matter*. In fact, I have spoken about various parts of executive compensation disclosure from that angle—CD&A, perquisites, options grant disclosure, even plain English.<sup>1</sup> Of course, principles come up in many other facets of the rulemaking.

Today I thought I would touch on two additional areas that seemed to me to be particularly within your purview as corporate secretaries and governance professionals. First, I'd like to discuss disclosure of related person transactions, a close cousin of compensation disclosure and another

striking example of how the principles matter. Second, I would like to talk for a few minutes about yet another way in which the new rules may intersect with all of you in a frequent and substantive manner-their implications for disclosure controls and procedures-and the interaction those might have with the rulemaking's principles-based structure.

### **A Principles-Based Approach**

I assume many of you are already familiar with the concept of "principles-based disclosure" from the work you have been doing in the securities and disclosure arena. Certainly, "principles-based" was not a new concept for the Commission with the executive compensation disclosure rulemaking. Perhaps the best and most obvious example is MD&A, with which we have all had experience.

There are a wide variety of views on how to define or explain the term "principles-based". Most people probably have a general idea of what it means but I have found it worthwhile when speaking on the topic to review a useful description and make sure we're all on the same page. My favorite is to quote a description that Robert Herz, chairman of the FASB, gave in 2002. Let me read a few sentences:

Under a principles-based approach, one starts with laying out the key objectives of good reporting in the subject area, and then provides guidance explaining the objective and relating it to some common examples. While rules are sometimes unavoidable, the intent is not to try to provide specific guidance, or rules, for every possible situation. Rather, if in doubt, the reader is directed back to the principles.<sup>2</sup>

One thing I hope my various speeches and remarks can do is to give you, as disclosure lawyers and governance professionals, a tool if you will so that when working with your management (or your directors) in implementing the new rules, you are not left empty-handed if confronted with the often repeated refrain of "where does it say I have to disclose [that]?" (whatever "that" is). As Bob Herz's description explains, if there is not an express rule or a specific example, one cannot just dismiss the question in a principles-based system. One is directed back to the principle.

So in looking at various pieces of the recent rulemaking, I find it useful to walk through the steps of a principle-based system: (1) identifying the key objective of the reporting or disclosure, (2) specifying some detailed rules (but not for every situation), (3) providing descriptive guidance and representative (but not exhaustive) examples about the application of the principle, and (4) remembering that the standard and its expectations really start and end with the principle.

### **Related Person Transactions**

Disclosure of related party transactions is a key, principles-based component of the Commission's July 26 rulemaking. These types of transactions, when they occur, are very closely related to the compensation picture for a named executive officer (or a director) which I think we should all keep in mind. As the Commission stated in the Release, "a materially

complete picture of financial relationships with a company involves disclosure regarding related party transactions". Actually, even without the standards and disclosure requirements for related person transactions that are contained in Item 404 of Regulation S-K, I personally would have thought that these types of matters might in many circumstances need to be disclosed and discussed in keeping with the principle of providing context to, and a fair understanding of, executive compensation. But we do not need to dwell on that idea as the Commission has a separate disclosure requirement for these matters.

Item 404 of Regulation S K centralizes and sets forth the standards for disclosure of related person transactions. As the Release expressly states in numerous places, the revisions were designed to make the related person transaction disclosure rule more principles-based. As such, Item 404 contains a broad principle for disclosure-a company must provide disclosure regarding:

- o any transaction since the beginning of the company's last fiscal year, or any currently proposed transaction;
- o in which the company was or is to be a participant;
- o in which the amount involved exceeds \$120,000; and
- o in which any related person had or will have a direct or indirect material interest.

So, walking through the principles-based steps that I just reviewed, we would start with the key objective. As laid out above, here it is to provide investors with material information about a transaction in which the company was or will be a participant and which has a direct or indirect material interest to a related person. The Commission has set forth a few narrow, specific rules and has provided narrative discussion and guidance to help with the application of the principle. But mostly, to answer your questions, you must be ready to return to the basic principle. It is the principle that matters.

Believing that using specific language and examples is an effective way to make a point, let's look at the first two words of the principle: "any transaction". How does that fit in our principles-based system? We know the key objective of related person transaction disclosure involves providing material information to investors about certain "transactions". What is covered? The Commission has provided a definition (and I quote from the Release)-"[t]he term "transaction" has a broad scope in Item 404(a). This term is not to be interpreted narrowly, but rather broadly includes, but is not limited to, any financial transaction, arrangement or relationship or any series of similar transactions, arrangements or relationships." In keeping with the notion that a principles-based system will have some rules, the Commission has set a disclosure floor of transactions worth at least \$120,000 and has provided a few narrow exceptions that are carved out from the definition of "transaction." But generally "transaction" is an expansive and inclusive term. The Release also discusses the term and its meaning, but not in application to every situation. Grounded in principles, the term is prepared for the ever evolving nature of transactions, arrangements and relationships as they develop in the future. Ultimately,

you may need to return to the principle and to your understanding of the key objective in order to meet your disclosure obligations.

All types of transactions, regardless of whether the Release or the rules mention them by name, must be analyzed and disclosed if appropriate. To further explore this challenge, let's look at how one example or case study-charitable contributions-might fit in the analysis. These are not mentioned by specific rule or example in the Commission's rulemaking. We must return to the principle.

I have heard very intelligent people assert, quite emphatically, that a charitable donation cannot trigger required disclosure, allegedly because it cannot be a transaction ("it's only a gift") for these purposes. I respectfully disagree. Determining whether disclosure is ultimately required under Item 404 involves walking through the entirety of the analysis behind the principle and the key objective (including whether a related person has a direct or indirect material interest) but I do not think there is anything in the language of the rule or in the principle that forecloses the possibility that a charitable contribution may be a transaction or a related person transaction. Remember the broad definition the Commission uses for "transaction" as well as the rest of the key objective behind related person transaction disclosure.

Imagine this hypothetical. A company makes a sizeable (that is, more than \$120,000) donation to an environmental organization which the company's CEO particularly likes. Is that a related person transaction that requires disclosure? Going back to our key objective, it seems attenuated to me, without more, to find a "direct or indirect material interest" for our hypothetical related person, the CEO, so disclosure may not be required. But it seems clear to me that it's a transaction based on the Commission's definition and discussion. It may be lack of materiality that precludes disclosure.

Change the facts a little. What if the environmental charity employs the CEO's son? What if the charity was in dire straits before the company's donation and the son was likely, like everyone else who works at the charity, to lose his job? The company's sizeable donation, however, allows the charity to remain in operation. That one seems fairly easy. In that hypothetical, the company's donation has allowed the CEO's son to keep his job, and I imagine most parents would have at least an indirect material interest in their children's employment and careers. Alternatively, what if the prominent and highly regarded head of the charity writes a letter (and pulls some strings) after the contribution is received and lands the CEO's daughter a prestigious internship with an international wildlife agency? I have no idea standing here today what the right answer to that one is, but I believe we could figure it out if we had all the relevant facts and walked through them with the principle in mind. Remember, it's the principle that matters. And I at least think that the fact that the Commission has designed Item 404 to be principles-based tells us pretty quickly that we can't shirk the analysis by saying that a charitable contribution does not fit into someone's preconceived notion of transaction. As an understanding of principles-based rules and disclosure makes clear, lacking express language or a direct example in the rulemaking we must return to the principle. That is not at all the same as saying we can stop our analysis or conclude that disclosure is not required.

## Putting Principles in Place: Disclosure Controls and Procedures

Navigating through the demands of principles-based disclosure is an important task and, as suggested by our charitable contribution example, not one conducive to superficial answers. I am happy to remind you, though, that you have some considerable resources at hand to help you meet those challenges. I believe you need to focus on at least a couple of things in this area. First, is your full team in place and on board? Second, how should your disclosure controls and procedures (or "DCP") be functioning in a principles-based world? I will return to the idea of how the entirety of your team intersects with disclosure controls and procedures at your company, but let's first look at the basics and the mechanics of DCP for a moment.

### 1. The Basic Structure and Mechanics of Disclosure Controls and Procedures.

As you know, disclosure controls and procedures must operate for all of the disclosures your company makes in its SEC filings, but to my mind our topic today-related person transaction disclosure-poses a particular challenge, and presents a special need, for robust disclosure controls and procedures. As you hopefully sensed while we were walking through our hypothetical about a company's charitable contribution, it is especially important to understand context and to have a broad sense of the facts when making determinations about the need for related person transaction disclosure. This becomes particularly the case when you consider principles-based examples.

Since at least 2002, public companies have been working with disclosure controls and procedures and hopefully reaping the benefits of having effective ones in place. Pursuant to Rule 13a 15(a) under the Securities Exchange Act of 1934, the Commission requires that public companies maintain disclosure controls and procedures. Those are then defined by Rule 13a 15(e) as

controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

I have elsewhere suggested that in light of the new executive compensation disclosure rules, companies should be reviewing and revamping as necessary their disclosure controls and procedures to make sure they're up to the task of complying with the new rules. I have heard numerous outside commentators make the same point, and I believe your company's disclosure controls and procedures are probably already a priority and very

much in focus for many if not all of you. Similarly, I would guess you have already begun the task of reviewing and updating them as necessary.

In a speech I gave last spring even before the final rules were adopted-or, I can assure you, drafted or finalized in any way-I attempted to focus people on what kinds of questions they might want to be asking and what kinds of changes to their disclosure controls and procedures they might need to be considering.<sup>3</sup> For example, I had asked (and if I were still in private practice I would have been asking my clients throughout this year) questions such as:

- Who will collect and aggregate these different types of information, which may not fit neatly with information collected to meet prior disclosure requirements?
- Who will be responsible for maintaining the information? For analyzing it? For ensuring that the company's compensation story (that's the new CD&A) is told correctly?
- Are existing disclosure committees properly positioned for the task? Do they include the right people?

Those types of questions and considerations are important, in my opinion, for the structure and mechanics of DCP generally and would probably apply for any type of new disclosure requirements. I do not want to diminish those factors in any respect, but I'd also like to take a few moments and drill down into some specialized questions and issues that I see as being particularly raised by the new executive compensation and related person disclosure requirements.

## 2. An Expansive View of the DCP Team.

I referred a couple of moments ago to your company's "team"-which might include disclosure counsel and advisors but also compensation specialists, management (including officers) and directors. Hopefully everyone in this room understands the substantive contributions you yourselves can make in addition to your role in operating your company's disclosure controls and procedures. I think your contributions to both substance and to process are important. And as I alluded a few moments ago, I think the same is true for the rest of your team.

I have spoken in the past about how officers (specifically CFO's but much of the same would apply to CEO's) fit in this mix, as well as how directors do.<sup>4</sup> I would like to encourage all of you, among others, to do that same type of analysis for yourselves and for your companies. How can or should your officers and directors be involved and what kind of contributions does your company need from them? Does your company need your compensation committee members, or some subset of them, to be engaged in your disclosure processes earlier than they have in the past? Do your officers? Some of you may have frequent interaction with the human resources and compensation specialists at your company (whether internal employees or outside consultants); others of you may not. I think all of you, however, should ask what input your company will need from those members of its team in order to provide the best executive compensation and related person disclosures that it can. Make sure, if you can, that those lines of

communications are well-established well in advance at your company.

I very briefly referred to drafting the new Compensation Discussion and Analysis section as a DCP consideration. This new disclosure challenge seems to me to be one that particularly requires a close working relationship among a cross-section of your team. I have heard some outside commentators refer to it as a "multi-disciplinary approach", and that makes a lot of sense to me. Remember specifically that your certifying officers (your CEO and CFO) may have a special interest in the CD&A given that it will be filed company disclosure and covered by their certifications. Also, your compensation committee should have a special interest in it, in light of their new Compensation Committee Report in which they must disclose whether they have reviewed the CD&A with management and whether they recommended to the board that the CD&A be included in the company's proxy statement and Report on Form 10 K.

Again, when preparing the new executive compensation and related person disclosures, for many companies the whole team will need to be at the table, at different points, for the benefit of investors through improved disclosure as well as to facilitate various team members meeting their own obligations under the securities laws. I would challenge each of you then with this question. In your positions as corporate secretaries, disclosure counsel and governance professionals, how can you facilitate that involvement of everyone on your company's team and encourage communication and input from all the necessary players? Now is the time to do this-this fall-prior to your upcoming proxy.

### 3. Disclosure Controls and Procedures in a Principles-Based World.

In order to properly achieve principles-based disclosure, I believe a company would need disclosure controls and procedures even if they weren't required by our rules in order to capture and contextualize the necessary information and formulate the necessary disclosure. Understanding the substance of and complying with the new disclosure requirements includes, in my opinion, embracing the principles-based theme. Principles-based disclosure is all about providing the relevant, material information to your investors. It is not about boilerplate or copying from precedent. Think back to the steps that Bob Herz laid out for how such a system works, what it requires. Also keep in mind that the Commission's definition of disclosure controls and procedures talks about information being "accumulated and communicated" to management and about disclosure decisions being made. Your disclosure controls and procedures-already in place and hopefully well-designed for the task at hand-should further your ability to confidently have all the necessary information at hand so that you and your colleagues can analyze it in light of the principles-based disclosure requirements and decide what exactly your company needs to disclose. I hope it will work that way for your companies at least, and I encourage you to have that goal in mind.

And while process is critical, don't forget the importance of the substance to the required disclosures. The two are closely connected of course. Think about your "team" from each angle. Other than their involvement with the processes, what specific information might you need substantively from your officers and directors? Obviously there's a lot of compensation information that will need to be collected, evaluated and disclosed as

appropriate for your directors and many of your officers (at least your CEO, your CFO and the three other highest paid). Your company should be positioned and in command of that information on its own though. But what about our topic earlier this afternoon-related person transactions-and my suggestion that robust disclosures controls and procedures may be especially critical in this area?

For related person disclosure, you may well need information-principles-based input-that you will *only* be able to obtain from the related persons themselves. You may need broader types of information-context-from sources within your own company. You may need to be able to match the two up, but only after the basic information has been collected in disparate ways. Are you prepared for all of this?

Perhaps one of the most obvious resources for obtaining information from related persons is your company's D&O questionnaires. Has your company updated those? Do they need to be updated? I know that anytime there are new disclosure requirements that cross paths with officers and directors, conscientious disclosure counsel add questions to questionnaires as needed or revise existing questions as appropriate. For example, this year I expect you may add questions derived from the new S K Item 407 disclosure requirements. But as with so much in this area, I would urge you not to stop with the most obvious responses or changes.

Think about your D&O questionnaires in terms of principles-based disclosure. Are they structured to capture principles-based information? Are your questionnaires still asking the right questions given the new disclosure requirements? Are they going to elicit all of the information that your company might need to craft the disclosure your investors deserve? For example, think about the charitable contributions example that I discussed earlier. Are you ever going to hear about a situation like that at your company so that you can even do the analysis and decide if it warrants disclosure or not? What about indirect interests that aren't expressly identified as such (nor excluded from being such) by the specific language of any relevant rule text, but should be picked up under the principles-based approach of the Commission's rulemaking? Shouldn't you make sure your processes (questionnaires or otherwise) are designed so that you can expect to be given that information? And in fact, isn't that another part of reviewing and revamping as necessary your disclosure controls and procedures? Again, we see that DCP is integrally connected to the substantive end-point of your public disclosure.

As part of "being at the table", I have also recommended in prior remarks that everyone on the team should be informed and well-advised about the substance of the new disclosure regime and how it will work. Your company needs substantive information from many on your team; they may also need substantive information from you. I have encouraged different people in various roles to ask questions and to seek out the answers they need. You can meet them in this effort. Are there training sessions or materials that you might provide that could help your officers and directors understand the new disclosure requirements and in particular how principles-based standards function? Is there anything you might do to help the rest of your team understand how the rules impact them, how disclosure *about them* may be required and in return how they can contribute to your company's compliance with the rules? I understand that

each of you is in a slightly different situation. Every company is run slightly differently. Different entities have, for different but equally valid reasons, different hierarchies and ways of organizing their processes and lines of communications. So I can't speak to how it would or should work at your specific company. But I hope you will step back and consider what is needed and what works, within your company. And I hope the officers and directors at your company would welcome your outreach and listen to your counsel if you try to bring them on board and help them understand the new principles-based disclosure requirements. Not only could that teamwork improve your company's disclosures for the benefit of investors, but it could also help your officers and your directors as they review those disclosures and, for some of them, as applicable, sign their certifications or approve a Compensation Committee Report that speaks to their having reviewed and recommended inclusion of the company's CD&A in its public filings.

### **Conclusion**

In helping your companies comply with its new disclosure obligations, all of you as disclosure counsel and governance professionals can, in my opinion, be well-served and guided by embracing the principles. And as I said earlier, I would also urge you to do anything you can do to bring the rest of your company's team into the principles-based fold-it will serve you, your officers and directors, your company, and your investors very well. The new rules will go effective in about a month, and companies and their disclosures will be called upon to comply with and reflect the new rules, and the principles, for the first time in public filings and reports after that. As is hopefully clear, I believe that the Commission has taken a significant step and significantly advanced the interests of investors by adopting its new principles-based disclosure standards. But in order for that to have the meaning it should (and to benefit investors as it should), we need America's public companies to embrace the principles and provide their own principles-based disclosures. Each of you can be a key team member in giving life to that promise, and I hope you will answer the call. I also hope we have given you some sense of how the principles can be an aid and provide important guidance to you and to your companies in this endeavor.

Thank you for sharing your time with me today. I would be happy to take any questions you might have.

### **Endnotes**

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<sup>1</sup>See, e.g., "Principles Matter," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 6, 2006, available at <http://www.sec.gov/news/speech/2006/spch090606jww.htm>; "The Principles Matter: Options Disclosure," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 11, 2006, available at <http://www.sec.gov/news/speech/2006/spch091106jww.htm>.

<sup>2</sup>"Remarks before the Financial Executives International Current Financial Reporting Issues Conference," Robert H. Herz, November 4, 2002.

<sup>3</sup>"The Need to Know," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, April 3, 2006, available at <http://www.sec.gov/news/speech/2006/spch040306jww.htm>

<sup>4</sup>See "Executive Compensation Disclosure and the Important Role of CFO's," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, October 3, 2006, available at <http://www.sec.gov/news/speech/2006/spch100306jww.htm>; "An Expansive View of Teamwork: Directors, Management and the SEC," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 25, 2006, available at <http://www.sec.gov/news/speech/2006/spch092506jww.htm>.

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<http://www.sec.gov/news/speech/2006/spch101206jww.htm>

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Modified: 10/30/2006

## P. CORPORATE GOVERNANCE

The rules consolidate the disclosure requirements regarding director independence and related corporate governance matters under a single item.

### Rules

The director independence and related corporate governance disclosure requirements (other than the Compensation Committee disclosure requirement which are discussed separately in *Part Q. Compensation Committee Disclosures and Compensation Committee Report*) are located in Items 407(a) through 407(d) and 407(f) through (h) of Regulation S-K which read as follows:

#### **Regulation S-K, Item 407 (Corporate governance).**

- (a) *Director Independence.* Identify each director and, when the disclosure called for by this paragraph is being presented in a proxy or information statement relating to the election of directors, each nominee for director, that is independent under the independence standards applicable to the registrant under paragraph (a)(1) of this Item. In addition, if such independence standards contain independence requirements for committees of the board of directors, identify each director that is a member of the compensation, nominating or audit committee that is not independent under such committee independence standards. If the registrant does not have a separately designated audit, nominating or compensation committee or committee performing similar functions, the registrant must provide the disclosure of directors that are not independent with respect to all members of the board of directors applying such committee independence standards.
- (1) In determining whether or not the director or nominee for director is independent for the purposes of paragraph (a) of this Item, the registrant shall use the applicable definition of independence, as follows:
- (i) If the registrant is a listed issuer whose securities are listed on a national securities exchange or in an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, the registrant's definition of independence that it uses for determining if a majority of the board of directors is independent in compliance with the listing standards applicable to the registrant. When determining whether the members of a committee of the board of directors are independent, the registrant definition of independence that it uses for determining if the members of that specific committee are independent in compliance with the independence standards applicable for the members of the specific committee in the listing standards of the national securities exchange or inter-dealer quotation system that the registrant uses for determining if a majority of the board of directors are independent. If the registrant does not have independence standards for a committee, the independence standards for that specific committee in the listing standards of the national securities exchange or inter-dealer quotation system that the registrant uses for determining if a majority of the board of directors are independent.

- (ii) If the registrant is not a listed issuer, a definition of independence of a national securities exchange or of an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, and state which definition is used. Whatever such definition the registrant chooses, it must use the same definition with respect to all directors and nominees for director. When determining whether the members of a specific committee of the board of directors are independent, if the national securities exchange or national securities association whose standards are used has independence standards for the members of a specific committee, use those committee specific standards.
  - (iii) If the information called for by paragraph (a) of this Item is being presented in a registration statement on Form S-1 (§ 239.11 of this chapter) under the Securities Act or on a Form 10 (§ 249.210 of this chapter) under the Exchange Act where the registrant has applied for listing with a national securities exchange or in an inter-dealer quotation system that has requirements that a majority of the board of directors be independent, the definition of independence that the registrant uses for determining if a majority of the board of directors is independent, and the definition of independence that the registrant uses for determining if members of the specific committee of the board of directors are independent, that is in compliance with the independence listing standards of the national securities exchange or inter-dealer quotation system on which it has applied for listing, or if the registrant has not adopted such definitions, the independence standards for determining if the majority of the board of directors is independent and if members of the committee of the board of directors are independent of that national securities exchange or inter-dealer quotation system.
- (2) If the registrant uses its own definitions for determining whether its directors and nominees for director, and members of specific committees of the board of directors, are independent, disclose whether these definitions are available to security holders on the registrant's Web site. If so, provide the registrant's Web site address. If not, include a copy of these policies in an appendix to the registrant's proxy statement or information statement that is provided to security holders at least once every three fiscal years or if the policies have been materially amended since the beginning of the registrant's last fiscal year. If a current copy of the policies is not available to security holders on the registrant's Web site, and is not included as an appendix to the registrant's proxy statement or information statement, identify the most recent fiscal year in which the policies were so included in satisfaction of this requirement.
- (3) For each director and nominee for director that is identified as independent, describe, by specific category or type, any transactions, relationships or arrangements not disclosed pursuant to Item 404(a) (§229.404(a)), or for investment companies, Item 22(b) of Schedule 14A (§240.14a-101 of this chapter), that were considered by the board of directors under the applicable independence definitions in determining that the director is independent.

## **Instructions to Item 407(a).**

1. If the registrant is a listed issuer whose securities are listed on a national securities exchange or in an inter-dealer quotation system which has requirements that a majority of the board of directors be independent, and also has exemptions to those requirements (for independence of a majority of the board of directors or committee member independence) upon which the registrant relied, disclose the exemption relied upon and explain the basis for the registrant's conclusion that such exemption is applicable. The same disclosure should be provided if the registrant is not a listed issuer and the national securities exchange or inter-dealer quotation system selected by the registrant has exemptions that are applicable to the registrant. Any national securities exchange or inter-dealer quotation system which has requirements that at least 50 percent of the members of a small business issuer's board of directors must be independent shall be considered a national securities exchange or inter-dealer quotation system which has requirements that a majority of the board of directors be independent for the purposes of the disclosure required by paragraph (a) of this Item.

2. Registrants shall provide the disclosure required by paragraph (a) of this Item for any person who served as a director during any part of the last completed fiscal year, except that no information called for by paragraph (a) of this Item need be given in a registration statement filed at a time when the registrant is not subject to the reporting requirements of section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) respecting any director who is no longer a director at the time of effectiveness of the registration statement.

3. The description of the specific categories or types of transactions, relationships or arrangements required by paragraph (a)(3) of this Item must be provided in such detail as is necessary to fully describe the nature of the transactions, relationships or arrangements.

### *(b) Board meetings and committees; annual meeting attendance.*

(1) State the total number of meetings of the board of directors (including regularly scheduled and special meetings) which were held during the last full fiscal year. Name each incumbent director who during the last full fiscal year attended fewer than 75 percent of the aggregate of:

- (i) The total number of meetings of the board of directors (held during the period for which he has been a director); and
- (ii) The total number of meetings held by all committees of the board on which he served (during the periods that he served).

(2) Describe the registrant's policy, if any, with regard to board members' attendance at annual meetings of security holders and state the number of board members who attended the prior year's annual meeting.

**Instruction to Item 407(b)(2).**

In lieu of providing the information required by paragraph (b)(2) of this Item in the proxy statement, the registrant may instead provide the registrant's Web site address where such information appears.

- (3) State whether or not the registrant has standing audit, nominating and compensation committees of the board of directors, or committees performing similar functions. If the registrant has such committees, however designated, identify each committee member, state the number of committee meetings held by each such committee during the last fiscal year and describe briefly the functions performed by each such committee. Such disclosure need not be provided to the extent it is duplicative of disclosure provided in accordance with paragraph (c), (d) or (e) of this Item.

*(c) Nominating committee.*

- (1) If the registrant does not have a standing nominating committee or committee performing similar functions, state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a committee and identify each director who participates in the consideration of director nominees.
- (2) Provide the following information regarding the registrant's director nomination process:
- (i) State whether or not the nominating committee has a charter. If the nominating committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the nominating committee charter;
  - (ii) If the nominating committee has a policy with regard to the consideration of any director candidates recommended by security holders, provide a description of the material elements of that policy, which shall include, but need not be limited to, a statement as to whether the committee will consider director candidates recommended by security holders;
  - (iii) If the nominating committee does not have a policy with regard to the consideration of any director candidates recommended by security holders, state that fact and state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a policy;
  - (iv) If the nominating committee will consider candidates recommended by security holders, describe the procedures to be followed by security holders in submitting such recommendations;
  - (v) Describe any specific minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for a position on the registrant's board of directors, and describe any specific qualities or skills that the nominating committee believes are necessary for one or more of the registrant's directors to possess;

- (vi) Describe the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether the nominee is recommended by a security holder, and whether, and if so how, the nominating committee (or the board) considers diversity in identifying nominees for director. If the nominating committee (or the board) has a policy with regard to the consideration of diversity in identifying director nominees, describe how this policy is implemented, as well as how the nominating committee (or the board) assesses the effectiveness of its policy;
- (vii) With regard to each nominee approved by the nominating committee for inclusion on the registrant's proxy card (other than nominees who are executive officers or who are directors standing for re-election), state which one or more of the following categories of persons or entities recommended that nominee: security holder, non-management director, chief executive officer, other executive officer, third-party search firm, or other specified source. With regard to each such nominee approved by a nominating committee of an investment company, state which one or more of the following additional categories of persons or entities recommended that nominee: security holder, director, chief executive officer, other executive officer, or employee of the investment company's investment adviser, principal underwriter, or any affiliated person of the investment adviser or principal underwriter;
- (viii) If the registrant pays a fee to any third party or parties to identify or evaluate or assist in identifying or evaluating potential nominees, disclose the function performed by each such third party; and
- (ix) If the registrant's nominating committee received, by a date not later than the 120th calendar day before the date of the registrant's proxy statement released to security holders in connection with the previous year's annual meeting, a recommended nominee from a security holder that beneficially owned more than 5% of the registrant's voting common stock for at least one year as of the date the recommendation was made, or from a group of security holders that beneficially owned, in the aggregate, more than 5% of the registrant's voting common stock, with each of the securities used to calculate that ownership held for at least one year as of the date the recommendation was made, identify the candidate and the security holder or security holder group that recommended the candidate and disclose whether the nominating committee chose to nominate the candidate, *provided, however*, that no such identification or disclosure is required without the written consent of both the security holder or security holder group and the candidate to be so identified.

**Instructions to Item 407(c)(2)(ix).**

1. For purposes of paragraph (c)(2)(ix) of this Item, the percentage of securities held by a nominating security holder may be determined using information set forth in the registrant's most

recent quarterly or annual report, and any current report subsequent thereto, filed with the Commission pursuant to the Exchange Act (or, in the case of a registrant that is an investment company registered under the Investment Company Act of 1940, the registrant's most recent report on Form N-CSR (§§249.331 and 274.128 of this chapter)), unless the party relying on such report knows or has reason to believe that the information contained therein is inaccurate.

2. For purposes of the registrant's obligation to provide the disclosure specified in paragraph (c)(2)(ix) of this Item, where the date of the annual meeting has been changed by more than 30 days from the date of the previous year's meeting, the obligation under that Item will arise where the registrant receives the security holder recommendation a reasonable time before the registrant begins to print and mail its proxy materials.

3. For purposes of paragraph (c)(2)(ix) of this Item, the percentage of securities held by a recommending security holder, as well as the holding period of those securities, may be determined by the registrant if the security holder is the registered holder of the securities. If the security holder is not the registered owner of the securities, he or she can submit one of the following to the registrant to evidence the required ownership percentage and holding period:

- a. A written statement from the "record" holder of the securities (usually a broker or bank) verifying that, at the time the security holder made the recommendation, he or she had held the required securities for at least one year; or
- b. If the security holder has filed a Schedule 13D (§240.13d-101 of this chapter), Schedule 13G (§240.13d-102 of this chapter), Form 3 (§249.103 of this chapter), Form 4 (§249.104 of this chapter), and/or Form 5 (§249.105 of this chapter), or amendments to those documents or updated forms, reflecting ownership of the securities as of or before the date of the recommendation, a copy of the schedule and/or form, and any subsequent amendments reporting a change in ownership level, as well as a written statement that the security holder continuously held the securities for the one-year period as of the date of the recommendation.

4. For purposes of the registrant's obligation to provide the disclosure specified in paragraph (c)(2)(ix) of this Item, the security holder or group must have provided to the registrant, at the time of the recommendation, the written consent of all parties to be identified and, where the security holder or group members are not registered holders, proof that the security holder or group satisfied the required ownership percentage and holding period as of the date of the recommendation.

#### **Instruction to Item 407(c)(2).**

For purposes of paragraph (c)(2) of this Item, the term *nominating committee* refers not only to nominating committees and committees performing similar functions, but also to groups of directors fulfilling the role of a nominating committee, including the entire board of directors.

- (3) Describe any material changes to the procedures by which security holders may recommend nominees to the registrant's board of directors, where those changes were implemented after the registrant last provided disclosure in response to the requirements of paragraph (c)(2)(iv) of this Item, or paragraph (c)(3) of this Item.

### **Instructions to Item 407(c)(3).**

1. The disclosure required in paragraph (c)(3) of this Item need only be provided in a registrant's quarterly or annual reports.
2. For purposes of paragraph (c)(3) of this Item, adoption of procedures by which security holders may recommend nominees to the registrant's board of directors, where the registrant's most recent disclosure in response to the requirements of paragraph (c)(2)(iv) of this Item, or paragraph (c)(3) of this Item, indicated that the registrant did not have in place such procedures, will constitute a material change.

#### *(d) Audit committee.*

- (1) State whether or not the audit committee has a charter. If the audit committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the audit committee charter.
- (2) If a listed issuer's board of directors determines, in accordance with the listing standards applicable to the issuer, to appoint a director to the audit committee who is not independent (apart from the requirements in §240.10A-3 of this chapter), including as a result of exceptional or limited or similar circumstances, disclose the nature of the relationship that makes that individual not independent and the reasons for the board of directors' determination.
- (3) (i) The audit committee must state whether:
  - (A) The audit committee has reviewed and discussed the audited financial statements with management;
  - (B) The audit committee has discussed with the independent auditors the matters required to be discussed by the statement on Auditing Standards No. 61, as amended (AICPA, *Professional Standards*, Vol. 1. AU section 380),<sup>1</sup> as adopted by the Public Company Accounting Oversight Board in Rule 3200T;
  - (C) The audit committee has received the written disclosures and the letter from the independent accountant required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence, and has discussed with the independent accountant the independent accountant's independence; and
  - (D) Based on the review and discussions referred to in paragraphs (d)(3)(i)(A) through (d)(3)(i)(C) of this Item, the audit committee recommended to the board of directors that the audited financial statements be included in the

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<sup>1</sup> Available at [http://www.pcaobus.org/standards/interim\\_standards/auditing\\_standards/index\\_au.asp?Series=300&section=300](http://www.pcaobus.org/standards/interim_standards/auditing_standards/index_au.asp?Series=300&section=300).

company's annual report on Form 10-K (17 CFR 249.310) (or, for closed-end investment companies registered under the Investment Company Act of 1940, (15 U.S.C. 80a-1 *et seq.*), the annual report to shareholders required by section 30(e) of the Investment Company Act of 1940 (15 U.S.C. 80a-29(e)) and Rule 30d-1 (17 CFR 270.30d-1) thereunder) for the last fiscal year for filing with the Commission.

- (ii) The name of each member of the company's audit committee (or, in the absence of an audit committee, the board committee performing equivalent functions or the entire board of directors) must appear below the disclosure required by paragraph (d)(3)(i) of this Item.

- (4) (i) If the registrant meets the following requirements, provide the disclosure in paragraph (d)(4)(ii) of this Item:

- (A) The registrant is a listed issuer, as defined in §240.10A-3 of this chapter;
- (B) The registrant is filing an annual report on Form 10-K (§ 249.310 of this chapter) or a proxy statement or information statement pursuant to the Exchange Act (15 U.S.C. 78a *et seq.*) if action is to be taken with respect to the election of directors; and
- (C) The registrant is neither:
  - 1. A subsidiary of another listed issuer that is relying on the exemption in §240.10A-3(c)(2) of this chapter; nor
  - 2. Relying on any of the exemptions in §240.10A-3(c)(4) through (c)(7) of this chapter.

- (ii) (A) State whether or not the registrant has a separately-designated standing audit committee established in accordance with section 3(a)(58)(A) of the Exchange Act (15 U.S.C. 78c(a)(58)(A)), or a committee performing similar functions. If the registrant has such a committee, however designated, identify each committee member. If the entire board of directors is acting as the registrant's audit committee as specified in section 3(a)(58)(B) of the Exchange Act (15 U.S.C. 78c(a)(58)(B)), so state.

- (B) If applicable, provide the disclosure required by §240.10A-3(d) of this chapter regarding an exemption from the listing standards for audit committees.

(5) *Audit committee financial expert.*

- (i) (A) Disclose that the registrant's board of directors has determined that the registrant either;

1. Has at least one audit committee financial expert serving on its audit committee; or
  2. Does not have an audit committee financial expert serving on its audit committee.
- (B) If the registrant provides the disclosure required by paragraph (d)(5)(i)(A)(1) of this Item, it must disclose the name of the audit committee financial expert and whether that person is *independent* as independence for audit committee members is defined in the listing standards applicable to the listed issuer.
- (C) If the registrant provides the disclosure required by paragraph (d)(5)(i)(A)(2) of this Item, it must explain why it does not have an audit committee financial expert.

**Instruction to Item 407(d)(5)(i).**

If the registrant's board of directors has determined that the registrant has more than one audit committee financial expert serving on its audit committee, the registrant may, but is not required to, disclose the names of those additional persons. A registrant choosing to identify such persons must indicate whether they are independent pursuant to paragraph (d)(5)(i)(B) of this Item.

- (ii) For purposes of this Item, an *audit committee financial expert* means a person who has the following attributes:
- (A) An understanding of generally accepted accounting principles and financial statements;
  - (B) The ability to assess the general application of such principles in connection with the accounting for estimates, accruals and reserves;
  - (C) Experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the registrant's financial statements, or experience actively supervising one or more persons engaged in such activities;
  - (D) An understanding of internal control over financial reporting; and
  - (E) An understanding of audit committee functions.
- (iii) A person shall have acquired such attributes through:
- (A) Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions;

- (B) Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;
  - (C) Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements; or
  - (D) Other relevant experience.
- (iv) *Safe Harbor.*
- (A) A person who is determined to be an audit committee financial expert will not be deemed an *expert* for any purpose, including without limitation for purposes of section 11 of the Securities Act (15 U.S.C. 77k), as a result of being designated or identified as an audit committee financial expert pursuant to this Item 407.
  - (B) The designation or identification of a person as an audit committee financial expert pursuant to this Item 407 does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification.
  - (C) The designation or identification of a person as an audit committee financial expert pursuant to this Item does not affect the duties, obligations or liability of any other member of the audit committee or board of directors.

**Instructions to Item 407(d)(5).**

1. The disclosure under paragraph (d)(5) of this Item is required only in a registrant's annual report. The registrant need not provide the disclosure required by paragraph (d)(5) of this Item in a proxy or information statement unless that registrant is electing to incorporate this information by reference from the proxy or information statement into its annual report pursuant to General Instruction G(3) to Form 10-K (17 CFR 249.310).
2. If a person qualifies as an audit committee financial expert by means of having held a position described in paragraph (d)(5)(iii)(D) of this Item, the registrant shall provide a brief listing of that person's relevant experience. Such disclosure may be made by reference to disclosures required under Item 401(e) (§229.401(e)).
3. In the case of a foreign private issuer with a two-tier board of directors, for purposes of paragraph (d)(5) of this Item, the term *board of directors* means the supervisory or non-management board. In the case of a foreign private issuer meeting the requirements of §240.10A-3(c)(3) of this chapter, for purposes of paragraph (d)(5) of this Item, the term *board of directors* means the issuer's board of auditors (or similar body) or statutory auditors, as applicable. Also, in the case of a foreign private issuer, the term *generally accepted accounting principles* in

paragraph (d)(5)(ii)(A) of this Item means the body of generally accepted accounting principles used by that issuer in its primary financial statements filed with the Commission.

4. A registrant that is an Asset-Backed Issuer (as defined in §229.1101) is not required to disclose the information required by paragraph (d)(5) of this Item.

**Instructions to Item 407(d).**

1. The information required by paragraphs (d)(1) - (3) of this Item shall not be deemed to be “soliciting material,” or to be “filed” with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 through 240.14b-2 or 240.14c-1 through 240.14c-101), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act. Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

2. The disclosure required by paragraphs (d)(1) – (3) of this Item need only be provided one time during any fiscal year.

3. The disclosure required by paragraph (d)(3) of this Item need not be provided in any filings other than a registrant’s proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting).

*(f) Shareholder communications.*

- (1) State whether or not the registrant’s board of directors provides a process for security holders to send communications to the board of directors and, if the registrant does not have such a process for security holders to send communications to the board of directors, state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a process.
- (2) If the registrant has a process for security holders to send communications to the board of directors:
  - (i) Describe the manner in which security holders can send communications to the board and, if applicable, to specified individual directors; and
  - (ii) If all security holder communications are not sent directly to board members, describe the registrant’s process for determining which communications will be relayed to board members.

## **Instructions to Item 407(f).**

1. In lieu of providing the information required by paragraph (f)(2) of this Item in the proxy statement, the registrant may instead provide the registrant's Web site address where such information appears.

2. For purposes of the disclosure required by paragraph (f)(2)(ii) of this Item, a registrant's process for collecting and organizing security holder communications, as well as similar or related activities, need not be disclosed provided that the registrant's process is approved by a majority of the independent directors or, in the case of a registrant that is an investment company, a majority of the directors who are not "interested persons" of the investment company as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)).

3. For purposes of this paragraph, communications from an officer or director of the registrant will not be viewed as "security holder communications." Communications from an employee or agent of the registrant will be viewed as "security holder communications" for purposes of this paragraph only if those communications are made solely in such employee's or agent's capacity as a security holder.

4. For purposes of this paragraph, security holder proposals submitted pursuant to §240.14a-8 of this chapter, and communications made in connection with such proposals, will not be viewed as "security holder communications."

(g) *Smaller reporting companies.* A registrant that qualifies as a "smaller reporting company," as defined by § 229.10(f)(1), is not required to provide:

(1) The disclosure required in paragraph (d)(5) of this Item in its first annual report filed pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m (a) or 78o(d)) following the effective date of its first registration statement filed under the Securities Act (15 U.S.C. 77a et seq.) or Exchange Act (15 U.S.C. 78a et seq.); and

(2) Need not provide the disclosures required by paragraphs (e)(4) and (e)(5) of this Item.

(h) *Board Leadership Structure and Role in Risk Oversight.* Briefly describe the leadership structure of the registrant's board, such as whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions, and, in the case of a registrant that is an investment company, whether the chairman of the board is an "interested person" of the registrant as defined in section 2(a)(19) of the Investment Company Act (15 U.S.C. 80a-2(a)(19)). If one person serves as both principal executive officer and chairman of the board, or if the chairman of the board of a registrant that is an investment company is an "interested person" of the registrant, disclose whether the registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the board. This disclosure should indicate why the registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the registrant. In addition, disclose the extent of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function, and the effect that this has on the board's leadership structure.

## Instructions to Item 407.

1. For purposes of this Item:

- a. *Listed issuer* means a listed issuer as defined in §240.10A-3 of this chapter;
- b. *National securities exchange* means a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a));
- c. *Inter-dealer quotation system* means an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)); and
- d. *National securities association* means a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that has been approved by the Commission (as that definition may be modified or supplemented).

2. With respect to paragraphs (c)(2)(i), (d)(1) and (e)(2) of this Item, disclose whether a current copy of the applicable committee charter is available to security holders on the registrant's Web site, and if so, provide the registrant's Web site address. If a current copy of the charter is not available to security holders on the registrant's Web site, include a copy of the charter in an appendix to the registrant's proxy or information statement that is provided to security holders at least once every three fiscal years, or if the charter has been materially amended since the beginning of the registrant's last fiscal year. If a current copy of the charter is not available to security holders on the registrant's Web site, and is not included as an appendix to the registrant's proxy or information statement, identify in which of the prior fiscal years the charter was so included in satisfaction of this requirement.

### Adopting Release Excerpts

Excerpts from the adopting releases include:

- We are consolidating our disclosure requirements regarding director independence and related corporate governance disclosure requirements under a single disclosure item and updating such disclosure requirements regarding director independence to reflect our current requirements and current listing standards.
- In addition, the amendments require, for each director or director nominee identified as independent, a description, by specific category or type, of any transactions, relationships or arrangements not disclosed pursuant to paragraph (a) of Item 404 that were considered by the board of directors of the company in determining that the applicable independence standards were met. Under our proposals, disclosure of the specific details of each such transaction, relationship or arrangement would have been required. Several commenters objected to providing this disclosure, given the potential for extensive detail about these types of transactions, relationships or arrangements, and some suggested instead providing disclosure by category or type of transaction. In response to the commenters, we have revised the disclosure requirement to permit transactions, relationships or arrangements of each director

or director nominee to be described by the specific category or type. Consistent with the rule proposals, the amended rule requires that the disclosure be made on a director by director basis, with separate disclosure of categories or types of transactions, relationships or arrangements for each director and director nominee. We have also adopted an instruction indicating that the description of the category or type must be sufficiently detailed so that the nature of the transactions, relationships or arrangements is readily apparent.

- As proposed, this independence disclosure is required for any person who served as a director of the company during any part of the year for which disclosure must be provided, even if the person no longer serves as director at the time of filing the registration statement or report or, if the information is in a proxy statement, if the director's term of office as a director will not continue after the meeting. In this regard, we believe that the independence status of a director is material while the person is serving as director, and not just as a matter of reelection.
- Under the amendments, a company is required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. In these circumstances, the amendments will require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not intended to influence a company's decision regarding its board leadership structure.
- The final rules also require companies to describe the board's role in the oversight of risk. We were persuaded by commenters who noted that risk oversight is a key competence of the board, and that additional disclosures would improve investor and shareholder understanding of the role of the board in the organization's risk management practices. Companies face a variety of risks, including credit risk, liquidity risk, and operational risk. As we noted in the Proposing Release, similar to disclosure about the leadership structure of a board, disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company. This disclosure requirement gives companies the flexibility to describe how the board administers its risk oversight function, such as through the whole board, or through a separate risk committee or the audit committee, for example. Where relevant, companies may want to address whether the individuals who supervise the day-to-day risk management responsibilities report directly to the board as a whole or to a board committee or how the board or committee otherwise receives information from such individuals.

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## Q. COMPENSATION COMMITTEE DISCLOSURES AND COMPENSATION COMMITTEE REPORT

The rules require new disclosures regarding the compensation committee and require the inclusion of a compensation committee report in the annual proxy statement similar to the audit committee report.

### Rules

The Compensation Committee disclosure and Compensation Committee Report requirements are located in Item 407(e) of Regulation S-K. An instruction to Item 407(e)(3)(iv) refers to the factors listed in subsections (b)(4)(i) through (vi) of Rule 10C-1 under the Exchange Act.

Note, however, a registrant that qualifies as a “smaller reporting company” is not required to comply with paragraphs (e)(4) or (e)(5) of Item 407.

- *See Part T. Smaller Reporting Companies.*

Items 407(e) and (g) of Regulation S-K read as follows:

#### **Regulation S-K, Item 407 (Corporate governance).**

##### *(e) Compensation committee.*

- (1) If the registrant does not have a standing compensation committee or committee performing similar functions, state the basis for the view of the board of directors that it is appropriate for the registrant not to have such a committee and identify each director who participates in the consideration of executive officer and director compensation.
- (2) State whether or not the compensation committee has a charter. If the compensation committee has a charter, provide the disclosure required by Instruction 2 to this Item regarding the compensation committee charter.
- (3) Provide a narrative description of the registrant's processes and procedures for the consideration and determination of executive and director compensation, including:
  - (i)(A) The scope of authority of the compensation committee (or persons performing the equivalent functions); and
    - (B) The extent to which the compensation committee (or persons performing the equivalent functions) may delegate any authority described in paragraph (e)(3)(i)(A) of this Item to other persons, specifying what authority may be so delegated and to whom;
  - (ii) Any role of executive officers in determining or recommending the amount or form of executive and director compensation; and

(iii) Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice) during the registrant's last completed fiscal year, identifying such consultants, stating whether such consultants were engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement:

- (A) If such compensation consultant was engaged by the compensation committee (or persons performing the equivalent functions) to provide advice or recommendations on the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice) and the compensation consultant or its affiliates also provided additional services to the registrant or its affiliates in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and the aggregate fees for such additional services. Disclose whether the decision to engage the compensation consultant or its affiliates for these other services was made, or recommended, by management, and whether the compensation committee or the board approved such other services of the compensation consultant or its affiliates.
- (B) If the compensation committee (or persons performing the equivalent functions) has not engaged a compensation consultant, but management has engaged a compensation consultant to provide advice or recommendations on the amount or form of executive and director compensation (other than any role limited to consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors of the registrant, and that is available generally to all salaried employees; or providing information that either is not customized for a particular registrant or that is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice) and such compensation consultant or its affiliates has provided additional services to the registrant in an amount in excess of \$120,000 during the registrant's last completed fiscal year, then disclose the aggregate fees for determining or recommending the amount or form of executive and director compensation and

the aggregate fees for any additional services provided by the compensation consultant or its affiliates.

- (iv) With regard to any compensation consultant identified in response to Item 407(e)(3)(iii) whose work has raised any conflict of interest, disclose the nature of the conflict and how the conflict is being addressed.

**Instruction to Item 407(e)(3)(iv).**

For purposes of this paragraph (e)(3)(iv), the factors listed in § 240.10C-1(b)(4)(i) through (vi) of this chapter are among the factors that should be considered in determining whether a conflict of interest exists.

- (4) Under the caption “Compensation Committee Interlocks and Insider Participation”:
  - (i) Identify each person who served as a member of the compensation committee of the registrant’s board of directors (or board committee performing equivalent functions) during the last completed fiscal year, indicating each committee member who:
    - (A) Was, during the fiscal year, an officer or employee of the registrant;
    - (B) Was formerly an officer of the registrant; or
    - (C) Had any relationship requiring disclosure by the registrant under any paragraph of Item 404 (§229.404). In this event, the disclosure required by Item 404 (§229.404) shall accompany such identification.
  - (ii) If the registrant has no compensation committee (or other board committee performing equivalent functions), the registrant shall identify each officer and employee of the registrant, and any former officer of the registrant, who, during the last completed fiscal year, participated in deliberations of the registrant’s board of directors concerning executive officer compensation.
  - (iii) Describe any of the following relationships that existed during the last completed fiscal year:
    - (A) An executive officer of the registrant served as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served on the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of the registrant;
    - (B) An executive officer of the registrant served as a director of another entity, one of whose executive officers served on the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of the registrant; and

(C) An executive officer of the registrant served as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served as a director of the registrant.

(iv) Disclosure required under paragraph (e)(4)(iii) of this Item regarding a compensation committee member or other director of the registrant who also served as an executive officer of another entity shall be accompanied by the disclosure called for by Item 404 with respect to that person.

**Instruction to Item 407(e)(4).**

For purposes of paragraph (e)(4) of this Item, the term *entity* shall not include an entity exempt from tax under section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501 (c)(3)).

(5) Under the caption “Compensation Committee Report:”

(i) The compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) must state whether:

(A) The compensation committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) (§229.402(b)) with management; and

(B) Based on the review and discussions referred to in paragraph (e)(5)(i)(A) of this Item, the compensation committee recommended to the board of directors that the Compensation Discussion and Analysis be included in the registrant’s annual report on Form 10-K (§249.310 of this chapter), proxy statement on Schedule 14A (§240.14a-101 of this chapter) or information statement on Schedule 14C (§240.14c-101 of this chapter).

(ii) The name of each member of the registrant's compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) must appear below the disclosure required by paragraph (e)(5)(i) of this Item.

**Instructions to Item 407(e)(5).**

1. The information required by paragraph (e)(5) of this Item shall not be deemed to be “soliciting material,” or to be “filed” with the Commission or subject to Regulation 14A or 14C (17 CFR 240.14a-1 through 240.14b-2 or 240.14c-1 through 240.14c-101), other than as provided in this Item, or to the liabilities of section 18 of the Exchange Act (15 U.S.C. 78r), except to the extent that the registrant specifically requests that the information be treated as soliciting material or specifically incorporates it by reference into a document filed under the Securities Act or the Exchange Act.

2. The disclosure required by paragraph (e)(5) of this Item need not be provided in any filings other than an annual report on Form 10-K (§249.310 of this chapter), a proxy statement on Schedule 14A (§240.14a-101 of this chapter) or an information statement on Schedule 14C (§240.14c-101 of this chapter). Such information will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference. If the registrant elects to incorporate this information by reference from the proxy or information statement into its annual report on Form 10-K pursuant to General Instruction G(3) to Form 10-K, the disclosure required by paragraph (e)(5) of this Item will be deemed furnished in the annual report on Form 10-K and will not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act as a result as a result of furnishing the disclosure in this manner.

3. The disclosure required by paragraph (e)(5) of this Item need only be provided one time during any fiscal year.

(g) *Smaller reporting companies.* A registrant that qualifies as a “smaller reporting company,” as defined by § 229.10(f)(1), is not required to provide:

(1) The disclosure required in paragraph (d)(5) of this Item in its first annual report filed pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m (a) or 78o(d)) following the effective date of its first registration statement filed under the Securities Act (15 U.S.C. 77a et seq.) or Exchange Act (15 U.S.C. 78a et seq.); and

(2) Need not provide the disclosures required by paragraphs (e)(4) and (e)(5) of this Item.

#### **Instructions to Item 407.**

1. For purposes of this Item:

a. *Listed issuer* means a listed issuer as defined in §240.10A-3 of this chapter;

b. *National securities exchange* means a national securities exchange registered pursuant to section 6(a) of the Exchange Act (15 U.S.C. 78f(a));

c. *Inter-dealer quotation system* means an automated inter-dealer quotation system of a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)); and

d. *National securities association* means a national securities association registered pursuant to section 15A(a) of the Exchange Act (15 U.S.C. 78o-3(a)) that has been approved by the Commission (as that definition may be modified or supplemented).

2. With respect to paragraphs (c)(2)(i), (d)(1) and (e)(2) of this Item, disclose whether a current copy of the applicable committee charter is available to security holders on the registrant’s Web site, and if so, provide the registrant’s Web site address. If a current copy of the charter is not available to security holders on the registrant’s Web site, include a copy of the charter in an appendix to the registrant’s proxy or information statement that is provided to security holders at least once every three fiscal years, or if the charter has been materially amended since the

beginning of the registrant's last fiscal year. If a current copy of the charter is not available to security holders on the registrant's Web site, and is not included as an appendix to the registrant's proxy or information statement, identify in which of the prior fiscal years the charter was so included in satisfaction of this requirement.

**§240.10C-1 (Listing standards relating to compensation committees).**

*(d) Required Standards*

- (4) *Independence of compensation consultants and other advisers.* The compensation committee of a listed issuer may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration the following factors, as well as any other factors identified by the relevant national securities exchange or national securities association in its listing standards:
- (i) The provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;
  - (ii) The amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;
  - (iii) The policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;
  - (iv) Any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee;
  - (v) Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser; and
  - (vi) Any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the issuer.

## Adopting Release Excerpts

Excerpts from the original adopting release include:

- Several commenters viewed this item as redundant with the Compensation Discussion and Analysis (“CD&A”) required under Item 402, and suggested that they be combined. While this item and CD&A both involve the determination of executive officer compensation, they have different focuses. Item 407(e) focuses on the company’s corporate governance structure that is in place for considering and determining executive and director compensation – such as the scope of authority of the compensation committee and others in making these determinations, as well as the resources utilized by the committee. In contrast, CD&A focuses on material information about the compensation policies and objectives of the company and seeks to put the quantitative disclosure about named executive officer compensation into perspective. We believe it is appropriate to discuss each of these matters separately and, accordingly, we have not combined them.
- Unlike the Audit Committee Report, the Compensation Committee Report will be required to be included or incorporated by reference into the company’s annual report on Form 10-K, so that it is presented along with CD&A when that disclosure is provided in the Form 10-K or incorporated by reference from a proxy or information statement. Like the Audit Committee Report, the Compensation Committee Report will only be required one time during any fiscal year. The name of each member of the company’s compensation committee (or, in the absence of a compensation committee, the persons performing equivalent functions or the entire board of directors) must appear below the disclosure. This report will be “furnished” rather than “filed.” The principal executive officer and principal financial officer will be able to look to the Compensation Committee Report in providing their certifications required under Exchange Act Rules 13a-14 and 15d-14.

Excerpts from the proposing release for the rules implementing the Dodd-Frank Act’s compensation committee and compensation adviser requirements include:

- Currently, Item 407(e)(3) focuses on the conflicts of interest that may arise from a compensation consultant also providing other non-executive compensation consulting services to an issuer, which may lead the consultant to provide executive compensation advice favored by management in order to obtain or retain such other assignments. Section 10C(c)(2) is more open-ended about conflicts of interest in that it requires issuers to disclose whether the work of a compensation consultant raised “any conflict of interest” and, if so, the nature of the conflict and how the conflict is being addressed. The term “conflict of interest” is not defined in Section 10C(c)(2), and our proposed rule would not supply a definition.
- As discussed above, Sections 10C(f) and 10C(b) of the Exchange Act require the Commission to adopt rules directing the exchanges to prohibit the listing of the securities of an issuer whose compensation committee does not consider the independence factors identified by the Commission when retaining compensation advisers. Section 10C(b)(2) identifies specific factors that must be included in these listing standards, and, as described above, we are proposing to include them in proposed Rule 10C-1(b)(4)(i) through (v).

- In light of the link between the requirement that the compensation committees of listed issuers consider independence factors before retaining compensation advisers and the disclosure requirements about compensation consultants and their conflicts of interest, we believe it would be appropriate to provide some guidance to issuers as to the factors that should be considered in determining whether there is a conflict of interest that would trigger disclosure under the proposed amendments. Therefore, we propose to include an instruction that identifies the factors set forth in proposed Rule 10C-1(b)(4)(i) through (v) as among the factors that issuers should consider in determining whether there is a conflict of interest that may need to be disclosed in response to our proposed amendments to Item 407(e)(3)(iii). Although only listed issuers will be required to consider the five independence factors before selecting a compensation consultant, we believe that these five factors will be helpful to all Exchange Act registrants subject to the proxy rules in assessing potential conflicts of interest.
- We have not concluded that the presence or absence of any of these individual factors indicates that a compensation consultant has a conflict of interest that would require disclosure under the proposed amendments, nor have we concluded that there are no other circumstances or factors that might present a conflict of interest for a compensation consultant retained by a compensation committee. Moreover, if, under our rules, disclosure of fees paid to a compensation consultant is required, this does not reflect a conclusion that a conflict of interest is present. In addition to considering the factors enumerated above and any other factors that the exchanges may highlight in applicable listing standards, the issuer would need to consider the specific facts and circumstances relating to a consultant's engagement to determine whether there may be a conflict of interest that would be required to be disclosed under our new rules.
- If a compensation committee determines that there is a conflict of interest with the compensation consultant based on the relevant facts and circumstances, the issuer would be required to provide a clear, concise and understandable description of the specific conflict and how the issuer has addressed it. A general description of an issuer's policies and procedures to address conflicts of interest or the appearance of conflicts of interest would not suffice.

### **Compensation Committee Report and Compensation Discussion and Analysis**

- The adopting release states that Compensation Discussion and Analysis is not the report of the compensation committee. However, given the requirement to approve CD&A in the compensation committee report and the fact that the compensation committee sets executive compensation policies and makes executive compensation decisions, the compensation committee is ultimately responsible for the disclosures required to be made in CD&A.
  - *See Part E. Compensation Discussion and Analysis.*

### **Location of Discussion of Compensation Committee’s Process and Procedures**

- The compensation program’s processes and procedures should generally be described in the description of the compensation committee required by item 407(e) of Regulation S-K, not in CD&A.

### **Updating Compensation Committee Processes and Procedures**

- Given the need to provide detailed disclosures regarding the compensation committee’s processes and procedures (including the roles played by executives and compensation consultants), companies should review their processes and procedures and consider whether they should be modified or refined.
  - To the extent a company’s processes or procedures are not clearly documented, the company should consider documenting them.

### **Compensation Consultant Conflicts of Interest**

- Neither the Dodd-Frank Act nor the rules implementing the Dodd-Frank Act’s compensation committee and compensation adviser requirements define what constitutes a compensation consultant “conflict of interest” that may require disclosure pursuant to Item 407(e)(3)(iv) of Regulation S-K. In the proposing release for the rules implementing the Dodd-Frank Act’s compensation committee and compensation adviser requirements the SEC noted that the rules are intended to address both:
  - conflicts of interest that may arise from a compensation consultant also providing other non-executive compensation consulting services to an issuer, which may lead the consultant to provide executive compensation advice favored by management in order to obtain or retain such other assignments; and
  - any other conflict of interest.
- Although not required to do so, to head off a comment from the SEC staff issuers that have concluded that no compensation consultant conflict of interest exists should consider so stating in the proxy statement and describing the process that the company went through to make this determination.

## **Smaller Reporting Companies**

- A registrant that qualifies as a “smaller reporting company” is not required to make the Compensation Committee Interlocks and Insider Participation disclosures or prepare a Compensation Committee Report.
  - *See Part T. Smaller Reporting Companies.*

## **R. PLAIN ENGLISH REQUIREMENT**

The rules require all executive and director compensation, related person transaction, beneficial ownership and corporate governance disclosures to be made using plain English.

### **Rules**

The plain english requirement is contained in Rule 13a-20(a) which reads as follows:

#### **Rule 13a-20 Plain English presentation of specified information.**

- (b) Any information included or incorporated by reference in a report filed under section 13(a) of the Act (15 U.S.C. 78m(a)) that is required to be disclosed pursuant to Item 402, 403, 404 or 407 of Regulation S-K (§§229.402, 229.403, 229.404 or 229.407 of this chapter) must be presented in a clear, concise and understandable manner. You must prepare the disclosure using the following standards:
- (1) Present information in clear, concise sections, paragraphs and sentences;
  - (2) Use short sentences;
  - (3) Use definite, concrete, everyday words;
  - (4) Use the active voice;
  - (5) Avoid multiple negatives;
  - (6) Use descriptive headings and subheadings;
  - (7) Use a tabular presentation or bullet lists for complex material, wherever possible;
  - (8) Avoid legal jargon and highly technical business and other terminology;
  - (9) Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information. Define terms in a glossary or other section of the document only if the meaning is unclear from the context. Use a glossary only if it facilitates understanding of the disclosure; and
  - (10) In designing the presentation of the information you may include pictures, logos, charts, graphs and other design elements so long as the design is not misleading and the required information is clear. You are encouraged to use tables, schedules, charts and graphic illustrations that present relevant data in an understandable manner, so long as such presentations are consistent with applicable disclosure requirements and consistent with other information in the document. You must draw graphs and charts to scale. Any information you provide must not be misleading.

## Note to Rule 13a-20.

In drafting the disclosure to comply with this section, you should avoid the following:

1. legalistic or overly complex presentations that make the substance of the disclosure difficult to understand;
2. vague “boilerplate” explanations that are imprecise and readily subject to different interpretations;
3. complex information copied directly from legal documents without any clear and concise explanation of the provision(s); and
4. disclosure repeated in different sections of the document that increases the size of the document but does not enhance the quality of the information.

## Practice Pointers

### SEC Focus on Plain English Requirement

- The requirement to provide clear and understandable disclosure is a major focus of the SEC.
  - See Christopher Cox, *Speech by SEC Chairman: Address to the 2007 Corporate Counsel Institute* (March 8, 2007), a copy of which is located at [Appendix R-I](#).
  - See also Christopher Cox, *Speech by SEC Chairman: Closing Remarks to the Second Annual Corporate Governance Summit* (March 23, 2007), a copy of which is located at [Appendix R-II](#).
  - See also John W. White, *Speech by SEC Staff: Keeping the Promises of Leadership and Teamwork: The 2007 Proxy Season and Executive Compensation Disclosures* (May 3, 2007), a copy of which is located at [Appendix R-III](#).
  - See also John W. White, *Speech by SEC Staff: Where’s the Analysis?* (October 9, 2007), a copy of which is located at [Appendix E-I](#).
  - See also *Staff Observations in the Review of Executive Compensation Disclosure* (Oct. 9, 2007), a copy of which is located at [Appendix B-IV](#).

### Role of Lawyers

- Lawyers play a critical role in improving executive compensation disclosures.
  - See Christopher Cox, *Speech by SEC Chairman: Address to the 2007 Corporate Counsel Institute* (March 8, 2007), a copy of which is located at [Appendix R-I](#).

### Plain English Resources

- See the following for additional information regarding drafting documents in plain English:

- *Plain English Disclosure*, SEC Release No. 33-7497 (Jan. 28, 1998), which can be found at [www.sec.gov/rules/final/33-7497.txt](http://www.sec.gov/rules/final/33-7497.txt).
- Christopher Cox, *Introductory Remarks Before the Executive Compensation Disclosure Conference* (Apr. 3, 2006), a copy of which is located at [Appendix R-IV](#).
- *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Aug. 1998), which can be found at [www.sec.gov/pdf/handbook.pdf](http://www.sec.gov/pdf/handbook.pdf).

**APPENDIX R-I**

**Christopher Cox, *Speech by SEC Chairman: Address to the  
2007 Corporate Counsel Institute* (March 8, 2007)**



**Speech by SEC Chairman:  
Address to the 2007 Corporate Counsel Institute**

*by*

**Chairman Christopher Cox**

*U.S. Securities and Exchange Commission*

Georgetown Law Center  
Washington, D.C.  
March 8, 2007

Thank you for that very kind introduction, and thanks especially to Dean Alex Aleinikoff, Program Chair Marc Gary, and Program Co-Chairs Allen Gross and Stephen Paige.

I couldn't be happier to be here this morning to speak to the Corporate Counsel Institute, because you are at the forefront of reshaping the rapidly changing landscape of the relationship between companies and their shareholders. You're destined to play a vital role in the implementation of every one of the Commission's new disclosure initiatives in this area.

This morning I'll mention just two topics in this connection. First, the recent changes we've been making in the way that companies disclose information and interact with their shareholders — and the opportunities that you have, as inside counsel, to get ahead of these changes and lead. Second, the responsibilities of counsel, including each of you practicing in the securities area, that we have had reason to address recently.

The disclosure changes I'm talking about are significant. They're destined to remake the very nature of communications between companies and investors. Whether in periodic reports or proxy solicitations or any other investor communication, we're trying to simplify things to make our disclosure more accessible and more useful to investors.

It's fitting that we're gathered at a law school, because it reminds of us how bewildered we all once were when we first heard the jargon and cant of the lawyer. Back when the deep structure of our minds was not influenced by the densely reticulated vocabulary of legalese, we could relate to the experiences of today's investors trying to make sense of their proxy statements. And for me, the environment here at Georgetown brings back other memories — of my time in the classroom as a teacher, a quarter century ago, teaching federal income tax. The students were bright young men and women, eager to learn. My job was to get across the important concepts of federal taxation without getting lost in the minutiae and the jargon.

I'll never forget my experience grading the students' final exams. There were two cases on the final - two business situations nefariously

constructed to contain every tax problem known to man. The exam lasted four hours. Naturally, each of the students filled up multiple blue books. All, that is, except one. I can't tell you how excited I was when I picked up this student's single blue book. I was intrigued to find out what this model of concision could possibly look like. And then, when I opened the cover, I discovered that he'd written on just the first page of the one blue book. Here is what he wrote:

"Dear Professor Cox: What I have learned in your course is that federal income tax is extraordinarily complicated. And when I go into business, I'll be sure to hire someone who knows what he's doing in this area."

I'm reasonably certain that this fellow ended up with a career in improv, rather than tax accounting. Either that or he went to work for Enron. And much as I appreciated the wry humor, I didn't have too much remorse about flunking him.

But you have to admit, that student had a point. The arduous process of unraveling the man-made complexities that are too often the hallmark of government rules and regulations isn't just hard work. It's entirely unnecessary. That's why, from the forms issuers must file, to the accounting standards they use, the SEC is waging an all-out war on complexity.

Just four months after I became Chairman, the Commission put a wide-ranging package of new rules into effect to simplify the U.S. public offering process. We broadened the scope of permissible communications both before and during an offering. We liberalized the rules for shelf registration statements, and completely eliminated the need to physically deliver final prospectuses in almost all cases. A new category of well-known seasoned issuers can now benefit from automatic shelf registration procedures — without having to worry about potential staff review.

In just three weeks, our new e-proxy rules will go into effect, further advancing our goal of tapping the enormous power of technology and the Internet to simplify and improve disclosure. We're going to be relentless in seeing to it that the language in which both regulation and disclosure are written is plain English.

Since this is a gathering of lawyers, it goes without saying: you're all multilingual.

Everyone here speaks Legalese. But even so, I'd be willing to bet you'd appreciate a good John Grisham novel more than a big fat 10-K, any day of the week. So let me ask you a question. Take off your lawyer hat, and put on your investor hat — the one you wear when you figure out what to do with your 401(k), your IRA, your 527 plan, or your lifetime savings. When you get that prospectus or that proxy statement in the mail — do you immediately plunk down in a comfortable chair and read it? How many people here actually read all of the stuff that comes in the mail courtesy of the SEC? [Laughter]

O.K. — and tell the truth now — how many of you throw it away?

Just as I thought.

Well, it goes without saying, that's a sad irony. Because the SEC is the

investor's advocate, and if you're an investor, you are our customer. Any enterprise has to be concerned if the customers are throwing away the products.

It's our aim to break down all the legalese and the jargon, the dense cover-your-assets boilerplate that reads more like the insurance policy it is than the helpful guide to investors that it's meant to be. And since lawyers continue to advise their clients to include more rather than less, and by all means to keep repeating the litigation-tested boilerplate, the best way to simplify things for investors is to give them new tools to cut through the fog.

The Internet and your computer are made for that. By putting proxies and 10Ks in searchable form, and by moving to a system of interactive data that lets you reorganize and collate and compare information at the touch of a button, we're going far beyond merely reproducing the paper documents in electronic form.

Interactive data, which will give every number in a prospectus or proxy statement a life of its own, will vastly improve the quality of analysis that's possible for investors and their intermediaries. It will make understanding the most important information about a company much easier. Interactive data will permit the nearly instantaneous analysis and comparison of broad ranges of data, which in turn will change the very nature of disclosure — and ultimately of investing itself.

It's because of the potential that interactive data holds to give investors and analysts remarkable new insights into the disclosures we already mandate that the SEC has recently committed \$54 million to convert all of our filings, and the entire EDGAR system, to this new interactive format. We are already accepting periodic reports to the SEC in this new interactive data format, and some 50 major public companies are using it. You should be using it, too. We're learning every day that interactive data is a cost saver for issuers, and a godsend for users. So I encourage you and the companies you represent to become leaders in this new investor-friendly way of reporting.

It's very likely that the data tags for the companies you represent are already available. The XBRL codes — that stands for eXtensible Business Reporting Language — are already written for most industries. By September, XBRL-US — the private sector organization that is responsible for interactive data in the United States — will have completed all the data tags for every industry. And they are making it available to the world for free. This is an entirely open-source project, not only here in America, but around the world in more than 100 countries.

The parent of FASB, the Financial Accounting Foundation, is contributing \$3 million to this project. The SEC is contributing over \$6 million. Several accounting firms and others are also contributing substantial monies to support XBRL US in getting this job done — and I want to publicly thank them all.

Just as our efforts to encourage companies to make their disclosures in plain English are designed to help the retail investors, this initiative is using the power of technology to help investors by getting more high quality information out of the same basic financial data. A good example of how this can work is the new executive compensation disclosure that most of you are familiar with. In the past, this disclosure has been among the most

complicated, and it's provided investors with some of the biggest challenges they've faced in analyzing and comparing data. The new compensation disclosure is making this info, at long last, more accessible, by distilling all of the various forms of compensation into one number.

But already we're seeing examples of overlawyering that are leading to 30- and 40-page long executive compensation sections in proxy statements. We're seeing companies including columns in the summary compensation tables even when there's nothing to report in those columns. This kind of slavish adherence to boilerplate disclosure is what we're trying to stamp out.

So it's fitting that we're gathered here this morning on Oliver Wendell Holmes's birthday.

After all, Justice Holmes wrote some of the most important decisions in some of the most complex areas of our jurisprudence. And he did it in famously pithy, short opinions that were often no more than a page or two in length.

He also had a mustache just like Mark Twain, who you will recall famously apologized about one of his own pieces of correspondence by saying, "I'm sorry this letter is so long, but I did not have time to make it shorter." Twain also classically defined a classic as something that everybody praises and nobody has read. Our object in overhauling SEC disclosure for the benefit of investors is that lawyers stop writing lengthy classics that no one wants to read and start writing like Holmes. We want to replace boilerplate with potboilers.

After all, if one of America's greatest jurists can cover great legal theories in one page of clean prose with no jargon, why can't a proxy statement tell a reader what she needs to know about the boss's pay in the same way?

So while we're giving people some grace in getting used to the new rules, the plain English part of executive compensation will be increasingly strictly enforced in the coming year. Meanwhile, this year, we're going to let interactive data do some of the simplification for us. Even before interactive data becomes the norm for all reporting companies, we're going to tag the executive compensation data for you using XBRL. And we're going to put an interactive data web tool on the SEC's website, to let users slice and dice the executive compensation data any way they like — or do industry comparisons, or even do analyses of particular forms of compensation, such as stock options. We're going to do this for at least several hundred of the largest public companies in America — and we expect to have it available in June.

The truth is, investors — and their representatives on the compensation committees of boards of directors — have a right to this information. And they have a right get it in a form they can really use.

Before I leave the topic of executive compensation, let me offer a word about the new Compensation Discussion and Analysis section. This new opportunity for a company to detail the objectives of its compensation program is what good disclosure is all about — and it's where inside counsel can play a vital role. The narrative in the CD&A should provide a qualitative look at the company's executive compensation policies, and shed light on the quantitative tabular data. This is your chance to plainly tell the company's compensation story. I urge you to take the opportunity and

make the most of it.

The truth is, as the SEC moves to strengthen the hand of investors in their relationships with the companies they own, your actions — the choices you make — will determine how successful these reforms will be. From the disclosures you make, to the structure of your boards of directors, to the way you respond to investor concerns and the way you solicit proxies, your implementation of our regulations is the fulcrum upon which the entire effort rests. It is only through your efforts that we'll be successful in protecting the interests of investors. Only through your efforts can we raise the standards for the protection of market participants, while at the same time making those markets more efficient.

This is not by any means aggrandizement or embellishment of the role of lawyers.

Long before Section 307 of Sarbanes-Oxley required the Commission to set minimum standards of professional conduct for lawyers, for at least five centuries, it has been recognized that lawyers are the indispensable guardians of the rule of law. Every lawyer — whether she was an engineering major in college, or a specialist in 16th English literature — knows that when Dick the Butcher said "The first thing we do, let's kill all the lawyers" in Shakespeare's *King Henry VI, Part 2*, he was talking about how to execute his plot to overthrow the government. To Dick the Butcher, just as to Jack the Ripper, or to this year's most egregious securities fraudster, getting rid of the lawyers would be an extremely useful step in getting away with murder.

Just as Shakespeare's audiences recognized it, so do we — and in the securities realm, lawyers are what today we call crucial gatekeepers responsible for safeguarding shareholders' interests by advising companies on disclosure standards and all of the requirements of our securities laws. It's because of this key role that you play that the SEC views you as important partners in our mission to protect investors. Your responsibility in this area wasn't created by Section 307 of Sarbanes-Oxley, although that provision of law now underscores it. The requirement of highly professional conduct affects all of the work you do and have always done.

For example, if you as corporate counsel find evidence of material violations of federal securities laws or breaches of fiduciary duty, then depending on the response you get from your supervisor or client you are required to "report up the ladder" to senior management and, if necessary, the board of directors. It's because the roles of gatekeeper and watchdog come with a great deal of responsibility that, when professionals — lawyers or accountants — fail to live up to their responsibility, the Commission will bring enforcement actions.

Just yesterday, the SEC won a jury verdict in San Diego on all counts in our case against Gateway for manipulating earnings. It's a case that shows the Commission's commitment to holding accounting professionals responsible.

And not surprisingly, we have been looking just as carefully at the role of lawyers in the stock option backdating scandals. The misconduct in these cases, which requires certain access to records, as well as authority to grant options, raises the question -- where were the lawyers? Where were the gatekeepers? And unfortunately, as the Commission's recent actions against individuals at Comverse, Monster Worldwide and McAfee have shown, the answer is quite troubling.

Last August, we brought charges against three former senior executives of Comverse Technology, including the company's former General Counsel. The facts in Comverse read like a Grisham novel. We alleged that high-paid corporate executives engaged in a decade-long fraudulent scheme. By backdating undisclosed in-the-money options to themselves and to others, they gave themselves strike prices that coincided with historic lows. We alleged that to further the scheme, the company's inside counsel falsified company records to make it appear that a board committee approved the option grants on the falsified grant dates. The former executives collectively made millions of dollars by exercising the illegally backdated options and then selling their Comverse shares. The General Counsel ultimately settled with the Commission, agreeing to pay over \$3 million in penalties, disgorgement, and prejudgment interest. He was also hit with a permanent officer-and-director bar, and suspension as an attorney before the Commission.

The story at Monster Worldwide wasn't any better. Last month, we sued the former General Counsel for his role in another multi-year scheme. The General Counsel, we alleged, secretly backdated stock options to thousands of Monster officers, directors and employees, including himself. He falsified documents to make it appear as if the company had actually granted options on dates that in reality had been selected after the fact. By looking backward, he could find a date when the stock price was low.

In the McAfee backdating case, we also sued the former General Counsel. We alleged that he wrongfully re-priced his own grants, as well as those awarded to others — all in order to secretly increase their value. The General Counsel concealed his fraudulent re-pricing by filing false stock ownership reports with the SEC. In addition, in his capacity as Secretary of the Compensation Committee at McAfee, the General Counsel allegedly falsified the minutes of committee meetings, and directed the company to issue a 420,000 share option grant to McAfee's chief executive after the date that the commission had expressly directed.

It isn't just in the backdating cases that we see lawyers failing to live up to their responsibilities. Last Thursday, in a case that recalls Oliver Stone's *Wall Street*, we charged 14 defendants in a brazen insider trading scheme using information stolen from UBS Securities and Morgan Stanley. We alleged that eight Wall Street professionals, including a Morgan Stanley attorney, participated in the scheme, which netted more than \$15 million in illegal insider trading profits on thousands of trades. This, too, is a tragic tale of a gatekeeper gone bad. The complaint charges that the attorney, who ironically worked in Morgan Stanley's compliance department, illegally passed on material, nonpublic information she stole from Morgan Stanley in exchange for sharing in the illicit trading profits.

There is a recent decision of the D.C. Circuit in one of our cases that I also want to draw to your attention. In *SEC v. Weiss*, the D.C. Circuit upheld Commission sanctions against bond counsel to the school district in Lawrence County, Pennsylvania. The court said that the lawyer violated the securities laws when he gave the school district an unqualified opinion on the tax-exempt status of a proposed municipal bond transaction, even though he had no reasonable basis for doing so — and even though he'd conducted no investigation of the underlying facts on which the opinion relied.

It is important to emphasize that neither this case nor any of the actions we have brought against lawyers have been for giving bad advice. Rather,

our actions against lawyers have focused on the lawyer's actual conduct.

The good news for all of you here is that while the number of enforcement actions against lawyers has increased over the past several years, these actions still are relatively infrequent. And because we rely daily on corporate counsel to help us get to the right answer in so many areas of our responsibilities, I want to re-emphasize that we view lawyers as critical partners in our mission.

Indeed, the great majority of the roughly 160 backdating investigations demonstrate this very point. A significant number of these cases were brought to our attention by self-reporting, as the result of sound legal counsel. In most of these cases the companies have undertaken extensive internal investigations — again as the result of wise counsel. In our experience, the vast majority of corporate counsels uphold their legal, ethical and fiduciary responsibilities to investors. They are worthy gatekeepers and faithful watchdogs.

Lawyers — including every one of you here this morning — have a vitally important role in ensuring that America's markets are honest, and in bolstering investor confidence in our entire system. In every transaction you handle, every governance problem you tackle, and every shareholder communication you write, keep in mind that America's investors are depending on you.

Here at Georgetown, they like to talk about vocations. And you don't have to be a Catholic to appreciate the importance of acknowledging a duty to help others in everything we undertake in our daily lives. There's a real nobility in contributing as a professional to the services not only of millions of average investors, but also the health and vitality of our nation's capital markets — the richest, deepest, and most liquid in the history of the world.

The importance of our capital markets — and hence, what each of you do every day — to the prosperity of our nation can't be overstated. Everyone in this room has a huge stake in that relationship. Our capital markets are the engine that continues to power our economy in the creation of millions of new jobs, and they're the source of a way forward for every young American thinking of going to college. They hold the retirement savings of our parents, and indeed, every one of us. They're the well our nation will tap to support the innovations in health care that will cure cancer, and conquer diabetes. It's worth doing everything we can to keep our capital markets working well, and to make them always better. As lawyers, and as securities professionals who are critical to the process of capital formation, every one of you is a contributor to our nation's success.

Thank you, each of you, for pursuing a vocation in our capital formation process — and for your work, your ideas, and your integrity. We at the SEC are doing our part to meet your needs as practitioners, and to fulfill our statutory mandate to protect investors and promote capital formation. And we're proud to be your partners.

<http://www.sec.gov/news/speech/2007/spch030807cc.htm>

**APPENDIX R-II**

**Christopher Cox, *Speech by SEC Chairman: Closing Remarks  
to the Second Annual Corporate Governance Summit* (March  
23, 2007)**



## U.S. Securities and Exchange Commission

### **Speech by SEC Chairman: Closing Remarks to the Second Annual Corporate Governance Summit**

*by*

**Chairman Christopher Cox**

*U.S. Securities and Exchange Commission*

USC Marshall School of Business  
Los Angeles, California  
March 23, 2007

Thank you, Tom [Marshall School of Business Dean Thomas Gilligan], for that kind introduction. It's great to be back at USC just as the Trojans are getting ready to play tonight in pursuit of another national championship. [Applause] It's good to know there are so many college basketball fans this far east of Westwood. And since I know in an audience this size there are many Bruin fans as well - this is a bipartisan group, as we say in Washington - I want to point out how splendid it is that Los Angeles teams represent over 12% of the Sweet 16. [Applause]

I want to tip my hat to President Sample and to Dean Gilligan for the outstanding job they are doing in elevating USC to the championship ranks not only in athletics but in every field of academics as well. It's true in both the undergraduate and the graduate programs that SC is attracting exceptional talent, and producing outstanding research. The global preeminence that the university has achieved is nowhere more in evidence than here at the Marshall School, where so much cutting-edge work is being done that is benefiting almost every aspect of business, finance, and accounting.

And because your faculty are so well established as leaders in their fields, the Securities and Exchange Commission knew to come here when we needed one of the nation's foremost experts in auditing. To help fix the problems with Sarbanes-Oxley and the 404 audit, I tapped Dr. Zoe-Vonna Palmrose, who was the PriceWaterhouseCoopers Professor of Auditing here at the Marshall School. She is now the Deputy Chief Accountant for the SEC. And she is working closely with the members of the Public Company Accounting Oversight Board to replace the existing auditing standard under section 404 with a more workable approach that is top-down, risk-based, and scalable for companies of all sizes. Of course the agency is delighted that she was also one of the presenters at this Summit.

As you know, getting Sarbanes-Oxley implementation right is of critical importance for America's investors, who pay the bills for 404 audits - and who depend on good internal controls to produce reliable financial statements. When that task is accomplished, and America's leadership in the world's increasingly competitive capital markets is reinforced, our

nation will have Dr. Palmrose to thank - and also USC, because the university is making a financial contribution to her service in Washington.

This is the Second Annual USC Corporate Governance Summit. Since it is my opportunity to provide the closing remarks, I can say with conviction that this year's program has been every bit as good as the first. And that's saying quite a lot, with all of the distinguished guests you attracted last year, including Don Nicolaisen, Denny Beresford, and Pat Haden. Don, of course, was the SEC's Chief Accountant when I began as Chairman, and he is responsible for the Roadmap to U.S. convergence with International Financial Reporting Standards that I endorsed in February of 2006. His successor as Chief Accountant, Conrad Hewitt, is our former top banking regulator in California, and a protégé of Denny Beresford. And Pat Haden, of course, is in a league of his own. He is USC's Renaissance man, equally accomplished in academics, sports, law, broadcasting, and business. His contributions to the university and to our community have been extraordinary.

For me, it really is a privilege to be back on campus in my current role. In fact, however, this isn't the first time that's happened: Two years ago, when I had just recently become SEC Chairman, I was here on campus for the USC-UCLA game. As you all remember, that was a classic all-day event that began in the morning with elaborate tailgate parties all around the campus and the Coliseum. And like all of these gatherings, it was a great opportunity to see old friends and meet new ones.

Well, during the pregame festivities a woman came up to me with her son, and rather sheepishly asked, "Are you the new Chairman of the SEC?" I told her I was, but she still seemed unsure, and said, "Really?" And I assured her that really, I was. And so she said, "will you sign this for my son?" And she handed me a football. I signed it for her, and she was very excited, and I watched her go back to her group of friends and say - "You'll never believe it! I just got the autograph of the new Chairman of the Southeastern Conference!"

So it's a special privilege to be here before an audience that may be almost as excited about securities regulation as that woman was about football.

By your attendance today at this Corporate Governance Summit, you've identified yourselves as leaders in the effort to reshape the relationship between companies and their shareholders. Every one of you is destined to play a vital role in the implementation of the SEC's new disclosure initiatives in this area. As you know, we at the SEC (that's the Securities and Exchange Commission) have been making some dramatic changes in the way that companies disclose information and interact with their shareholders. These changes are remaking the very nature of communications between companies and investors. Whether in periodic reports, or proxy solicitations, or any other investor communication, our overarching goal is to make disclosure more accessible and more useful to investors.

From the forms issuers file to the accounting standards they use, the SEC is waging an all-out war on complexity. And in this effort we're tapping the power of technology to bring higher-quality information to investors more quickly and more easily than ever before. Our new e-proxy rules will soon make it possible for investors to realize the full potential of interactive data. And in a related area, our ongoing conceptual work to update the proxy rules could pave the way for an Electronic Shareholder Forum in which

investors could securely and anonymously share information about their company. That cutting-edge thinking is already spurring private firms to invest in creative new ways for shareholders to use the Internet to communicate with one another.

Nothing is more important to investors' understanding of the governance climate at their company than the description of the philosophy and the practice of compensating management. With that principle in mind, the SEC recently put into place a comprehensive rewrite of the rules governing executive compensation disclosure. As you know, and as Karen Ferguson's panel discussed yesterday, those rules have just gone into effect this year. And in the last several weeks, the first proxy statements containing the new disclosures have been filed with the Commission.

In a moment, I'll show you a brief demonstration of what investors can do with some of these new compensation numbers when we leverage the information with the power of interactive data. But just as important as the new numbers - including the one number that summarizes all forms of an executive's compensation last year - is the new narrative disclosure in the Compensation Disclosure and Analysis. This is intended to be very different than the boilerplate we've had in the past. It's an opportunity for a candid conversation between a company and its shareholders about the reasons it structures executive compensation the way it does, and the policies that the company will apply on a going-forward basis. And it's all required to be written in plain English.

Now, I realize that since this is a gathering of corporate governance experts, it's likely that many of you are lawyers. And in that case, you're multilingual. Your second language is Legalese. But even for the lawyers among us, I'd be willing to bet you'd appreciate a good John Grisham novel far more than a big fat 10-K, any day of the week.

So let me ask you a question. Take off your lawyer hat, and put on your investor hat - the one you wear when you figure out what to do with your 401(k), your IRA, your 527 plan, or your lifetime savings. When you get that prospectus or that proxy statement in the mail - do you immediately plunk down in a comfortable chair and read it? How many people here actually read all of the stuff that comes in the mail courtesy of the SEC? [Laughter] And tell the truth now - how many of you throw it away? [Almost all hands raised]

Just as I thought.

Well, it goes without saying, that's a sad irony. Because the SEC is the investor's advocate, and if you're an investor, you're our customer. Any enterprise has to be concerned if the customers are throwing away the product. So it's our aim to break down all the legalese and the jargon, and the dense cover-your-assets boilerplate that reads more like the insurance policy it is than the helpful guide to investors that it's meant to be.

Nowhere is this more important than with the new executive compensation disclosure, because of its close connection to good corporate governance. In the past, the disclosure about executives' pay has been among the most complicated for investors to decipher. That's why the SEC is so adamant that the new Compensation Discussion and Analysis be written in plain English. But now that the proxy season is well under way, and we've reviewed the first of this year's crop, alarm bells are ringing. Already we're seeing examples of over-lawyering that are leading to 30- and 40-page

long executive compensation sections in proxy statements.

I have to report that we are disappointed with the lack of clarity in much of the narrative disclosure that's been filed with the SEC so far. Based on the early returns, the average Compensation Disclosure and Analysis section isn't anywhere close to plain English. In fact, according to objective third-party testing, most of it's as tough to read as a Ph.D. dissertation.

A private sector investor relations firm, Clarity Communications, has analyzed 40 companies' CD&As for their level of compliance with the plain English requirement. They determined that all 40 of them fall far short of accepted standards of readability. In fact, they found that most of the disclosure documents failed even to meet the readability standards that states require for insurance forms.

For starters, the executive pay disclosures in the study were verbose. We had it in mind that they'd be just a few pages long, but the median length for the CD&As was 5,472 words - over 1,000 words more than the U.S. Constitution.

And the longest was more than 13,500 words - a far sight longer than a full-length feature in the New Yorker.

But we have tools to help us fight back. Just as the Black-Scholes model is a commonplace when it comes to compliance with the stock option compensation rules, we may soon be looking to the Gunning-Fog and Flesch-Kincaid models to judge the level of compliance with the plain English rules.

Those are the readability metrics that were used in this study. Specifically, the study used three models: the Gunning-Fog Index, the Flesch Reading Ease test, and the Flesch-Kincaid readability algorithm.

It's worth taking a moment to consider how these tools work. Let's start with the Gunning Fog Index, named for its creator, Robert Gunning. (You've got to love a readability algorithm called the Fog Index.)

Actually, the Gunning Fog Index is a venerable linguistic tool that's been around for over half a century. It was developed in 1952 to measure the readability of English prose, based on sentence length and the number of complex words. Writing that's aimed at a general audience should have a Fog Index number of less than 12. So let's take the Wall Street Journal as an example of writing aimed at a highly educated general audience. Not surprisingly, the articles in the Wall Street Journal score just under 12, with a typical Fog Index of between 11 and 12.

Over at Readers Digest, which targets a broader slice of the general public, they usually score around 8.

So where do you think our new Compensation Disclosure and Analysis sections come in, seeing as how they're newly minted in "plain English" for the average investor? In these tests, the average Fog Index for the CD&As in the sample was 16.45. That's about the same as an academic paper, such as a Ph.D. dissertation here at USC.

And things may be even worse than that, because the test they used could only calculate the Fog Index accurately up to a maximum of 17. Believe it

or not, 15 of the 40 companies maxed out at 17, or even blew straight through the limit and scored higher. Since scores over 17 didn't count in the average, the 16.45 average score that was reported actually sugarcoats the full extent of the problem.

The most readable CD&A in the group came in at 14.02. That means the Wall Street Journal editors would have flunked it if it had been submitted to them for publication.

And if all that weren't bad news enough, there's more. The results from the Flesch Reading Ease test were just as bad. This test was developed at Columbia University. In fact, its creator was also a lawyer and a writer, and he earned his Ph.D. for inventing it. The algorithm computes readability based on the complexity of the words used - specifically, the average number of syllables per word - and the average number of words per sentence.

Scores on this test range from 0 to 100. Just as in English class, getting 100 is good. The higher the score, the more readable the writing. To provide a little context, what the test administrators consider "standard writing" - the kind, for example, that appears in Readers Digest - averages about 60 to 70 on this scale. Most states that have plain English standards in force for insurance forms require a score between 40 and 50 on this test.

So, do you think the average CD&A is as readable as your standard insurance contract? Apparently not.

In the sample of 40 proxy statements that were reviewed in these tests, the average Flesch Reading Ease score was just 34.86. If that were your grade in English class on a 100-point scale, you'd not only flunk - you'd be sent back a grade.

The good news is, Sen. Barack Obama and the SEC's General Counsel, Brian Cartwright, could read and understand these disclosures. That's because they were both President of the Harvard Law Review. And a 34.86 is just about the same score that's earned by the not-so-readable essays in that publication.

Fully two-thirds of American adults simply can't read at a level of 34.86, according to the Accessibility Institute at the University of Texas.

Of course, readability tests such as these are only a rough guide to whether disclosures are made in plain English. Like the grammar check in Microsoft Word, they wouldn't recognize poetry if they saw it. They certainly can't tell if the CD&As are accurate and complete, which is what the whole enterprise is ultimately about.

But the SEC's own qualitative review of this year's proxy statements indicates that we have far to go before we can say that legalese and jargon have truly been replaced by plain English. It's clear that many companies are letting lawyers have the final say on the CD&A. As the firm that undertook this study points out, many of the problems could easily have been fixed in just a few hours by a qualified copy editor. Retail investors deserve better.

It's important to understand how we got to this unhappy juncture, lest we address only the symptoms, and wind up right back where we started. So

let's return to the state of nature, as it were, in the early 20th century, before today's patterns and practices had developed.

You will not be surprised to hear that prospectuses and proxy statements used to be shorter, and less cumbersome. The accretion of detail that comprises today's much longer investor disclosures took time. Whereas in 1934 securities lawyers were writing on an essentially blank slate when it came to compliance, today we have the benefit of seven decades of judicial common law, regulatory interpretations, congressional enactments, and industry standards. Increasingly in recent years, the omnipresent threat of litigation, which can instill a healthy fear into managers of other people's money when conscience is insufficient, has had a decidedly unhealthy influence on the writing style in disclosure documents. That's because slowly but surely, the main purpose of the drafting exercise has shifted from informing investors to insuring the issuer and the underwriter against potential claims. In the process, the jargon of lawyers has taken over.

The lawyers' understandable concern, of course, extends not only to the full disclosure of all material facts - in that the SEC wholly concurs - but equally if not more strongly, to the recital of magic words from court opinions, rules, and regulations that have definitively addressed some topic or other. I think we've all observed that there is a near-religious scrupulousness in this adherence to "legally correct" language. If a competitor in the same industry has faced a disclosure issue that has survived a court test, by all means someone in the company's legal department will want to mimic the very phrases. Choosing words to describe the company's business that no other company has used in exactly the same way is thought to be indefensibly risky.

And so the overarching purpose seems no longer to be informing the investor, but above all else erecting a sturdy defense against potential claims that something was left out or improperly expressed. Rather obviously, the result of all this is not plain English.

If I leave you with no other message from today's talk, I hope it will be this: The SEC is dead serious about shedding 70 years of accumulated bad habits in writing. We are well aware that our retail disclosure system has devolved into a self-serving exercise for issuers, underwriters, and their lawyers. No company that serves retail customers would seek to draw their attention to important subjects with an 80- page doorstop. Nor should we, if we are to continue to deserve our title as "the investor's advocate."

Ordinary Americans are busy people. They're neither idle nor rich. And they haven't got the time on their hands to discover that what they really need to know is in the footnotes on page 63 of their proxy statement. They are working mothers and fathers, and young people trying to gain skills and build careers, and seniors fighting illness and disability who are trying to make ends meet. Their savings mean the world to them, so it is not for lack of interest that they throw away the SEC's mandated disclosure documents. It is rather because those documents are too long, too dense, and too hopelessly unintelligible for retail investors to decipher in the necessarily limited time they have between other chores.

It doesn't have to be this way. The Compensation Discussion and Analysis section is a brand new creation. Obviously, no one has drafted these before. There's no boilerplate out there. No precedents to mark up and reuse. So there's no reason for a company to "match up" its disclosure to that of its peers or competitors. Every company has a chance to start with

a clean slate.

For those of you who are still getting ready to file this year's proxy statement, I hope you take the opportunity to make a difference, and plainly tell the company's compensation story to your investors.

Of course, the narrative side of the new compensation disclosures is just half the picture. At the SEC, we're planning to give investors even more tools to make the most of the new quantitative information that's being disclosed. I promised you a demonstration, and you won't be disappointed.

As you know, whether or not the CD&A is in plain English, the new executive compensation disclosure has vastly simplified things for investors. It used to be that an investor would have to hunt throughout the proxy statement, the financials, and the footnotes to track down all the various forms of CEO pay. Now, there is one number that totals all of this information, and a clear summary table that shows all the components of the total.

This data-rich disclosure is tailor made for interactive data, which lets users slice and dice the information any way they like.

If the executive compensation data were tagged in XBRL, the computer language of interactive data, then any investor could quickly do industry comparisons, or even analyses of particular forms of compensation, such as stock options.

Of course, right now only a handful of early adopters are reporting their financial information to the SEC using interactive data. We aim to change that very soon. But even before interactive data becomes the norm for all reporting companies, we're going to tag the executive compensation data for you using XBRL. We're going to do this with at least several hundred of the largest public companies in America. And we expect to have it available in June.

You won't see the XBRL coding, of course. That's because just like the HTML code that operates in the background when you surf the web, it's invisible to the user. But what you will see is its power. And to make it easy for you to take advantage of this new power, we're going to put an interactive data web tool on the SEC's site.

[Chairman Cox begins live computer demonstration]

Before I show you what you'll be able to do in the very near future with interactive data, let me show you some of the brand new features of executive compensation disclosure that are already available to you on the Internet. As a result of the new information that's being provided in the current proxy season, there's a great deal more at your fingertips than ever before. And today, you don't even need to use the SEC's EDGAR website to tap into it. You might prefer to use your favorite search engine instead.

[Chairman Cox opens Google search page]

Let's say you're interested in the way the top executives are paid at General Electric. You can just Google the phrase "GE executive compensation 2006". Next we'll click "Search", and then scroll down a bit - and here we see a direct link to the GE proxy statement.

Now we're on the GE website. And here we can see a link to the PDF version of the 2006 proxy statement.

[Chairman Cox opens PDF version of proxy statement]

Now let's go to the Table of Contents. As you can see, the Summary Compensation Table is listed here. It's on page 21. So let's jump to page 21 - and right away we see the new single figure for the total compensation of each of the top executives.

But let's say we want to get fancy, and calculate total compensation a different way. For example, we might want to figure total pay using the grant date fair value of all of the options that were granted last year, instead of the annual 123R expense that ties to the income statements.

Let's do that for GE's chief executive officer.

Here on the Summary Compensation Table we find the 123R figures for the option and stock awards. So let's do some simple math. We'll subtract the 123R values from total pay, because we don't want to use them.

Now we need to find the grant date fair value of all the stock awards and options granted to the CEO last year, because that's what we want to use instead. So let's scroll two pages down to the Plan-Based Awards table in the proxy statement.

[Chairman Cox displays Plan-Based Awards table]

And here are the grant date fair value figures we're looking for. The last bit of math we'll need to do is add this to the CEO's total compensation.

Now we can see the CEO's compensation measured a different way. Instead of the 123R measurement for the value of stock options, we've used the grant date fair value for all the options he was granted last year. As you can see, if we figure it this way, GE's CEO actually made about \$1.7 million less in 2006 than was reported using the 123R number.

Now remember, we discovered all of this on a Google search. But it took a little work.

Today, there's not a good free website that links to this kind of information for many different companies, and that lets investors do this sort of math automatically. But that's about to change. In just a few weeks, the SEC plans to take executive compensation disclosure to a new level. And the way we plan to do it is with interactive data.

Let me show you some of the big advantages of interactive data.

[Chairman Cox displays prototype SEC executive compensation Search page]

This is a mock-up of one of the SEC's planned executive compensation web pages. The SEC will tag the executive compensation data with hidden computer codes, written in XBRL. And we'll give you some exciting new tools that will unlock the power of that XBRL code.

We're doing this all in open source - so it will be available to any

programmer or software developer who wants to build even fancier tools to analyze SEC data.

One thing an investor might want to do is create a comparison of pay data from several public companies. As an example, let's type in a few company names on the SEC's prototype search page.

[Chairman Cox types in names of seven companies on Search page]

I'm simply using the names of the most recent proxy filers with the SEC, as listed by the Wall Street Journal as of last week. And I'm including GE as well, since we started with it.

Now, we just check the box for whichever officer interests us. Let's pick the CEO.

And since we're interested in "Total Compensation," we'll check that box. Finally, we check "Table" to display the results in tabular format.

Now, by clicking "Build Report," we instantly create a display of the total compensation for each CEO in this sample of seven companies. As you can see, this report makes it exceptionally easy to compare CEO pay among these companies.

Let's go back to the Search page now. Just as a final flourish before I wrap up, let's say we want to compare the total CEO compensation at all seven of these companies using the 123R figure for stock options, on the one hand, and using grant date fair value of all grants last year, on the other hand.

As you'll see, this is going to be a lot easier and faster using interactive data than it was when we had to cut and paste the data into our calculator.

We start by adding "Grant Date Fair Value" as a category we want to report. Now, just for variety, let's check "Graph" instead of "Table." All that's left is to click "Build Report."

As you can see, this time the hidden XBRL code has done all the work for us. We've created a graphic display comparing the total compensation for each CEO as calculated using each of the two different methods.

With no more effort than that, we can now see which firms show higher compensation using the 123R method, and which companies show higher compensation using the grant date fair value for all of last year's grants. In this case, five of the seven firms show higher compensation using 123R. Two show higher compensation using all of last year's grants.

That's just a few examples of what interactive data can do for you - and what you'll be able to do yourself in a very short while.

And that's why interactive data is one of the SEC's top priorities. This exciting new way for investors to get more and better information about the companies they own is part of our commitment to renewing the SEC's focus on the retail investor.

Without question, getting investors the information they need, in a form they can use, is the most basic ingredient of insuring good corporate

governance. But the truth is, as the SEC moves to strengthen the hand of investors in their knowledge and understanding of the companies they own, the choices each of you makes will determine how successful these reforms will be. From the quality of disclosure, to the structure of boards of directors, to the way firms address investor concerns and solicit proxies, the implementation of our regulations is the fulcrum upon which the entire effort rests.

It is only through your efforts that we'll be successful in protecting the interests of investors. With your help, we can we raise the standards for the protection of market participants, and at the same time be confident that we are truly making our markets more efficient.

So thank you for what you do each day. And in particular, thank you for your devotion of time and energy these last two day at this Corporate Governance Summit. America's investors can be grateful for your devotion to the cause of sound corporate governance. And in that endeavor, we at the Securities and Exchange Commission are proud to be your partners.

<http://www.sec.gov/news/speech/2007/spch032307cc.htm>

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Modified: 03/26/2007

**APPENDIX R-III**

**John W. White, *Speech by SEC Staff: Keeping the Promises of Leadership and Teamwork: The 2007 Proxy Season and Executive Compensation Disclosures* (May 3, 2007)**



## U.S. Securities and Exchange Commission

### **Speech by SEC Staff: Keeping the Promises of Leadership and Teamwork: The 2007 Proxy Season and Executive Compensation Disclosures**

*by*

**John W. White**

*Director, Division of Corporation Finance  
U.S. Securities and Exchange Commission*

27th Annual Ray Garrett Jr. Corporate and Securities Law Institute  
Chicago, IL  
May 3, 2007

Good morning. Thank you Mark [Gerstein] for that gracious introduction. I also want to thank Northwestern Law School for the invitation to speak today. I am very happy to be here, which for me is my second visit to the Ray Garrett Institute, now in its 27th year. Just like its namesake who served as the chairman of the SEC from August 1973 until October 1975,<sup>1</sup> the Institute stands out as a real Midwestern leader in its field. It is my privilege to speak with all of you here today and I hope I can do justice to those standards of the former Chairman and of the Institute.

Last year, Martin Dunn, Deputy Director of the Division, gave the keynote speech at this conference. I was rereading his remarks this weekend. Fortunately Vice-Chancellor Leo Strine is the one who actually has to follow in Marty's footsteps, because that is a hard thing to do. Marty gave an enlightened (and humorous) review of how the Division should and does recommend rules in an enlightened manner. He closed with a paragraph that outlined the four pending rulemaking projects for the Division at that time and concluded that they all met that enlightened standard. Those four projects were the best price rule amendments, foreign private issuer deregistration, electronic proxy and executive compensation disclosure. I am proud to say that one year later the Commission has successfully completed its rulemaking in those four areas. In the case of one of those rulemakings, not only is it completed, but it is already fully in action. It is grabbing daily newspaper headlines. It is a leading topic of conversations in board rooms and chat rooms alike. What topic? Executive compensation, of course, and the wave of new disclosures that are coming out this proxy season in light of the rules which the Commission adopted last summer.

Like anything that is both prominent and substantive, the SEC's new rules for executive compensation disclosure have found both great fans and great detractors. The same is true for the disclosures that have arisen in response to those rules. With my time this morning, I would like to step back and cut through some of the recent rhetoric to take a look at where we are today with the rules and the accompanying disclosures, and what that might tell us about where we're going or where we may need to go.

Before I do that, though, I should remind you all that I am speaking today only for myself and the views I express do not necessarily reflect the views of the SEC or of any members of its staff other than myself. The SEC as a matter of policy, of course, disclaims responsibility for the private statements of any of its employees.

When asked in a recent interview what his proudest accomplishment had been since joining the Commission, Chairman Chris Cox without hesitation invoked the new executive compensation disclosure rules. They truly have represented a sea change in the disclosures that public companies provide their shareholders about the compensation that they pay to their own leaders, their CEO, CFO and the three other most highly paid executives. I have been at the SEC for only a little over a year—so it may be easier for me—but I would also cite the executive compensation disclosure rules package if someone asked me what was most remarkable and noteworthy about my time at the Commission.

We are just now beginning to see the vast wealth of new information that these rules are providing investors. Both the fans and the detractors that I just mentioned are absorbing and analyzing the new data, and we are still early in that process. I think we can all agree, however, that the new rules have made a difference and are having a real impact for our markets and the investing public. And they are producing disclosure that is grabbing headlines almost every day.

As I talked repeatedly about last fall, the commitment of public companies and their advisors to take up the new rules and make them meaningful in practice has been a critical facet of this new paradigm. I have also talked frequently about the Division's teaming with the private bar and public companies to try to elicit the most useful and valuable disclosures that we can on behalf of investors. Many in the private sector seem to have embraced that challenge, and I believe we are beginning to see the fruits of our efforts. Through published interpretive guidance, public speaking on the topic, and the various phone calls and questions we have answered, the Division has also been trying to do its part.

That continues now as we are beginning to see the first wave of proxy disclosures made under the new rules. I have mentioned it in various other forums, but let me point out again that the Division has undertaken an important project of reviewing the disclosures filed under the new rules by a critical mass of companies. We also intend to publish a report on those reviews this fall for the benefit of the public as well as companies that did not have their own disclosures reviewed this time. (So stay tuned for that, and see if you agree that we are doing our part. And if you don't, please let me know.)

Talking with you today, I truly do not know what our review report will say, or how this season's disclosures will be evaluated in the final analysis. We can take some early snapshots of how the rules are working, however. As we all know and I have acknowledged, there are some vocal critics, and their criticisms should not be dismissed out of hand. At the same time, there are many things I find to be positive about the new rules and the disclosures that are emerging under them. With those equities in mind, I thought I would take up some of what we've been hearing and try to think about some discrete items (often complaints) in a more balanced way.

**Analysis (or lack thereof).**

We have already all become accustomed to talking about the new "CD&A" but there have been complaints from some quarters that companies have forgotten what the "A" in "CD&A" stands for, that CD&A—Compensation Discussion & Analysis—is devoid of "analysis". Various public commentators have lobbed in this criticism, and it is one thing that the staff of Corporation Finance will be considering as we undertake our reviews of disclosures for this first year. CD&A disclosures may not yet be quite where they should. At the same time, in my opinion today, many companies seem to have made a good faith attempt in this regard. These are new rules and their "principles-based" nature represents a fairly dramatic shift for disclosure in this area.

The Commission explained CD&A in its release adopting the new rules, and you need look no further to understand what Corporation Finance will be looking for when we review the new disclosures.

The purpose of the Compensation Discussion and Analysis disclosure is to provide material information about the compensation objectives and policies for named executive officers without resort to boilerplate disclosure. The Compensation Discussion and Analysis is intended to put into perspective for investors the numbers and narrative that follow it.<sup>2</sup>

CD&A is a striking new piece of the compensation disclosure landscape but I would also encourage everyone to see it as an *opportunity* and to embrace it as such. As I noted a moment ago, the new rules require that a lot of new information be disclosed. CD&A is the company's chance to put that information in context and to help investors make sense of it all. Chairman Cox perhaps put it most succinctly and eloquently in his opening remarks at the Open Meeting for adoption of the rules, when he stated that "[CD&A] will give companies an opportunity to explain their compensation policies, and to share with investors *how* they arrived at the particular levels and forms of compensation for their highest paid executives."<sup>3</sup> When we look at your CD&A disclosures, Corporation Finance will be looking to see if you've answered the "how" (as Chairman Cox said) and the "why" questions rather than merely the "who, what, where and when". The reviews that Corporation Finance has undertaken, along with our corresponding report, may ask for a higher level of analysis in CD&A. I don't know yet. But we do understand that this is the very first year for CD&A. Our expectations for the second year will be higher.

There has also already been some clamoring for the Commission to amend its rule (S K Item 402(b)) on CD&A in order to force more analysis. Typically these critics want to make the rule more prescriptive and to abandon the principles-based mandate that the Commission put in place last July. I have my own doubts about the effectiveness of such an approach. I cannot say, obviously, that the time will never come for such a rule change, but in my opinion, we are not there yet.

**The Question of Length.**

One of the most frequent complaints I have been hearing (and the press has been reporting) is that the new disclosures are just *too long*. And not only are there too many words, but those words are too dense and are housed in sentences that are too complex. Chairman Cox has looked at this

himself and has lamented what he sees as a failure of "plain English."<sup>4</sup>

I am a big believer in plain English and in well-written, clear and concise prose. It was one of the key topics that I included in the remarks I made last September to kick off the Division's outreach to the private sector on the new executive compensation disclosure rules.<sup>5</sup> All the information in the world is of no use if no one can understand it. There are several projects underway to craft an example or model of plain English disclosure under the new rules. I look forward to seeing what comes out of those projects. But I would not overlook the fact that some public companies are already modeling plain English in their executive compensation reporting.

I also think that criticisms of the length and language of the new disclosures can go too far. One of the primary drivers of length of the disclosure in proxy statements is that executive compensation itself tends to be very complicated and varies significantly in form and function, in spirit and letter, from company to company. Even if plain English principles are faithfully applied, under the new rules there may very well be substantially more disclosure required overall.

Our new rules require a considerably larger amount of information now than in the past. For example, we are seeing new and in some cases very detailed or extensive disclosure about:

- severance and change-in-control arrangements
- pension benefits and non-qualified deferred compensation,
- option grants and other equity awards, including outstanding holdings
- timing of option grants, and
- director compensation

Just as a few examples. To my mind, this is a good thing and is responsive to the needs and stated desires of investors. We are now learning all kinds of things about public companies and their executives that were rarely if ever shared with the public in the past. Some outside commentators, including some in the press, have criticized the new disclosures for being overwhelming or for needing to be "sifted through" in order to find the desired bits of information. Ironically, though, those same commentaries and articles then highlight various sorts of specific information and details that the authors find important or interesting to them, such as exercises of stock options or withdrawals from deferred compensation plans. These commenters seem to argue that the Commission should have required a smaller subset of information than it did—of course, they want exactly the subset that is of interest to them. That their neighbor has an interest in some completely different subset seems lost on these commenters.

Criticisms of the length and language of executive compensation disclosures tend to be fairly amorphous complaints. It is also not necessarily clear—if you agree with those criticisms on their merits—whether the problems or weaknesses leading to those complaints are rooted in the rules themselves, or in companies' failure to comply with the rules. I would urge people to keep in mind, though, that the Commission was seeking to establish a "layered" disclosure approach, with CD&A as the top layer. Disclosure is intended to be available for the many types of investors and users of proxy statements, but as you drill down, not all of that disclosure will be relevant

to all readers. This may lead some to conclude that the disclosure provided on some topics is irrelevant or excessive or both, and that the information made available regarding those matters is therefore either "buried" or in turn obscures other, more meaningful disclosure. Not every layer is going to be interesting to every reader. But ideally every reader will be able to find more of the information that he or she needs and with the new CD&A which we just discussed as the guide, the reader will have the context in which to understand the rest of the admittedly expanded information that companies are now providing.

### **Drilling Down.**

Looking broadly at the new disclosure packages, a few things seem clear. CD&A is providing a new insight into executive compensation at public companies. Those disclosures may need some refining—certainly some critics are insisting on it—but the CD&A is proving it can be a real resource for investors. Both with the CD&A and elsewhere, companies are now providing a much greater breadth and depth of disclosure than they did in the past. This is part and parcel of the dreaded length criticism—but there seem to me to be tremendous gains here as well. But what about the specific things that are making up that length? The new tables and accompanying narratives. How should we feel about those individual disclosures? In the time remaining for my segment this morning, I would like to talk about a few discrete areas of disclosure that have been the focus of particular scrutiny (and occasional complaint): disclosure of performance targets when they are material, including alternative disclosure when the specific targets may be excluded; the use of "negative numbers" in the tables; disclosure about the role of the CEO; and disclosure about perquisites.

**1. Performance targets.** Our rules are quite clear on this one, and at least at first blush, it seems like they are also quite unpopular among some. Companies do not seem eager to disclose their performance targets as we have set up in our rules. Early reports suggest that less than half of reporting companies are disclosing specific performance targets used in awarding annual bonuses or long-term incentive pay. Of course, some companies may not use performance targets; others may rightly be relying on the confidential treatment exclusion provided under our rules. Others, though, may be failing to make the required disclosures.

The staff has heard an almost unanimous chorus from investors—confirmed privately by many in-house and law firm counsel—that companies are not providing required disclosure about performance targets in some cases. That too many companies are invalidly claiming the confidential information exclusion. In other words, some companies may be incorrectly asserting that they would suffer competitive harm if they provided the required material disclosure about performance targets used for executive compensation purposes. This is obviously something that the staff in Corporation Finance will be taking a very hard look at. Investors have made it very clear that they want this information and that it is quite material to them. I am not interested in suggesting any loosening of the confidential treatment standards. We have great respect for those standards in the Division of Corporation Finance. At the same time, though, public companies need to employ the same respect for the rules as we do, and not try to claim cover from them if the company's facts do not in fact fit within the rules. And as part of our review process in Corporation Finance, the staff will be prepared, as appropriate, to ask companies to justify their use of the exclusion. Companies that are using the exclusion and therefore not

disclosing their specific performance targets should be prepared to provide the staff with an open and full explanation of those decisions and those targets.

**2. Alternative disclosure when performance targets may be excluded.** I am also hearing what sound like valid concerns about the disclosures that are being provided by companies that are claiming the exclusion for confidential information. If the targets are in fact protected by this exclusion and thus do not need to be disclosed, then the company still must provide investors with a sense of how hard the targets are to achieve or how likely it is they will be met. This is again key information for investors. They want to know whether or not the targets are real targets or are more akin to shadows and are going to result in essentially guaranteed awards. I am not impressed by disclosure that targets "are difficult but possible to achieve" without more. Another complaint I have heard relates to identification of targets simply as "intended to encourage superior performance". Is there any target for which that is *not* true? Without more, identifying a target simply as "challenging but achievable" or as "designed to promote excellence and motivate management" seems an empty disclosure that I would not think is useful to investors. And again, this is a specific area at which the Corporation Finance staff will take a close look in reviewing this year's proxy disclosures. And I think it's possible we could consider whether it would be appropriate to recommend rulemaking on this one to recalibrate the rules

**3. Negative numbers.** We have heard some concern about the impact that "negative numbers" have on reporting under our new tables. Negative numbers arise, for example, from the decrease in actuarial value of pension plans or from various calculations that must be made with regard to compensation cost from equity-based awards (such as expensing of options). These negative numbers then feed into aggregate calculations which must be reflected in our tables and in some cases, but not all, may result in a negative amount being reflected in a column itself. In thinking through these disclosures, we had to make choices in our recommendation on final rules to the Commission and through reasoned analysis and consideration of public comment, we ended up at a position that in some cases allows offsets (those negative numbers get netted in the mix) but restricts the presentation of negative numbers as a total. In other situations, a negative number appears in the table and feeds into total compensation. Some people agree with one approach, some agree with another. Some have complained that they are not able to get clearly the information they want. Or that companies have determined their named executive officers on the basis of information that unhelpfully includes those offsets and negative numbers. Complaints about the disclosures presented though are really complaints about our rule choices. We will evaluate those based on actual practice under the rules and what the impact has been. Certainly we are very interested in listening to what others have to say in this area.

**4. Disclosure about the role of the CEO.** For the most part, I am heartened by the robust disclosures that are emerging under the new rules, and I believe the leaders of America's public companies have stepped up to comply with their disclosure obligations and to provide meaningful information to their shareholders. I have heard worries though that the leaders at the highest level, America's CEO's, are not embracing the call to provide robust disclosure about their own roles in their companies' compensation processes. Clearly this is something our rules now require. Did the CEO have the ability to call or attend even portions of compensation committee meetings? Did she meet with any consultants used by the

compensation committee? Did the CEO retain or have access to any other compensation consultants who influenced the company's executive compensation? What input did the CEO have as compensation packages were being crafted? These are just some examples of the types of principles-based questions that companies should be asking and then considering disclosure of the answers. A review of the disclosures we've received will help us understand how this all is playing out. And I hope we will find that America's CEO's are listening to their counsel and advisers who are urging them to comply with the principles and to provide robust disclosure in this area as well as others. But, as you can perhaps tell, I have some initial concerns.

**5. Disclosure about perquisites.** This is another principles-based area, and I believe our new rules are pretty clear about how perquisites should be evaluated and disclosed. I also believe the new rules are making a real difference. I found interesting the study that Paul Hodgson of The Corporate Library has done of the new perks disclosures. In short, he found that many companies are disclosing considerably more perks this year than last. The triggers for our rules and our disclosure requirements in this area are a good example of our changes provoking meaningful, new and expanded disclosures. Yes, this in some instances has added to length and to the quantity of disclosures. But with regard to perquisites, this seems clearly to be of interest and importance to investors. And again, we will see what the review process finds.

### **Next Steps.**

At the beginning of my remarks I mentioned the Corporation Finance review project and report that you can expect us to publish this fall. Clearly giving feedback on the disclosures this year is a key objective for us and something we hope will be useful to public companies as they prepare their disclosures for their second proxy season with the new rules. We will also be considering if there are any changes to the rules that might be advisable, and the Division will then recommend those to the Commission for proposal as appropriate. Should we revise the way the rules treat negative numbers? Should the rules for disclosure of performance targets be refined? I do not know the answers today, but we are certainly studying these and other questions like them. If there are common questions that are coming up and which the staff can answer, we will also try to do that. So our reviews and the final report are a learning project for us, as well as hopefully for the public.

As I noted earlier, the SEC staff, and especially myself, have asked the private sector to do its part to generate and provide the quality disclosures to which investors are entitled. And we are appreciative of what has been done. We also understand there has been an added challenge to that because of the principles-based nature of the new rules. Corporation Finance intends to continue doing its part as well, which includes a sensitivity and respect for the principles-based nature of the new disclosure regime. That does not mean we will not comment on disclosure deficiencies and failures when we think we see them, however. Or that we will not ask hard questions. As with our review process generally, some of our comments will be satisfied by future disclosures, but some companies may find themselves needing to file amended Reports on Form 10 K this year. We are taking all of this very seriously.

### **Conclusion.**

I have spent much of my time today, as I do every time I speak these days, talking about *disclosure*. It is the heart and hallmark of our work in Corporation Finance. But I do not think we can or should deny the ripple effects. As these new, enhanced disclosures are being made, corporate America and its shareholders are taking note. And talking more. Perhaps that increased dialogue is another positive consequence of the new rules. Those in the private sector are not the only ones taking note and taking part in the dialogue of course. There were many shareholder proposals this year with non-binding proposals relating to executive compensation. President Bush spoke last winter in New York about executive compensation. Even Congress has joined the debate. Less than two weeks ago, the House of Representatives, led by Representative Barney Frank, passed by a 269–134 margin a bill to give shareholders a nonbinding vote on executive pay disclosures and change of control packages. I believe Senator Barak Obama has introduced an identical bill in the Senate. Clearly executive compensation will remain one of the hot topics of the day in corporate board rooms, in chat rooms, and even in Washington. I believe the Commission's leadership in adopting its new disclosure rules has made a positive contribution to that public dialogue and I look forward to its future iterations. On a smaller note, I have very much enjoyed talking with all of you about this topic today, and I look forward to the panel discussion that follows. Thank you again for the invitation to be here and for your time and attention. I would be happy to take any questions you might have.

## Endnotes

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<sup>1</sup> Chairman Garrett also served in 1956 as the Director of the SEC's Division of Corporate Regulation, which was a predecessor to the Division of Investment Management.

<sup>2</sup> SEC Release No. 33-8732A, "Executive Compensation and Related Person Disclosure," August 29, 2006, available at <http://www.sec.gov/rules/final/2006/33-8732a.pdf>.

<sup>3</sup> "Introductory Remarks at the SEC Open Meeting," Christopher Cox, Chairman, U.S. Securities and Exchange Commission, July 26, 2006, available at <http://www.sec.gov/news/speech/2006/spch072606cc.htm>.

<sup>4</sup> "Closing Remarks to the Second Annual Corporate Governance Summit," Christopher Cox, Chairman, U.S. Securities and Exchange Commission, March 23, 2007, available at <http://www.sec.gov/news/speech/2007/spch032307cc.htm>.

<sup>5</sup> "Principles Matter," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, September 6, 2006, available at <http://www.sec.gov/news/speech/2006/spch090606jww.htm>.

<http://www.sec.gov/news/speech/2007/spch050307jww.htm>

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Modified: 05/09/2007

**APPENDIX R-IV**

**Christopher Cox, *Introductory Remarks Before the Executive  
Compensation Disclosure Conference* (Apr. 3, 2006)**



## U.S. Securities and Exchange Commission

### **Speech by SEC Chairman: Introductory Remarks Before the Executive Compensation Disclosure Conference**

*by*

**Chairman Christopher Cox**

*U.S. Securities and Exchange Commission*

Washington, DC  
April 3, 2006

Good morning, and thanks, Joe. You're a Renaissance man: a lawyer, an economist, a former SEC Commissioner, a former senior adviser to President Reagan's Council of Economic Advisers, and now a professor of Law and Business at Stanford. Is there anything you can't do? I don't know if you can pitch, but I understand the Nationals need all the help they can get this year.

And thank you for planning this conference. Executive compensation—the how, and the how much—has been an increasingly salient topic for several years now.

It's been 10 years since Disney President Michael Ovitz received a severance package worth more than \$140 million after holding the job for less than 18 months. The shareholder suit is still going on, with the Delaware court's ruling now on appeal.

It's been three years since NYSE chairman Richard Grasso received a \$187.5 million severance package—consisting of a \$139.5 million lump sum retirement benefit, an additional \$48 million in deferred compensation, plus another \$10 million in severance pay—that many people thought was quite a lot for a non-profit chair. The New York Attorney General was certainly one of those. And in 2004 he sued to get \$100 million of it back. Everyone is still waiting to see where that one ends up, too.

There are many other stories such as these that have captured the attention of the press and the public—not to mention Congress, and both federal and state regulators.

Perhaps it shouldn't be surprising that these issues generate so much popular attention: after all, exposing details of the "lifestyles of the rich and famous" makes good copy. Many of these tales feature divorce, and even "Desperate Housewives" who are only too happy to spill the beans on some of the more unusual aspects of their former husbands' compensation.

But it's worth pausing and asking ourselves exactly why ordinary Americans want so much to know what the boss is paid. Many sociological explanations have been advanced, but the most important reason is also the most overlooked: they're investors.

It isn't just the detached curiosity of supermarket tabloid readers that drives this need to know. It's the fact that today's investor class truly represents a cross section of the population.

It's a remarkable fact of the early 21st century that more than half of Americans own stock. That means that investors aren't just the coupon clippers of old—a privileged group of high-income elites with chauffeurs named Alfred and their own private bankers.

More and more, when you think "investor," you need to see in your mind's eye Aunt Sally—and her neighbor Jim across the street, who runs the local deli. Millions of investors today come from American households that sit around the kitchen table and make tough choices about their monthly budgets. They expect the companies they invest in to do the same.

For Aunt Sally and her neighbor Jim, one of the claims on their wages is the money they set aside for retirement, for their children's college tuition, or to buy a house. Like most Americans, they do comparison shopping for breakfast cereal, and they don't replace the shower curtain until it has a tear and leaks. So it's not surprising they don't understand how an executive can take from their company as part of his compensation a shower curtain that costs \$6,000.

These glimpses of ostentation and extravagance often tell investors more about the mindset of management than a 75-page corporate budget. So if something like that is going to be part of compensation, investors have a right to know. And it's the SEC's job to see to it that they do know.

On the other hand, it's not the Commission's job to substitute our judgment for that of the board about what would be the "best" level of compensation. Surely many executives deserve every penny they're paid, and more. Being a CEO requires a rarefied collection of attributes and skills that are in too short supply. And it's a fact that competition in the market for executive talent can be fierce.

So the federal government won't opine on the proper level of compensation. Nor will we express our preferences as to its form. If a company's directors believe it takes a \$6,000 shower curtain, or a \$140 million severance package, to get the job done, fine—but at least the shareholders ought to know. They're entitled to information on the specifics of the major perks. And they deserve a clear expression of what the entire compensation package is worth.

Perhaps most important of all, they ought to know the reasoning that leads to the choices a company makes. That's the genesis of our proposed new rules.

We want the company to explain publicly its actions, so we're proposing to replace the Compensation Committee Report and the performance graph,

which was often pro forma and written in legalese, with a new Compensation Discussion and Analysis section. The new CD&A will allow the board to have a frank discussion with their bosses, the shareholders. And since the purpose here is to communicate, the new CD&A is to be written in plain English—the new official language of the SEC.

Plain English uses plain words, and among other basic ingredients, the active voice. We want to promote the use of the active voice not just because it makes for punchier sentences, but because it requires a definite subject to go with the predicate. That's the only way that investors will be able to figure out who did what to whom. So it won't cut it to say, "It was decided to give Mr. Smithers a suitable commemorative of his service with the company," when what could be said instead is that "we are giving Mr. Smithers a life-time supply of gold-trimmed paper tissues valued at \$1 million. In return, Mr. Smithers agreed to waive his rights to sue the company for breach of contract."

It's an open secret that today's Compensation Committee Report is boilerplate. It's simply a waste of trees and ink. I could probably use an example from the proxy statement of most any public company in America, but to avoid giving offense I've picked one that's going out of business.

Here's what Enron's proxy statement said in 2001:

*"The Compensation and Management Development Committee's responsibility is to establish Enron's compensation strategy and to ensure that the senior executives of Enron and its wholly owned subsidiaries are compensated effectively in a manner consistent with the stated compensation strategy of Enron, internal equity considerations, competitive practices, and the requirements of appropriate regulatory bodies."*

Of course, notwithstanding the length of that sentence, we actually learned nothing about what Enron's compensation strategy might be—neither there nor anywhere else in the proxy statement.

There's a word for that kind of disclosure: a word that appears as the title of a tightly written 80-page book by Princeton professor Harry Frankfurt. If that allusion is too elliptical, some synonyms are claptrap, hokum, drivel, and balderdash.

In the future, we hope to see less legalese and Dilbert-ese, and more plain speaking. That's because the proxy statement is meant to help investors decide how to vote.

I understand that for the real-life inhabitants of the world that Dilbert satirizes, cutting the Prof. Frankfurt stuff could be a tall order. After all, if you spend the day "touching base," "networking," "workshopping," "impacting," "strategizing," "implementing," and "going forward with your key performance indicators," it's hard to think in clear and precise terms.

But I want you to know we're entirely serious about the plain English piece of this initiative.

So far, the executive compensation rule proposal has been well received. Most of the comments, which you can find on our Web site, are positive. And most of them are in plain English. The very first one you'll find states the matter in exceptionally clear terms:

*"It is about time someone did something to let us know how the companies in which we have invested our hard earned money are compensating the executives."*

Of course, not every commentator approves of everything we're proposing. And so we'll look at every single suggestion, and use every single one that can in some way improve the proposal. The comment period closes in a week, on April 10. So you can still get your licks in by going to [sec.gov](http://sec.gov) and clicking on Proposed Rules. Or you can reach out to me or to John White, our new Director of the Division of Corporation Finance, who is also here today and will address you later.

If you have an idea about how to improve this proposal, by all means we want to hear it. I'd be particularly interested in any help you can give us in writing the rule itself in plain English—all 91 pages of it. After all, for all of its prestige and power, the SEC is just one small part of the same sprawling government bureaucracy that is capable of calling roadkill "vehicle-induced wildlife fatalities." We don't want that kind of nonsense creeping into the SEC's rules, any more than we want it in proxy statements and annual reports.

For your assistance in that regard, the legions of lawyers, accountants, and business people across the country who will have to decipher and comply with this new rule will forever thank you.

I have no doubt that the outstanding panelists we'll be hearing from during this conference will themselves be speaking with crystal clarity. Both you, Joe, and Stanford's Rock Center are to be congratulated for recruiting an absolutely top-flight group of panelists and moderators.

All of us at the SEC are happy to contribute; and you can measure our enthusiasm by the fact that three of our Commissioners will be attending, as well as several members of our staff.

You should all pay special attention to John White's remarks at lunch. Not because his 14 days at the Commission have given him any secret insights or inside information, but because if he were still in the private sector, his detailed advice would have cost you thousands of dollars. Now, since he has joined the SEC, he has to give it away for free. How's that for a deal?

It's excellent advice, both for you and for the investors who benefit from your work. The very useful guidance he'll provide is a great example of why we're so honored, and investors are so fortunate, that Director White is now helping to lead the Commission.

In addition to John's very practical pointers, here's some advice from the Chairman: ask your lawyers to use the SEC's Plain English Handbook—and if you really like them, perhaps you could buy them a copy of Lynne Truss's book, *Eats, Shoots & Leaves*, just for good measure.

It's been a pleasure to kick off our conference this morning. This is a wonderful event. To the panelists and moderators, I want to thank you for your time and effort. To the Commissioners, staff, and our Rock Center organizers, again thanks to each of you.

Learn a lot, enjoy this unique opportunity for informal exchange between regulators and regulated, and most importantly, keep doing what you do best. You are all part of making our country's capital markets the healthiest, safest and best in the world.

Thank you for what you do.

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<http://www.sec.gov/news/speech/2006/spch040306cc.htm>

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Modified: 04/03/2006

## S. AMENDMENTS TO FORM 8-K

The rules revised the treatment of compensatory arrangements under Form 8-K by removing them from Item 1.01 and adding a new disclosure requirement for such arrangements in Item 5.02.

The rules adopted in January 2011 made certain revisions to the Form 8-K disclosures required regarding the results of shareholder votes in light of the say-on-frequency vote required by the Dodd-Frank Act's say-on-pay requirements.

The SEC has published Compliance & Disclosure Interpretations regarding Form 8-K.

### Rules

The changes to Form 8-K related to treatment of compensatory arrangements are located in Items 1.01 and 5.02 and the disclosure requirements relating to the say-on-frequency vote are located in Item 5.07 which read as follows:

#### Form 8-K

##### Item 1.01. Entry into a Material Definitive Agreement.

- (a) If the registrant has entered into a material definitive agreement not made in the ordinary course of business of the registrant, or into any amendment of such agreement that is material to the registrant, disclose the following information:
- (1) the date on which the agreement was entered into or amended, the identity of the parties to the agreement or amendment and a brief description of any material relationship between the registrant or its affiliates and any of the parties, other than in respect of the material definitive agreement or amendment; and
  - (2) a brief description of the terms and conditions of the agreement or amendment that are material to the registrant.
- (b) For purposes of this Item 1.01, a *material definitive agreement* means an agreement that provides for obligations that are material to and enforceable against the registrant, or rights that are material to the registrant and enforceable by the registrant against one or more other parties to the agreement, in each case whether or not subject to conditions.

#### Instructions.

1. Any material definitive agreement of the registrant not made in the ordinary course of the registrant's business must be disclosed under this Item 1.01. An agreement is deemed to be not made in the ordinary course of a registrant's business even if the agreement is such as ordinarily accompanies the kind of business conducted by the registrant if it involves the subject matter identified in Item 601(b)(10)(ii)(A)-(D) of Regulation S-K (17 CFR 229.601(b)(10)(ii)(A)-(D)). An agreement involving the subject matter identified in Item 601(b)(10)(iii)(A) or (B) need not be disclosed under this Item.

2. A registrant must provide disclosure under this Item 1.01 if the registrant succeeds as a party to the agreement or amendment to the agreement by assumption or assignment (other than in connection with a merger or acquisition or similar transaction).

3. With respect to asset-backed securities, as defined in Item 1101 of Regulation AB (17 CFR 229.1101), disclosure is required under this Item 1.01 regarding the entry into or an amendment to a definitive agreement that is material to the asset-backed securities transaction, even if the registrant is not a party to such agreement (e.g., a servicing agreement with a servicer contemplated by Item 1108(a)(3) of Regulation AB (17 CFR 229.1108(a)(3))).

**Item 5.02. Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.**

(a) (1) If a director has resigned or refuses to stand for re-election to the board of directors since the date of the last annual meeting of shareholders because of a disagreement with the registrant, known to an executive officer of the registrant, as defined in 17 CFR 240.3b-7, on any matter relating to the registrant's operations, policies or practices, or if a director has been removed for cause from the board of directors, disclose the following information:

- (i) the date of such resignation, refusal to stand for re-election or removal;
- (ii) any positions held by the director on any committee of the board of directors at the time of the director's resignation, refusal to stand for re-election or removal; and
- (iii) a brief description of the circumstances representing the disagreement that the registrant believes caused, in whole or in part, the director's resignation, refusal to stand for re-election or removal.

(2) If the director has furnished the registrant with any written correspondence concerning the circumstances surrounding his or her resignation, refusal or removal, the registrant shall file a copy of the document as an exhibit to the report on Form 8-K.

(3) The registrant also must:

- (i) provide the director with a copy of the disclosures it is making in response to this Item 5.02 no later than the day the registrant file the disclosures with the Commission;
- (ii) provide the director with the opportunity to furnish the registrant as promptly as possible with a letter addressed to the registrant stating whether he or she agrees with the statements made by the registrant in response to this Item 5.02 and, if not, stating the respects in which he or she does not agree; and
- (iii) file any letter received by the registrant from the director with the Commission as an exhibit by an amendment to the previously filed Form 8-K within two business days after receipt by the registrant.

(b) If the registrant's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or any person performing similar functions, or

any named executive officer, retires, resigns or is terminated from that position, or if a director retires, resigns, is removed, or refuses to stand for re-election (except in circumstances described in paragraph (a) of this Item 5.02), disclose the fact that the event has occurred and the date of the event.

- (c) If the registrant appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or person performing similar functions, disclose the following information with respect to the newly appointed officer:
- (1) the name and position of the newly appointed officer and the date of the appointment;
  - (2) the information required by Items 401(b), (d), (e) and Item 404(a) of Regulation S-K (17 CFR 229.401(b), (d), (e) and 229.404(a)); and
  - (3) a brief description of any material plan, contract or arrangement (whether or not written) to which a covered officer is a party or in which he or she participates that is entered into or material amendment in connection with the triggering event or any grant or award to any such covered person or modification thereto, under any such plan, contract or arrangement in connection with any such event.

**Instruction to paragraph (c).**

If the registrant intends to make a public announcement of the appointment other than by means of a report on Form 8-K, the registrant may delay filing the Form 8-K containing the disclosures required by this Item 5.02(c) until the day on which the registrant otherwise makes public announcement of the appointment of such officer.

- (d) If the registrant elects a new director, except by a vote of security holders at an annual meeting or special meeting convened for such purpose, disclose the following information:
- (1) the name of the newly elected director and the date of election;
  - (2) a brief description of any arrangement or understanding between the new director and any other persons, naming such persons, pursuant to which such director was selected as a director;
  - (3) the committees of the board of directors to which the new director has been, or at the time of this disclosure is expected to be, named;
  - (4) the information required by Item 404(a) of Regulation S-K (17 CFR 229.404(a)); and
  - (5) a brief description of any material plan, contract or arrangement (whether or not written) to which the director is a party or in which he or she participates that is entered into or material amendment in connection with the triggering event or any grant or award to any such covered person or modification thereto, under any such plan, contract or arrangement in connection with any such event.
- (e) If the registrant enters into, adopts, or otherwise commences a material compensatory plan, contract or arrangement (whether or not written), as to which the registrant's principal

executive officer, principal financial officer, or a named executive officer participates or is a party, or such compensatory plan, contract or arrangement is materially amended or modified, or a material grant or award under any such plan, contract or arrangement to any such person is made or materially modified, then the registrant shall provide a brief description of the terms and conditions of the plan, contract or arrangement and the amounts payable to the officer thereunder.

**Instructions to paragraph (e).**

1. Disclosure under this Item 5.02(e) shall be required whether or not the specified event is in connection with events otherwise triggering disclosure pursuant to this Item 5.02.
2. Grants or awards (or modifications thereto) made pursuant to a plan, contract or arrangement (whether involving cash or equity), that are materially consistent with the previously disclosed terms of such plan, contract or arrangement, need not be disclosed under this Item 5.02(e), provided the registrant has previously disclosed such terms and the grant, award or modification is disclosed when Item 402 of Regulation S-K (17 CFR 229.402) requires such disclosure.
- (f) If the salary or bonus of a named executive officer cannot be calculated as of the most recent practicable date and is omitted from the Summary Compensation Table as specified in Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K, disclose the appropriate information under this Item 5.02(f) when there is a payment, grant, award, decision or other occurrence as a result of which such amounts become calculable in whole or part. Disclosure under this Item 5.02(f) shall include a new total compensation figure for the named executive officer, using the new salary or bonus information to recalculate the information that was previously provided with respect to the named executive officer in the registrant's Summary Compensation Table for which the salary and bonus information was omitted in reliance on Instruction 1 to Item 402(c)(2)(iii) and (iv) of Regulation S-K (17 CFR 229.402(c)(2)(iii) and (iv)).

**Instructions to Item 5.02.**

1. The disclosure requirements of this Item 5.02 do not apply to a registrant that is a wholly-owned subsidiary of an issuer with a class of securities registered under Section 12 of the Exchange Act (15 U.S.C. 78l), or that is required to file reports under Section 15(d) of the Exchange Act (15 U.S.C. 78o(d)).
2. To the extent that any information called for in Item 5.02(c)(3) or Item 5.02(d)(3) or Item 5.02(d)(4) is not determined or is unavailable at the time of the required filing, the registrant shall include a statement this effect in the filing and then must file an amendment to its Form 8-K filing under this Item 5.02 containing such information within four business days after the information is determined or becomes available.
3. The registrant need not provide information with respect to plans, contracts, and arrangements to the extent they do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees.

4. For purposes of this Item, the term “named executive officer” shall refer to those executive officers for whom disclosure was required in the registrant’s most recent filing with the Commission under the Securities Act (15 U.S.C. 77a et seq.) or Exchange Act (15 U.S.C. 78a et seq.) that required disclosure pursuant to Item 402(c) of Regulation S-K (17 CFR 229.402(c)).

**Item 5.07. Submission of Matters to a Vote of Security Holders.**

If any matter was submitted to a vote of security holders, through the solicitation of proxies or otherwise, provide the following information:

- (a) The date of the meeting and whether it was an annual or special meeting. This information must be provided only if a meeting of security holders was held.
- (b) If the meeting involved the election of directors, the name of each director elected at the meeting, as well as a brief description of each other matter voted upon at the meeting; and state the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes as to each such matter, including a separate tabulation with respect to each nominee for office. For the vote on the frequency of shareholder advisory votes on executive compensation required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1) and §240.14a-21(b), state the number of votes cast for each of 1 year, 2 years, and 3 years, as well as the number of abstentions.
- (c) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (17 CFR 240.14a-101)) terminating any solicitation subject to Rule 14a-12(c), including the cost or anticipated cost to the registrant.
- (d) No later than one hundred fifty calendar days after the end of the annual or other meeting of shareholders at which shareholders voted on the frequency of shareholder votes on the compensation of executives as required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1), but in no event later than sixty calendar days prior to the deadline for submission of shareholder proposals under §240.14a-8, as disclosed in the registrant’s most recent proxy statement for an annual or other meeting of shareholders relating to the election of directors at which shareholders voted on the frequency of shareholder votes on the compensation of executives as required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1(a)(2)), by amendment to the most recent Form 8-K filed pursuant to (b) of this Item, disclose the company’s decision in light of such vote as to how frequently the company will include a shareholder vote on the compensation of executives in its proxy materials until the next required vote on the frequency of shareholder votes on the compensation of executives.

**Instruction 1 to Item 5.07.**

The four business day period for reporting the event under this Item 5.07, other than with respect to Item 5.07(d), shall begin to run on the day on which the meeting ended. The registrant shall disclose on Form 8-K under this Item 5.07 the preliminary voting results. The registrant shall file an amended report on Form 8-K under this Item 5.07 to disclose the final voting results within four business days after the final voting results are known. However, no preliminary voting results need

be disclosed under this Item 5.07 if the registrant has disclosed final voting results on Form 8-K under this Item.

### Adopting Release and Interpretative Guidance

A copy of the SEC's Compliance & Disclosure Interpretations dated July 8, 2011 regarding Form 8-K is located at [Appendix S-1](#)

- An electronic copy of the compliance & disclosure interpretations which is intended to be updated from time to time can be found at <http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>

Relevant excerpts from the adopting release include:

- [P]articularly because of the terms of Item 601(b)(10), Item 1.01 of Form 8-K triggered compensation disclosure of the types of matters that, in some cases, appear to have fallen short of the “unquestionably or presumptively material” standard associated with the expanded Form 8-K disclosure items.
- Accordingly, we are adopting amendments to Form 8-K that will uncouple Item 601(b)(10)(iii) of Regulation S-K from the current disclosure requirements of Form 8-K. As proposed, we are eliminating employment compensation arrangements from the scope of Item 1.01 altogether and expanding Item 5.02 of Form 8-K to cover only those compensatory arrangements with executive officers and directors that we believe are unquestionably or presumptively material.
- Specifically, we are deleting the last sentence of former Instruction 1 to Item 1.01 of Form 8-K, which references the portions of Item 601(b)(10) of Regulation S-K that specifically relate to management compensation and compensatory plans. In place of the deleted sentence, we are adding a sentence specifying that agreements involving the subject matter identified in Item 601(b)(10)(iii)(A) and (B) of Regulation S-K need not be disclosed under amended Item 1.01 of Form 8-K. This change also will apply to the disclosure of terminations of material definitive agreements under Item 1.02 of Form 8-K, which references the definition of “material definitive agreement” in Item 1.01 of Form 8-K.
- As proposed, we are modifying Item 5.02 to capture generally the information already required under that item, as well as additional information regarding material employment compensation arrangements involving named executive officers that, prior to today's amendments, would be called for under Item 1.01... We are accomplishing this by taking the following steps:
  - expanding the information regarding retirement, resignation or termination to include all persons falling within the definition of named executive officers for the company's previous fiscal year, whether or not included in the list specified in Item 5.02 prior to these amendments;
  - expanding the disclosure items covered under Item 5.02 beyond employment agreements to require a brief description of any material plan, contract or arrangement to which a

- covered officer or director is a party or in which he or she participates that is entered into or materially amended in connection with any of the triggering events specified in Item 5.02(c) and (d), or any grant or award to any such covered person, or modification thereto, under any such plan, contract or arrangement in connection with any such event;
- with respect to the principal executive officer, the principal financial officer, or persons falling within the definition of named executive officer for the company’s previous fiscal year, expanding the disclosure items to include a brief description of any material new compensatory plan, contract or arrangement, or new grant or award thereunder (whether or not written), and any material amendment to any compensatory plan, contract or arrangement (or any modification to a grant or award thereunder), whether or not such occurrence is in connection with a triggering event specified in Item 5.02. Grants or awards or modifications thereto will not be required to be disclosed if they are consistent with the terms of previously disclosed plans or arrangements and they are disclosed the next time the company is required to provide new disclosure under Item 402 of Regulation S-K; and
  - adding a requirement for disclosure of salary or bonus for the most recent fiscal year that was not available at the latest practicable date in connection with disclosure under Item 402 of Regulation S-K. This disclosure will also require a new total compensation recalculation to reflect the new salary or bonus information.
- We are including a new Instruction to Item 5.02 that will clarify that for purposes of this Item the named executive officers are the persons for whom disclosure was required in the most recent filing with the Commission that required disclosure under Item 402(c) of Regulation S-K or Item 402(b) of Regulation S-B, as applicable.

## Practice Pointers

### **Main Changes to the Treatment of Compensatory Arrangements under Form 8-K**

- The main change to Form 8-K is that entry into compensatory plans, contracts or arrangements with directors and executive officers is no longer covered by Item 1.01.
  - Note any such compensatory plans, contracts or arrangements may still be material contracts required to be included as exhibits to periodic reports on the same basis as before.
  - Note new Item 5.02(e) covers entry into and material amendments of material compensatory plans, contracts or arrangements with the CEO, CFO and the named executive officers.
  - The revisions also cover entry into and material amendments of material compensatory plans, contracts or arrangements with certain “principal officers” and directors in connection with the appointment or election of such individuals.
- Also note, Item 5.02(b) has been amended to cover retirement, resignation or termination of any named executive officer (instead of just “principal officers”).

- The revisions to Form 8-K clarify that the named executive officers are those named executive officers who were in the company's most recent filing that required disclosure under Item 402(c) of Regulation S-K.

### **Disclosure of Determination of Named Executive Officer's Salary or Bonus Now Required**

- If a named executive officer's salary or bonus was not determinable when a company filed its proxy statement (or Form 10-K), when such officer's salary or bonus becomes determinable the company must file a Form 8-K disclosing under Item 5.02(e) the amount awarded as salary or bonus.

### **Update Disclosure Controls and Procedures**

- Companies should educate their compensation committee, disclosure committee and appropriate personnel regarding the changes to Form 8-K and update their disclosure controls and procedures to reflect such changes and ensure timely filings under Form 8-K.

**APPENDIX S-I**

*SEC Compliance & Disclosure Interpretations regarding Form  
8-K (July 8, 2011)*



## Exchange Act Form 8-K

**Last Update: July 8, 2011**

These interpretations replace the Form 8-K interpretations in the July 1997 Manual of Publicly Available Telephone Interpretations, the June 13, 2003 Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures and the November 22, 2004 Form 8-K Frequently Asked Questions. Some of the interpretations included here were originally published in the sources noted above, and have been revised in some cases. The bracketed date following each interpretation is the latest date of publication or revision.

### QUESTIONS AND ANSWERS OF GENERAL APPLICABILITY

#### Section 101. Form 8-K — General Guidance

##### Question 101.01

**Question:** If a triggering event specified in one of the items of Form 8-K occurs within four business days before a registrant's filing of a periodic report, may the registrant disclose the event in its periodic report rather than a separate Form 8-K? If so, under what item of the periodic report should the event be disclosed? Item 5 of Part II of Form 10-Q and Item 9B of Form 10-K appear to be limited to events that were required to be disclosed during the period covered by those reports.

**Answer:** Yes, a triggering event occurring within four business days before the registrant's filing of a periodic report may be disclosed in that periodic report, except for filings required to be made under Item 4.01 of Form 8-K, Changes in Registrant's Certifying Accountant and Item 4.02 of Form 8-K, Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review. The registrant may disclose triggering events, other than Items 4.01 and 4.02 events, on the periodic report under Item 5 of Part II of Form 10-Q or Item 9B of Form 10-K, as applicable. All Item 4.01 and Item 4.02 events must be reported on Form 8-K. Of course, amendments to previously filed Forms 8-K must be filed on a Form 8-K/A. See also Exchange Act Form 8-K [Question 106.04](#) regarding the ability to rely on Item 2.02 of Form 8-K. [April 2, 2008]

##### Question 101.02

**Question:** Some items of Form 8-K are triggered by the specified event occurring in relation to the "registrant" (such as Items 1.01, 1.02, 2.03, 2.04). Other items of Form 8-K refer also to majority-owned subsidiaries (such as Item 2.01). Should registrants interpret all Form 8-K Items as applying the triggering event to the registrant and subsidiaries, other than

items that obviously apply only at the registrant level, such as changes in directors and principal officers?

**Answer:** Yes. Triggering events apply to registrants and subsidiaries. For example, entry by a subsidiary into a non-ordinary course definitive agreement that is material to the registrant is reportable under Item 1.01 and termination of such an agreement is reportable under Item 1.02. Similarly, Item 2.03 disclosure is triggered by definitive obligations or off-balance sheet arrangements of the registrant and/or its subsidiaries that are material to the registrant. [April 2, 2008]

#### Question 101.03

**Question:** General Instruction E to Form 8-K requires that a copy of the report be filed with each exchange where the registrant's securities are listed. Does the term "exchange" as used in the instruction refer only to domestic exchanges?

**Answer:** Yes. The term "exchange" as used in the instruction refers only to domestic exchanges and, accordingly, Form 8-K reports need be furnished only to domestic exchanges. [April 2, 2008]

#### Question 101.04

**Question:** If a Form 8-K contains audited annual financial statements that are a revised version of financial statements previously filed with the Commission and have been revised to reflect the effects of certain subsequent events, such as discontinued operations, a change in reportable segments or a change in accounting principle, then under Item 601(b)(101) (i) of Regulation S-K, the filer must submit an interactive data file with the Form 8-K for those revised audited annual financial statements. Paragraph 6(a) of General Instruction C of Form 6-K contains a similar requirement. Item 601(b)(101)(ii) of Regulation S-K and Paragraph 6(b) of General Instruction C of Form 6-K permit a filer to voluntarily submit an interactive data file with a Form 8-K or 6-K, respectively, under specified conditions. Is a filer permitted to voluntarily submit an interactive data file with a Form 8-K or 6-K for other financial statements that may be included in the Form 8-K or 6-K, but for which an interactive data file is not required to be submitted? For example, if the Form 6-K contains interim financial statements other than pursuant to the nine-month updating requirement of Item 8.A.5 of Form 20-F?

**Answer:** Yes, if the filer otherwise complies with Item 601(b)(101)(ii) of Regulation S-K and Paragraph 6(b) of General Instruction C of Form 6-K, as applicable. [Sep. 14, 2009]

#### Question 101.05

**Question:** If a filer is required to submit an interactive data file with a form other than a Form 8-K or 6-K, may the filer satisfy this requirement by submitting the interactive data file with a Form 8-K or 6-K?

**Answer:** No. If a filer does not submit an interactive data file with a form as required, the filer must amend the form to include the interactive data file. [Sep. 14, 2009]

**Section 102. Item 1.01 Entry into a Material Definitive Agreement**

## Question 102.01

**Question:** If an agreement that was not material at the time the registrant entered into it becomes material at a later date, must the registrant file an Item 1.01 Form 8-K at the time the agreement becomes material?

**Answer:** No. If an agreement becomes material to the registrant but was not material to the registrant when it entered into, or amended, the agreement, the registrant need not file a Form 8-K under Item 1.01. In any event, the registrant must file the agreement as an exhibit to the periodic report relating to the reporting period in which the agreement became material if, at any time during that period, the agreement was material to the registrant. In this regard, the registrant would apply the requirements of Item 601 of Regulation S-K to determine if the agreement must be filed with the periodic report. [April 2, 2008]

## Question 102.02

**Question:** Is a placement agency or underwriting agreement a material definitive agreement for purposes of Item 1.01? If so, does the requirement to disclose the parties to the agreement require disclosure of the name of the placement agent or underwriter? Would such disclosure render the safe harbor from the definition of an "offer" included in Securities Act Rule 135c not available for the Form 8-K filing?

**Answer:** The registrant must determine whether specific agreements are material using established standards of materiality and with reference to Instruction 1 to Item 1.01. If the registrant determines that such an agreement requires filing under Item 1.01, it may, as under Item 3.02, omit the identity of the underwriters from the disclosure in the Form 8-K to remain within the safe harbor of Rule 135c. [April 2, 2008]

## Question 102.03

**Question:** Must a material definitive agreement be summarized in the body of the Form 8-K if it is filed as an exhibit to the Form 8-K?

**Answer:** Yes. Item 1.01 requires "a brief description of the material terms and conditions of the agreement or amendment that are material to the registrant." Therefore, incorporation by reference of the actual agreement would not satisfy this disclosure requirement. In some cases, the agreement may be so brief that it may make sense to disclose all the terms of the agreement into the body of the Form 8-K. [April 2, 2008]

**Section 103. Item 1.02 Termination of a Material Definitive Agreement**

## Question 103.01

**Question:** A material definitive agreement has an advance notice provision that requires 180 days advance notice to terminate. The counterparty delivers to the registrant written advance notice of termination. Even though the registrant intends to negotiate with the counterparty and

believes in good faith that the agreement will ultimately not be terminated, is an Item 1.02 Form 8-K required when the registrant receives the appropriate advance notice of termination?

**Answer:** Yes. Although Instruction 1 to Item 1.02 notes that no disclosure is required solely by reason of that item during negotiations or discussions regarding termination of a material definitive agreement unless and until the agreement has been terminated, and Instruction 2 indicates that no disclosure is required if the registrant believes in good faith that the material definitive agreement has not been terminated, Instruction 2 clarifies that, once notice of termination pursuant to the terms of the agreement has been received, the Form 8-K is required, notwithstanding the registrant's continued efforts to negotiate a continuation of the contract. [April 2, 2008]

#### Question 103.02

**Question:** A material definitive agreement expires automatically on June 30, 200X, but is continued for successive one-year terms until the next June 30th unless one party sends a non-renewal notice during a 30-day window period six months before the automatic renewal – in other words, January. Does non-renewal of this type of agreement by sending the notice in January trigger Item 1.02 disclosure?

**Answer:** Yes. The triggering event is the sending of the notice in January, not the termination of the agreement on June 30th. However, automatic renewal in accordance with the terms of the agreement (in other words, when no non-renewal notice is sent) does not trigger the filing of an Item 1.01 Form 8-K. [April 2, 2008]

#### Question 103.03

**Question:** A material definitive agreement expires on June 30, 200X. It provides that either party may renew the agreement for another one-year term ending on June 30th if it sends a renewal notice to the other party during January, and the other party does not affirmatively reject that notice in February. If neither party sends a renewal notice during January, which means that the agreement terminates on June 30th, is an Item 1.02 Form 8-K filing required?

**Answer:** No. This would be a termination on the agreement's stated termination date that does not trigger an Item 1.02 filing. If one party sends a renewal notice that is not rejected, an Item 1.01 Form 8-K is required. Such a filing would be triggered by the passage of the rejection deadline on February 28th, and not the sending of the renewal notice in January. [April 2, 2008]

### Section 104. Item 1.03 Bankruptcy or Receivership

None

### Section 105. Item 2.01 Completion of Acquisition or Disposition of Assets

None

**Section 106. Item 2.02 Results of Operations and Financial Condition**

## Question 106.01

**Question:** Item 2.02 of Form 8-K contains a conditional exemption from its requirement to furnish a Form 8-K where earnings information is presented orally, telephonically, by webcast, by broadcast or by similar means. Among other conditions, the company must provide on its web site any financial and other statistical information contained in the presentation, together with any information that would be required by Regulation G. Would an audio file of the initial webcast satisfy this condition to the exemption?

**Answer:** Yes, provided that: (1) the audio file contains all material financial and other statistical information included in the presentation that was not previously disclosed, and (2) investors can access it and replay it through the company's web site. Alternatively, slides or a similar presentation posted on the web site at the time of the presentation containing the required, previously undisclosed, material financial and other statistical information would satisfy the condition. In each case, the company must provide all previously undisclosed material financial and other statistical information, including information provided in connection with any questions and answers. Regulation FD also may impose disclosure requirements in these circumstances. [Jan. 11, 2010]

## Question 106.02

**Question:** A company issues its earnings release after the close of the market and holds a properly noticed conference call to discuss its earnings two hours later. That conference call contains material, previously undisclosed, information of the type described under Item 2.02 of Form 8-K. Because of this timing, the company is unable to furnish its earnings release on a Form 8-K before its conference call. Accordingly, the company cannot rely on the exemption from the requirement to furnish the information in the conference call on a Form 8-K. What must the company file with regard to its conference call?

**Answer:** The company must furnish the material, previously non-public, financial and other statistical information required to be furnished on Item 2.02 of Form 8-K as an exhibit to a Form 8-K and satisfy the other requirements of Item 2.02 of Form 8-K. A transcript of the portion of the conference call or slides or a similar presentation including such information will satisfy this requirement. In each case, all material, previously undisclosed, financial and other statistical information, including that provided in connection with any questions and answers, must be provided. [Jan. 11, 2010]

## Question 106.03

**Question:** Item 2.02 of Form 8-K contains a conditional exemption from its requirement to furnish a Form 8-K where earnings information is presented orally, telephonically, by webcast, by broadcast or by similar means. Among other conditions, the company must provide on its web site any material financial and other statistical information not previously disclosed

and contained in the presentation, together with any information that would be required by Regulation G. When must all of this information appear on the company's web site?

**Answer:** The required information must appear on the company's web site at the time the oral presentation is made. In the case of information that is not provided in a presentation itself but, rather, is disclosed unexpectedly in connection with the question and answer session that was part of that oral presentation, the information must be posted on the company's web site promptly after it is disclosed. Any requirements of Regulation FD also must be satisfied. A webcast of the oral presentation would be sufficient to meet this requirement. [Jan. 11, 2010]

#### Question 106.04

**Question:** Company X files its quarterly earnings release as an exhibit to its Form 10-Q on Wednesday morning, prior to holding its earnings conference call Wednesday afternoon. Assuming that all of the other conditions of Item 2.02(b) are met, may the company rely on the exemption for its conference call even if it does not also furnish the earnings release in an Item 2.02 Form 8-K?

**Answer:** Yes. Company X's filing of the earnings release as an exhibit to its Form 10-Q, rather than in an Item 2.02 Form 8-K, before the conference call takes place, would not preclude reliance on the exemption for the conference call. [Jan. 11, 2010]

#### Question 106.05

**Question:** Does a company's failure to furnish to the Commission the Form 8-K required by Item 2.02 in a timely manner affect the company's eligibility to use Form S-3?

**Answer:** No. Form S-3 requires the company to have filed in "a timely manner all reports required to be filed in twelve calendar months and any portion of a month immediately preceding the filing of the registration statement." Because an Item 2.02 Form 8-K is furnished to the Commission, rather than filed with the Commission, failure to furnish such a Form 8-K in a timely manner would not affect a company's eligibility to use Form S-3. While not affecting a company's Form S-3 eligibility, failure to comply with Item 2.02 of Form 8-K would, of course, be a violation of Section 13(a) of the Exchange Act and the rules thereunder. [Jan. 11, 2010]

#### Question 106.06

**Question:** Company A issues a press release announcing its results of operations for a just-completed fiscal quarter, including its expected adjusted earnings (a non-GAAP financial measure) for the fiscal period. Would this press release be subject to Item 2.02 of Form 8-K?

**Answer:** Yes, because it contains material, non-public information regarding its results of operations for a completed fiscal period. The adjusted earnings range presented would be subject to the requirements of Item 2.02 applicable to non-GAAP financial measures. [Jan. 11, 2010]

## Question 106.07

**Question:** A registrant reports "preliminary" earnings and results of operations for a completed quarterly period, and some of these amounts may even be estimates. In issuing this preliminary earnings release, must the registrant comply with all of the requirements of, and instructions to, Item 2.02 of Form 8-K?

**Answer:** Yes. [April 24, 2009]

**Section 107. Item 2.03 Creation of a Direct Financial Obligation under an Off-Balance Sheet Arrangement of a Registrant**

## Question 107.01

**Question:** Instruction 2 to Item 2.03 states that if the registrant is not a party to the transaction creating the contingent obligation arising under the off-balance sheet arrangement, the four business day period begins on the "earlier of" (1) the fourth business day after the contingent obligation is created or arises, and (2) the day on which an executive officer becomes aware. How can a registrant disclose something of which it is not aware?

**Answer:** A registrant must maintain disclosure and internal controls and procedures designed to ensure that information required to be disclosed by the issuer in the reports that it files under the Exchange Act, including Current Reports on Form 8-K, is recorded, processed, summarized and reported within the required time frames. Instruction 2 to Item 2.03 provides for an additional four business days as a "grace" period given the nature of the requirement. [April 2, 2008]

## Question 107.02

**Question:** If a registrant has a long-term debt issuance in a private placement that is coming due, and replaces it or refunds it with another long term debt issuance of the same principal amount and with similar terms in another private placement, is a Form 8-K required to be filed under Item 2.03?

**Answer:** Item 2.03 requires disclosure of a direct financial obligation that is material to the registrant. Materiality is a facts and circumstances determination. Whether the financial obligation is a refinancing on similar terms is one such fact; the amount of the obligation is another. Depending on other facts and circumstances (including but not limited to factors such as current impact on covenants, liquidity and debt capacity and other debt requirements), a registrant may be able to conclude that a financial obligation in this situation is not material. [April 2, 2008]

**Section 108. Item 2.04 Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement**

## Question 108.01

**Question:** Is an Item 2.04 Form 8-K required if all conditions necessary to an event triggering acceleration or an increase in a direct financial

obligation under an agreement have occurred but the counterparty has not declared, or provided notice of, a default?

**Answer:** It depends on how the agreement is written. If, as is often the case, such declaration or notice is necessary prior to the increase or the acceleration of the obligation, then Item 2.04 is not triggered. If no such declaration or notice is necessary and the increase or acceleration is triggered automatically on the occurrence of an event without declaration or notice and the consequences of the event are material to the registrant, then disclosure is required under Item 2.04. [April 2, 2008]

### **Section 109. Item 2.05 Costs Associated with Exit or Disposal Activities**

#### Question 109.01

**Question:** Are costs associated with an exit activity limited to those addressed in FASB Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS 146)?

**Answer:** No. SFAS 146 addresses certain costs associated with an exit activity. Paragraph 2 of SFAS 146 states that such costs include, but are not limited to, those costs addressed by the SFAS. Other costs that may need to be disclosed pursuant to Item 2.05 of Form 8-K are addressed by FASB Statements of Financial Accounting Standards Nos. 87, 88, 106 and 112. [April 2, 2008]

#### Question 109.02

**Question:** If a registrant, in connection with an exit activity, is terminating employees, must it file the Form 8-K when the registrant commits to the plan, or can it wait until it has informed its employees?

**Answer:** Item 2.05 was intended to be generally consistent with SFAS 146. SFAS 146 states that, if a registrant is terminating employees as part of a plan to exit an activity, it need not disclose the commitment to the plan until it has informed affected employees. Similarly, a Form 8-K need not be filed until those employees have been informed. See paragraphs 8, 20 and 21 of SFAS 146. [April 2, 2008]

### **Section 110. Item 2.06 Material Impairments**

None

### **Section 111. Item 3.01 Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing**

None

### **Section 112. Item 3.02 Unregistered Sales of Equity Securities**

#### Question 112.01

**Question:** Does the grant of stock options pursuant to an employee stock

option plan require disclosure under Item 3.02 of Form 8-K?

**Answer:** If a grant of stock options pursuant to an employee stock option plan does not constitute a "sale" or "offer to sell" under Securities Act Section 2(a)(3), the grant need not be reported under Item 3.02 of Form 8-K. See, e.g., *Millennium Pharmaceuticals, Inc.* (May 21, 1998). [April 2, 2008]

Question 112.02

**Question:** If a registrant sells, in an unregistered transaction, shares of a class of equity securities that is not currently outstanding, would the volume threshold under Item 3.02 of Form 8-K be exceeded by such sale?

**Answer:** Yes. As such, in these circumstances, an Item 3.02 Form 8-K filing requirement would be triggered. [April 2, 2008]

### **Section 113. Item 3.03 Material Modification to Rights of Security Holders**

None

### **Section 114. Item 4.01 Changes in Registrant's Certifying Accountant**

Question 114.01

**Question:** If a principal accountant resigns, declines to stand for re-election or is dismissed because its registration with the PCAOB has been revoked, should the registrant disclose this fact when filing an Item 4.01 Form 8-K to report a change in certifying accountant?

**Answer:** Yes. Disclosure of the revocation of the accountant's PCAOB registration is necessary to understanding the required disclosure with respect to whether the former accountant resigned, declined to stand for re-election or was dismissed. [Jan. 14, 2011]

Question 114.02

**Question:** A registrant engages a new principal accountant that is related in some manner to the former principal accountant (e.g., the firms are affiliates or are member firms of the same network), but the new principal accountant is a separate legal entity and is separately registered with the PCAOB. Should the registrant file an Item 4.01 Form 8-K to report a change in certifying accountant?

**Answer:** Yes. Because the new principal accountant is a different legal entity from the former principal accountant and is separately registered with the PCAOB, there is a change in certifying accountant, which must be reported on Item 4.01 Form 8 K. [Jan. 14, 2011]

Question 114.03

**Question:** If a registrant's principal accountant enters into a business

combination with another accounting firm, should the registrant file an Item 4.01 Form 8-K to report a change in certifying accountant?

**Answer:** Whether an Item 4.01 Form 8-K is required will depend on how the combination is structured and on other facts and circumstances. Accounting firms that enter into business combinations are encouraged to discuss their transactions with the [Division's Office of Chief Accountant](#). [Jan. 14, 2011]

### **Section 115. Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review**

#### Question 115.01

**Question:** If a registrant has taken appropriate action to prevent reliance on the financial statements and also has filed a Form 8-K under Item 4.02 (a), must the registrant file a second Form 8-K under Item 4.02(b) if it is separately advised by, or receives notice from, its auditor that the auditor has reached the same conclusion?

**Answer:** No. If the registrant has reported that reliance should not be placed on previously issued financial statements because of an error in such financial statements, the issuer does not need to file a second Form 8-K to indicate that the auditor also has concluded that future reliance should not be placed on its audit report, unless the auditor's conclusion relates to an error or matter different from that which triggered the registrant's filing under Item 4.02(a). [April 2, 2008]

#### Question 115.02

**Question:** Does the Item 4.02 requirement to file a Form 8-K if a company concludes that any previously issued financial statements should no longer be relied upon because of an error in such financial statements, as addressed in FASB Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections, apply to pro forma financial information?

**Answer:** No. The Item 4.02 requirement does not apply to pro forma financial information. If an error is detected in pro forma financial information, an amendment to the form containing such information may be required to correct the error. [April 2, 2008]

#### Question 115.03

**Question:** Must a filer provide disclosures under Item 4.02(a) of Form 8-K when it discovers a material error in its Interactive Data File while the financial statements upon which they are based do not contain an error and may continue to be relied on?

**Answer:** No. Item 4.02(a) requires a Form 8-K only when the filer determines that previously issued financial statements should no longer be relied upon because of an error in those financial statements. If a filer wants to voluntarily provide non-reliance disclosure similar to Item 4.02(a) that pertains only to the interactive data, it can do so under either Item 7.01 or Item 8.01 of Form 8-K. In any event, if a filer finds a material error

in its Interactive Data File, it must file an amendment to correct the error. In addition, once a filer becomes aware of the error in its Interactive Data File, it must correct the error promptly in order for the Interactive Data File to be eligible for the modified treatment under the federal securities laws provided by Rule 406T of Regulation S-T. [May 29, 2009]

### **Section 116. Item 5.01 Changes in Control of Registrant**

None

### **Section 117. Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers**

#### Question 117.01

**Question:** When is the obligation to report an event specified in Item 5.02 (b) of Form 8-K triggered? Must the Form 8-K filed to report an Item 5.02 (b) event disclose the effective date of the resignation or other event?

**Answer:** With respect to any resignation, retirement or refusal to stand for re-election reportable under Item 5.02(b), other than in the corporate governance policy situations addressed in Question 117.15, the Form 8-K reporting obligation is triggered by a notice of a decision to resign, retire or refuse to stand for re-election provided by the director, whether or not such notice is written, and regardless of whether the resignation, retirement or refusal to stand for re-election is conditional or subject to acceptance. The disclosure shall specify the effective date of the resignation or retirement. In the case of a refusal to stand for re-election, the registrant must disclose when the election in question will occur, for example, at the registrant's next annual meeting. No disclosure is required solely by reason of Item 5.02(b) of discussions or consideration of resignation, retirement or refusal to stand for re-election. Whether communications represent discussion or consideration, on the one hand, or notice of a decision, on the other hand, is a facts and circumstances determination. A registrant should ensure that it has appropriate disclosure controls and procedures in place – for example, a board policy that all directors must provide any such notice directly to the corporate secretary – to determine when a notice of resignation, retirement or refusal has been communicated to the registrant. [June 26, 2008]

#### Question 117.02

**Question:** Item 5.02(b) of Form 8-K requires current disclosure when any named executive officer retires, resigns or is terminated from that position. Since status as a named executive officer is determined based on the level of total compensation under Item 402(a)(3) of Regulation S-K, does this mean that disclosure on Form 8-K is triggered when the person is no longer required to be included in the Summary Compensation Table because of the executive officer's level of total compensation?

**Answer:** No. Under Instruction 4 to Item 5.02, the term "named executive officer" refers to those executive officers for whom disclosure under Item 402(c) of Regulation S-K was required in the most recent Commission filing. A Form 8-K is triggered under Item 5.02(b) when one of those

officers retires, resigns or is terminated from the position that the executive officer is listed as holding in the most recent filing including executive compensation disclosure under Item 402(c) of Regulation S-K. [April 2, 2008]

#### Question 117.03

**Question:** A registrant's principal operating officer has his duties and responsibilities as principal operating officer removed and reassigned to other personnel in the organization; however, the person remains employed by the registrant, and the person's title remains the same. Is the registrant required to file a Form 8-K under Item 5.02 to report the principal operating officer's termination?

**Answer:** Yes. The term "termination" includes situations where an officer identified in Item 5.02 has been demoted or has had his or her duties and responsibilities removed such that he or she no longer functions in the position of that officer. [April 2, 2008]

#### Question 117.04

**Question:** If a registrant decides not to nominate a director for re-election at its next annual meeting, is a Form 8-K required?

**Answer:** No. That situation is not covered under the phrase "is removed." However, if the director, upon receiving notice from the registrant that it does not intend to nominate him or her for re-election, then resigns his or her position as a director, then a Form 8-K would be required pursuant to Item 5.02. If the director tells the registrant that he or she refuses to stand for re-election, a Form 8-K is required because the director has communicated a "refusal to stand for re-election," whether or not in response to an offer by the registrant to be nominated. [April 2, 2008]

#### Question 117.05

**Question:** If a registrant appoints a new executive officer, it may delay disclosure until it makes a public announcement of the event under the Instruction to Item 5.02(c). If the new executive officer were simultaneously appointed to the board of directors of the registrant, would the registrant have to disclose such appointment pursuant to Item 5.02(d) within four business days following such appointment, even if that date is before the public announcement of the officer's appointment?

**Answer:** No. In these circumstances, disclosures under paragraph (d) of Item 5.02 may be delayed to the time of public announcement consistent with Item 5.02(c). Similarly, any disclosure required under paragraph (e) of Item 5.02 may be delayed to the time of public announcement consistent with Item 5.02(c). [April 2, 2008]

#### Question 117.06

**Question:** If the registrant does not consider its principal accounting officer an executive officer for purposes of Items 401 or 404 of Regulation S-K, must the registrant make all of the disclosures required by Item 5.02(c)(2) of Form 8-K?

**Answer:** Yes. All of the information required by Item 5.02(c)(2) regarding specified newly appointed officers, including a registrant's principal accounting officer, is required to be reported on Form 8-K even if the information was not required to be disclosed in the Form 10-K because the position does not fall within the definition of an executive officer for purposes of Items 401 or 404 of Regulation S-K. [April 2, 2008]

#### Question 117.07

**Question:** If a director is elected to the board of directors other than by a vote of security holders at a meeting, but the director's term will begin on a later date, when is the reporting requirement under Item 5.02(d) of Form 8-K triggered?

**Answer:** The reporting requirement is triggered as of the date of the director's election to the board. The Item 5.02(d) Form 8-K should disclose the date on which the director's term begins. [April 2, 2008]

#### Question 117.08

**Question:** The board of directors of the registrant adopts a material equity compensation plan in which named executive officers are eligible to participate. No awards have been made under the plan. Does board adoption of the plan trigger disclosure under Item 5.02(e)? Does the fact that adoption of the plan is subject to shareholder approval affect the timing of disclosure under Item 5.02(e)?

**Answer:** Adoption by the registrant's board of directors of a material equity compensation plan in which named executive officers are eligible to participate requires current disclosure pursuant to Item 5.02(e) of Form 8-K. Where the registrant's board adopts a compensation plan subject to shareholder approval, the obligation to file a Form 8-K pursuant to Item 5.02(e) is triggered upon receipt of shareholder approval of the plan. Similarly, if a reportable plan amendment or stock option grant is adopted subject to shareholder approval, the obligation to file a Form 8-K pursuant to Item 5.02 is triggered upon receipt of shareholder approval of the plan amendment or grant. [April 2, 2008]

#### Question 117.09

**Question:** The board of directors of the registrant adopts a material cash bonus plan under which named executive officers participate. No specific performance criteria, performance goals or bonus opportunities have been communicated to plan participants. Does the adoption of such a plan require disclosure pursuant to Item 5.02(e) of Form 8-K?

**Answer:** Yes. Moreover, if the plan is adopted and is also subject to shareholder approval, the receipt of shareholder approval – and not the plan's adoption – triggers the obligation to file a Form 8-K pursuant to Item 5.02(e). [April 2, 2008]

#### Question 117.10

**Question:** After the adoption of a material cash bonus plan has been disclosed in an Item 5.02(e) Form 8-K, the board of directors sets specific

performance goals and business criteria for named executive officers during the performance period. Does this action require disclosure pursuant to Item 5.02(e) of Form 8-K if the specific performance goals and business criteria set for the performance period are materially consistent with the previously disclosed terms of the plan?

**Answer:** No. In reliance on Instruction 2 to Item 5.02(e), the registrant is not required to file an Item 5.02(e) Form 8-K to report this action if the specific performance goals and business criteria set for the performance period are materially consistent with the previously disclosed terms of the plan, for example if the specific goals and criteria are among the previously disclosed performance goals and business criteria (such as EBITDA, return on equity or other applicable measure) that the plan may apply or has applied. [April 2, 2008]

#### Question 117.11

**Question:** A registrant pays out a material cash award pursuant to a cash bonus plan for which disclosure previously was filed consistent with Exchange Act Form 8-K Questions 117.09 and 117.10. Does payment of the award require disclosure pursuant to Item 5.02(e) of Form 8-K?

**Answer:** Disclosure under Item 5.02(e) depends on the circumstances relating to the payment of the cash award. If the registrant pays out a cash award upon determining that the performance criteria have been satisfied, pursuant to Instruction 2 to Item 5.02(e), a Form 8-K reporting such a payment would not be required under Item 5.02(e) because the payment was materially consistent with the previously disclosed terms of the plan. However, if the registrant exercised discretion to pay the bonus even though the specified performance criteria were not satisfied, a Form 8-K reporting such a payment would be required under Item 5.02(e) because the payment was not materially consistent with the previously disclosed terms of the plan, even if the plan provided for the exercise of such discretion. [April 2, 2008]

#### Question 117.12

**Question:** If an Item 5.02(e) Form 8-K is filed to disclose an annual non-equity incentive plan award, does the disclosure have to include the specific target levels?

**Answer:** The registrant is not required to provide disclosure pursuant to Item 5.02(e) of target levels with respect to specific quantitative or qualitative performance related-factors, or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, the disclosure of which would result in competitive harm for the registrant. This position is consistent with the treatment of similar information under Instruction 4 to Item 402(b) of Regulation S-K and Instruction 2 to Item 402(e)(1) of Regulation S-K. [April 24, 2009]

#### Question 117.13

**Question:** If a previously-disclosed employment agreement provides that the principal executive officer is entitled to receive a cash bonus in an amount determined by the compensation committee in its discretion, would

an Item 5.02(e) Form 8-K be required when the committee makes an ad hoc determination of the amount of the principal executive officer's bonus at the end of the first year that the contract is in effect? Would an Item 5.02(e) Form 8-K be required if the committee makes an ad hoc determination of the amount of the CEO's bonus at the end of the second year in which the contract is in effect?

**Answer:** No. In both cases, no Item 5.02(e) Form 8-K would be required to report the discretionary bonus amount. Disclosure regarding material information about the bonus should be included in the registrant's Compensation Discussion and Analysis and related disclosures under Item 402 of Regulation S-K. [April 2, 2008]

#### Question 117.14

**Question:** A registrant intends to terminate an executive compensation plan. Item 5.02(e) requires that material amendments or modifications of compensatory arrangements be disclosed on Form 8-K. Does this item require disclosure of plan terminations?

**Answer:** Yes. A termination should be disclosed if it constitutes a material amendment or modification of the executive compensation plan. Release No. 33-8732A stated that "[i]nstead of being required to be disclosed based on the general requirements with regard to material definitive agreements in Item 1.01 and Item 1.02 of Form 8-K, employment compensation arrangements will now be covered under Item 5.02 of Form 8-K, as amended." [April 2, 2008]

#### Question 117.15

**Question:** If a company has a corporate governance policy that requires a director to tender her resignation from the board of directors upon the occurrence of an event — such as reaching mandatory retirement age, changing jobs or failing to receive a majority of votes cast for election of directors at the annual meeting of shareholders — when must a company file a Form 8-K under Item 5.02(b)?

**Answer:** Under these circumstances, in which a director tenders her resignation only because she is required to do so in order to comply with a corporate governance policy, the company must file a Form 8-K under Item 5.02(b) within four business days of the board's decision to accept the director's tender of resignation. If the board does not accept the director's tender of resignation — and thus, the director remains on the board — the company should consider informing shareholders as to whether and to what extent corporate governance policies are being followed and enforced. [June 26, 2008]

#### Question 117.16

**Question:** A registrant appoints a new director, triggering the obligation to file a Form 8-K pursuant to Item 5.02(d). The newly appointed director enters into the standard compensatory and other agreements and arrangements that the company provides its non-employee directors (*e.g.*, an equity award, annual cash compensation and an indemnification agreement). Pursuant to Item 5.02(d)(5), must the Form 8-K describe

these compensatory and other agreements and arrangements?

**Answer:** Yes. Item 5.02(d)(5) requires a brief description of the newly appointed director's compensatory and other agreements and arrangements, even if they are consistent with the registrant's previously disclosed standard agreements and arrangements for non-employee directors. In lieu of describing any material plan, contract or arrangement to which the director is a party or in which he or she participates, (but not material amendments or grants or awards or modifications thereto), the registrant may cross-reference the description of such plan, contract or arrangement from the Item 402 disclosure in the company's most recent annual report on Form 10-K or proxy statement. [May 29, 2009]

### **Section 118. Item 5.03 Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year**

#### Question 118.01

**Question:** Does the restatement of a registrant's articles of incorporation, without any substantive amendments to those articles or any requirement to be approved by security holders, trigger a Form 8-K filing requirement?

**Answer:** No. An Item 5.03 Form 8-K is not required to be filed when the registrant is merely restating its articles of incorporation (*e.g.*, a restatement that merely consolidates previous amendments without any substantive changes to the articles of incorporation). However, the Division staff recommends that a registrant refile its complete articles of incorporation, if restated, in its next periodic report for ease of reference by investors. [April 2, 2008]

### **Section 119. Item 5.04 Temporary Suspension of Trading Under Registrant's Employee Benefit Plans**

#### Question 119.01

**Question:** Is a Form 8-K filing required for the notice of any time period that constitutes a "blackout period" for purposes of the notice requirements under ERISA, without regard to whether it is also a "blackout period" for purposes of Section 306(a) of the Sarbanes-Oxley Act of 2002 and Regulation BTR?

**Answer:** No. Item 5.04 applies only to a notice of a "blackout period" under Section 306(a) of Sarbanes-Oxley and Regulation BTR. [May 29, 2009]

### **Section 120. Item 5.05 Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics**

None

### **Section 121. Item 5.06 Change in Shell Company Status**

None

**Section 121A. Item 5.07 Submission of Matters to a Vote of Security Holders**

## Question 121A.01

**Question:** How should an issuer calculate the four business day filing period for an Item 5.07 Form 8-K?

**Answer:** Pursuant to Instruction 1 to Item 5.07, the date on which the shareholder meeting ends is the triggering event for an Item 5.07 Form 8-K. Day one of the four-business day filing period is the day after the date on which the shareholder meeting ends. For example, if the meeting ends on Tuesday, day one would be Wednesday, and the four-business day filing period would end on Monday. [Feb. 16, 2010]

## Question 121A.02

**Question:** Does the Item 5.07(b) requirement to report the number of shareholder votes cast for, against or withheld with respect to a matter apply only to matters voted upon at a meeting that involves the election of directors?

**Answer:** No. This reporting obligation applies with respect to any matter submitted to a vote of security holders, through the solicitation of proxies or otherwise. [June 4, 2010]

## Question 121A.03

**Question:** Item 5.07(b) requires disclosure of the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes, as to each matter submitted to a vote of security holders. With respect to the advisory vote on the frequency of shareholder advisory votes on executive compensation, Item 5.07(b) requires disclosure of the number of votes cast for each of the one, two and three year frequency options, as well as the number of abstentions. Are companies also required to state the number of broker non-votes with respect to the frequency of shareholder advisory votes on executive compensation?

**Answer:** No. Item 5.07(b) does not require disclosure of the number of broker non-votes with respect to the advisory vote on the frequency of shareholder advisory votes on executive compensation. If a company believes this information would be useful for investors, then it may disclose such information under Item 5.07(b). [July 8, 2011]

## Question 121A.04

**Question:** May an issuer disclose its decision as to how frequently it will include a shareholder advisory vote on executive compensation in its proxy materials in a periodic report instead of an Item 5.07 Form 8-K, pursuant to General Instruction B.3 to Form 8-K?

**Answer:** Yes. Pursuant to General Instruction B.3, an issuer may report Item 5.07 Form 8-K information in a periodic report that is filed on or before the date that an Item 5.07 Form 8-K would otherwise be due. If the issuer reports its annual meeting voting results in a Form 10-Q or Form 10-

K, it may file a new Item 5.07 Form 8-K, rather than an amended Form 10-Q or Form 10-K, to report its decision as to how frequently it will include a shareholder advisory vote on executive compensation in its proxy materials. However, if the issuer reports its annual meeting voting results in an Item 5.07(b) Form 8-K and also intends to report its frequency decision in a Form 8-K, then, as required by Item 5.07(d), that Form 8-K must be filed as an amendment to the Item 5.07(b) Form 8-K - using submission type 8-K/A - and not as a new Form 8-K. [July 8, 2011]

**Section 122. Item 6.01 ABS Information and Computational Material**

None

**Section 123. Item 6.02 Change of Servicer or Trustee**

None

**Section 124. Item 6.03 Change in Credit Enhancement or Other External Support**

None

**Section 125. Item 6.04 Failure to Make a Required Distribution**

None

**Section 126. Item 6.05 Securities Act Updating Disclosure**

None

**Section 127. Item 7.01 Regulation FD Disclosure**

None

**Section 128. Item 8.01 Other Events**

None

**Section 129. Item 9.01 Financial Statements and Exhibits**

Question 129.01

**Question:** Is the automatic 71-day extension of time in Item 9.01 of Form 8-K available with respect to dispositions?

**Answer:** No. The automatic 71-day extension of time in Item 9.01 of Form 8-K is available only with respect to acquisitions, not dispositions. The Division's Office of the Chief Accountant will continue to address questions regarding dispositions on a case-by-case basis. [April 2, 2008]

**INTERPRETIVE RESPONSES REGARDING PARTICULAR SITUATIONS**

**Section 201. Form 8-K – General Guidance**

None

**Section 202. Item 1.01 Entry into a Material Definitive Agreement**

**202.01** If an Item 1.01 Form 8-K filing requirement is triggered in early April for a registrant with a calendar year fiscal year (*i.e.*, after the end of the registrant's first quarter but before the registrant is required to file its Form 10-Q for that quarter), and the registrant timely files the Item 1.01 Form 8-K but does not file the agreement (to which the Item 1.01 Form 8-K relates) as an exhibit to that Form 8-K, the registrant is required to file the agreement as an exhibit to its second quarter Form 10-Q. The disclosure requirement under Item 1.01 of Form 8-K does not alter the existing requirements for the filing of exhibits under Item 601 of Regulation S-K. [April 10, 2008]

**Section 203. Item 1.02 Termination of a Material Definitive Agreement**

None

**Section 204. Item 1.03 Bankruptcy or Receivership**

None

**Section 205. Item 2.01 Completion of Acquisition or Disposition of Assets**

**205.01** Item 2.01 of Form 8-K, which calls for disclosure of the acquisition or disposition of a significant amount of assets, does not require disclosure of the execution of a contract to acquire or dispose of the assets. Disclosure under Item 2.01 is specifically required only when such an acquisition or disposition is consummated. Nevertheless, the filing of a Form 8-K reporting the execution of a contract for the acquisition or disposition of assets may be required earlier by Item 1.01 of Form 8-K if the registrant has entered into a material definitive agreement not made in the ordinary course of business of the registrant (or an amendment of such agreement that is material). Even if Item 1.01 and Item 2.01 do not require disclosure, if the registrant deems the contract to be of importance to security holders, then the registrant may voluntarily disclose it pursuant to Item 8.01. The financial statement requirement of Item 9.01 is triggered by Item 2.01, but is not triggered by Item 1.01 or 8.01. [April 2, 2008]

**205.02** The purchase by a reporting company of a minority stock interest in a business from an independent third party (which is accounted for under the cost method) would not require the filing of the financial statements of that business with any Form 8-K filed to report the transaction, so long as that minority position did not result in the reporting company's control of the assets. [April 2, 2008]

**205.03** A wholly-owned subsidiary acquires a significant amount of assets from its parent. Both the subsidiary and the parent are reporting companies. The term "any person" found in Instruction 1 to Item 2.01 of Form 8-K refers to the company that has the obligation to file the report.

Therefore, while Instruction 1 would not require a filing by the parent, the subsidiary would be required to file the report. [April 2, 2008]

**205.04** An indefinite closing of a portion of a company's restaurant facilities, coupled with a write-down of its assets in excess of 10 percent, constitutes an "other disposition" for purposes of Instruction 2 to Item 2.01 of Form 8-K, and thus requires the filing of a Form 8-K report. [April 2, 2008]

**205.05** Paragraph (iii) of Instruction 1 to Item 2.01 of Form 8-K indicates that a Form 8-K filing is not required to report the redemption or acquisition of securities from the public, or the sale or other disposition of securities to the public, by the issuer of such securities or by a wholly-owned subsidiary of that issuer. This instruction does not apply to the sale of a subsidiary's equity, because the subsidiary would not be wholly-owned after the transaction is completed. [April 2, 2008]

#### **Section 206. Item 2.02 Results of Operations and Financial Condition**

**206.01** Item 2.02(b) provides that a Form 8-K is not required to report the disclosure of material nonpublic information that is disclosed orally, telephonically, by webcast, broadcast or similar means if, among other things, that presentation is complementary to and initially occurs within 48 hours following a related written announcement or release that has been furnished on an Item 2.02 Form 8-K. This 48-hour safe harbor is construed literally and is not the equivalent of two business or calendar days. [April 2, 2008]

#### **Section 207. Item 2.03 Creation of a Direct Financial Obligation under an Off-Balance Sheet Arrangement of a Registrant**

None

#### **Section 208. Item 2.04 Triggering Events That Accelerate or Increase a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement**

**208.01** A voluntary redemption of convertible notes by a registrant is not a triggering event for purposes of Item 2.04 of Form 8-K. [April 2, 2008]

**208.02** A company disagrees with the legitimacy of a notice of default and brings the matter to arbitration, pursuant to its rights under the terms of the applicable loan agreement. The matter is pending with an arbitrator. Notwithstanding its good faith belief that no event of default has taken place and the fact that the arbitrator has yet to rule on the legitimacy of the event of default, the notice of default is a triggering event under Item 2.04. When the company files the Form 8-K, it may include a discussion of the basis for its belief that no event of default has occurred. [April 2, 2008]

#### **Section 209. Item 2.05 Costs Associated with Exit or Disposal Activities**

**209.01** An Item 2.05 Form 8-K filing requirement is triggered when a registrant's board or board committee, or the registrant's officer(s)

authorized to take such action if board action is not required, commits the registrant to a "plan of termination" that meets the description of such a plan in paragraph 8 of SFAS No. 146, under which material charges will be incurred under generally accepted accounting principles applicable to the registrant under the plan. The "plan of termination" need not fall within an "exit activity," as defined in SFAS No. 146, or otherwise constitute an "exit or disposal plan" (or part of one), to trigger an Item 2.05 Form 8-K filing requirement. [April 2, 2008]

### **Section 210. Item 2.06 Material Impairments**

None

### **Section 211. Item 3.01 Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing**

**211.01** A registrant's common stock is traded on the OTC Bulletin Board, which is not an automated inter-dealer quotation system of a registered national securities association, and is not otherwise traded on an exchange. The registrant has applied to list its common stock on the American Stock Exchange. In this instance, an Item 3.01 Form 8-K filing requirement is not triggered upon the registrant's application for listing on the American Stock Exchange, or upon the approval of the application. [April 2, 2008]

### **Section 212. Item 3.02 Unregistered Sales of Equity Securities**

**212.01** An Item 3.02 Form 8-K filing requirement is triggered when a registrant enters into an agreement enforceable against the registrant to issue unregistered equity securities to a third party in exchange for services and the applicable volume threshold is exceeded. [April 2, 2008]

**212.02** If an Exchange Act reporting, wholly-owned subsidiary receives an additional equity investment from its Exchange Act reporting parent and the volume threshold under Item 3.02 of Form 8-K is exceeded, the wholly-owned subsidiary is required to file an Item 3.02 Form 8-K to report the additional equity investment, regardless of whether the wholly-owned subsidiary meets the conditions for the filing of abbreviated periodic reports under General Instruction H of Form 10-Q and General Instruction I of Form 10-K. [April 2, 2008]

**212.03** An Item 3.02 Form 8-K filing requirement is triggered upon an unregistered sale of warrants to purchase equity securities (or an unregistered sale of options outside a stock option plan), if the volume threshold under Item 3.02 is exceeded, or upon an unregistered sale of convertible notes (convertible into equity securities), if the volume threshold under Item 3.02 of the underlying equity security issuable upon conversion is exceeded. Pursuant to Item 701(e) of Regulation S-K, the registrant must disclose the terms of, as applicable, the exercise of the warrants or the options or the conversion of the convertible notes in the Item 3.02 Form 8-K. If the Item 3.02 Form 8-K that discloses the initial sale of the warrants, the options, or the convertible notes also discloses the maximum amount of the underlying securities that may be issued through, as applicable, the exercise of the warrants or the options or the conversion of the convertible notes, then a subsequent Item 3.02 Form 8-K filing requirement is *not* triggered upon the exercise of the warrants or the

options or the conversion of the notes. [April 2, 2008]

### **Section 213. Item 3.03 Material Modifications to Rights of Security Holders**

**213.01** Upon adoption of a shareholder rights plan, a registrant undertook to make a dividend of a preferred share purchase right for each outstanding share of common stock. The Plan was adopted by the board on August 9. The certificate of designation related to the preferred share purchase right was filed with the state on August 25. The dividend, not yet declared, will occur only upon certain change in control events. Under Item 3.03(b) of Form 8-K, the triggering event related to the plan occurs not upon adoption of the plan or upon filing of the certificate of designation with the state, but rather upon the issuance of the dividend. The rights of the holders of the registered common stock are not materially limited or qualified until the issuance of, in this case, the preferred share purchase rights. The preferred share purchase rights are not issued until the dividend is declared and the rights are distributed. Although the registrant is not required to file an Item 3.03 Form 8-K until the issuance of the dividend, the registrant must file an Item 1.01 Form 8-K when it enters into the shareholder rights plan if the plan constitutes a material definitive agreement not made in the ordinary course of business. [April 2, 2008]

### **Section 214. Item 4.01 Changes in Registrant's Certifying Accountant**

**214.01** Item 4.01 of Form 8-K requires an issuer to report a change in its certifying accountant. The item also requires that the issuer request the former accountant to furnish a letter stating whether the former accountant agrees with the issuer's statements concerning the reasons for the change. Where the former accountant declines to provide such a letter, the issuer should indicate that fact in the Form 8-K. [April 2, 2008]

**214.02** Item 4.01 of Form 8-K requires a registrant to report changes in its certifying accountant. The company must file the report on a Form 8-K and must file any required amendments to the report on a Form 8-K/A. It is not sufficient to report the event in a periodic report. See Exchange Act Form 8-K [Question 101.01](#). [April 2, 2008]

### **Section 215. Item 4.02 Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review**

**215.01** Item 4.02 of Form 8-K requires an issuer to report a decision that its past financial statements should no longer be relied upon. The company must file the report on a Form 8-K and file any required amendments on a Form 8-K/A. It is not sufficient to report the event in a periodic report. See Exchange Act Form 8-K [Question 101.01](#). [April 2, 2008]

### **Section 216. Item 5.01 Changes in Control of Registrant**

None

### **Section 217. Item 5.02 Departure of Certain Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers**

**217.01** Item 5.02(a) of Form 8-K requires registrants to describe the circumstances of a director's resignation when he or she resigned "because of a disagreement with the registrant... on any matter related to the registrant's operations, policies or practices." A disagreement with the process chosen by the Chairman and other board members to address a director's alleged violation of a company's policy regarding unauthorized public disclosures and the board's related decision to ask the director to resign is a disagreement on matters "related to the registrant's operations, policies or practices." See [In the Matter of Hewlett Packard Company](#), Release 34-55801 (May 23, 2007). [April 2, 2008]

**217.02** When a principal financial officer temporarily turns his or her duties over to another person, a company must file a Form 8-K under Item 5.02(b) to report that the original principal financial officer has temporarily stepped down and under Item 5.02(c) to report that the replacement principal financial officer has been appointed. If the original principal financial officer returns to the position, then the company must file a Form 8-K under Item 5.02(b) to report the departure of the temporary principal financial officer and under Item 5.02(c) to report the "re-appointment" of the original principal financial officer. [April 2, 2008]

**217.03** A director who is designated by an issuer's majority shareholder gives notice that he will resign if the majority shareholder sells its entire holdings of issuer stock. This notice triggers an obligation to file an Item 5.02(b) Form 8-K, which should state clearly the nature of the contingency and the extent to which the resigning director can control occurrence of the contingency. [April 2, 2008]

**217.04** Item 5.02(b) of Form 8-K does not require a registrant to report the death of a director or listed officer. [April 2, 2008]

**217.05** If, pursuant to a contractual provision in a named executive officer's employment contract or otherwise, the registrant must notify the named executive officer of the termination of his or her employment a specified number of days prior to the date on which the named executive officer's employment would end, an Item 5.02(b) Form 8-K filing requirement is triggered on the date the registrant notifies the named executive officer of his or her termination, not on the date the named executive officer's employment actually ends. [April 2, 2008]

**217.06** A registrant appoints a new principal accounting officer, which triggers an Item 5.02(c) Form 8-K filing requirement. The registrant can decide to delay the filing of the Item 5.02(c) Form 8-K until it makes a public announcement of the appointment of the new principal accounting officer, pursuant to the Instruction to paragraph (c) of Item 5.02. The new principal accounting officer replaces the old principal accounting officer, who retired, resigned, or was terminated from that position. The retirement, resignation, or termination of the old principal accounting officer triggers an Item 5.02(b) Form 8-K filing requirement. The registrant may not delay the filing of the Item 5.02(b) Form 8-K until the filing of the Form 5.02(c) Form 8-K. Rather, the Item 5.02(b) Form 8-K filing obligation is triggered by the old principal accounting officer's notice of a decision to retire or resign or by the notice of termination, whether or not such notice is written. [April 2, 2008]

**217.07** A director was appointed by board vote and, at the same time, named to the audit committee. Both the appointment of the director to the board and the committee assignment were disclosed under Item 5.02(d) of Form 8-K. Three months later, the board rotates committee assignments, and the new director is moved from the audit committee to the compensation committee. No new Form 8-K or amendment to the Item 5.02(d) Form 8-K is required by Instruction 2 to Item 5.02 in this situation, provided that the change in committee assignment was not contemplated at the time of the director's initial election to the board and appointment to the audit committee. [April 2, 2008]

**217.08** In the past, a named executive officer entered into an employment agreement that will, pursuant to its terms, expire after two years. The employment agreement automatically extends for an additional two-year term, unless the registrant or the named executive officer affirmatively gives notice that it is not renewing the agreement. The automatic renewal of the employment agreement (*i.e.*, when the original two-year term of the employment agreement expires and neither party gives notice that it does not wish to renew the agreement) does not trigger an Item 5.02(e) Form 8-K filing requirement. [April 2, 2008]

**217.09** Foreign private issuers that satisfy the Item 402 of Regulation S-K disclosure requirement by providing compensation disclosure in accordance with Item 402(a)(1) should refer to Instruction 4 to Item 5.02 to determine who is a "named executive officer." The named executive officers will be those individuals for whom disclosure was provided in the last Securities Act or Exchange Act filing pursuant to Item 6.B or 6.E.2 of Form 20-F. [April 2, 2008]

#### **Section 218. Item 5.03 Amendments to Articles of Incorporation or Bylaws; Changes in Fiscal Year**

**218.01** Release No. 34-26589, which significantly amended Rule 15d-10, states that "[a] change from a fiscal year ending as of the last day of the month to a 52-53 week fiscal year commencing within seven days of the month end (or from a 52-53 week to a month end) is not deemed a change in fiscal year for purposes of reporting subject to Rule 13a-10 or 15d-10 if the new fiscal year commences with the end of the old fiscal year. In such cases, a transition report would not be required. Either the old or new fiscal year could, therefore, be as short as 359 days, or as long as 371 days (372 in a leap year)." While a transition report would not be required in such a situation, an Item 5.03(b) Form 8-K would have to be filed to report the change in fiscal year-end. [April 2, 2008]

#### **Section 219. Item 5.04 Temporary Suspension of Trading Under Registrant's Employee Benefit Plans**

None

#### **Section 220. Item 5.05 Amendments to the Registrant's Code of Ethics, or Waiver of a Provision of the Code of Ethics**

None

#### **Section 221. Item 5.06 Change in Shell Company Status**

None

**Section 222. Item 6.01 ABS Information and Computational Material**

None

**Section 223. Item 6.02 Change of Servicer or Trustee**

None

**Section 224. Item 6.03 Change in Credit Enhancement or Other External Support**

None

**Section 225. Item 6.04 Failure to Make a Required Distribution**

None

**Section 226. Item 6.05 Securities Act Updating Disclosure**

None

**Section 227. Item 7.01 Regulation FD Disclosure**

None

**Section 228. Item 8.01 Other Events**

None

**Section 229. Item 9.01 Financial Statements and Exhibits**

**229.01** Item 20.D. of Industry Guide 5 requires, *inter alia*, an undertaking to file every three months post-effective amendments containing financial statements of acquired properties. Even if the automatic 71-day extension of time to file the financial statements for an acquired property is applicable to a Form 8-K, this extension does *not* apply to the Guide 5 post-effective amendment. Accordingly, the post-effective amendment must be filed when required by Item 20 of Guide 5, and must contain the required financial statements. This is the same position as that taken before the Form 8-K extensions were made automatic. [April 2, 2008]

**229.02** During the pendency of a 71-day extension applicable to a Form 8-K, Securities Act offerings may not be made except as provided in the Instruction to Item 9.01 of Form 8-K. The Division staff has been asked whether this provision applies to real estate limited partnership offerings, thus prohibiting sales from being made until financial statements for properties acquired during the offering period have been filed (even when the quarterly post-effective amendment is not yet due). The amendment to Form 8-K was not intended to change the procedure established in Item 20.D. of Guide 5. Accordingly, when properties are acquired during the offering period, the registrant may continue sales activities notwithstanding

the pendency of an 8-K extension, so long as the quarterly post-effective amendments containing the financial statements are filed when required. [April 2, 2008]

**229.03** The Instruction to Item 9.01 of Form 8-K addresses the status of transactions in securities registered under the Securities Act and Rule 144 sales during the pendency of an extension, but does not address the status of such sales after a denial of a request for waiver of financial statements. This question will be dealt with on a case-by-case basis. [April 2, 2008]

**229.04** Item 17(b)(7) of Form S-4 states generally that the financial statements of acquired companies that were not previously Exchange Act reporting companies need be audited only to the extent practicable, unless the Form S-4 prospectus is to be used for resales by any person deemed an underwriter within the meaning of Rule 145(c), in which case such financial statements must be audited. The Division staff was asked whether a resale pursuant to Rule 145(d), in lieu of the Form S-4 prospectus, would require the financial statements to be audited. The Division staff noted that Rule 145(d) is not included in the Instruction to Item 9.01 of Form 8-K regarding sales pursuant to Rule 144 during the 71-day extension period for filing financial statements. As the audited financial statements for the acquired company would be required pursuant to Item 9.01 of Form 8-K, a resale pursuant to Rule 145(d) would not be permitted until they are filed. [April 2, 2008]

<http://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>

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## T. SMALLER REPORTING COMPANIES

On December 19, 2007, the SEC adopted amendments to its disclosure and reporting requirements to streamline and simplify disclosure requirements, including executive compensation disclosure requirements, for companies that qualify as smaller reporting companies.

The SEC has published Smaller Reporting Company Compliance & Disclosure Interpretations.

### Rules

The rules that define “smaller reporting company” are located in paragraph (f) of Item 10 of Regulation S-K, which reads as follows:

(f) *Smaller reporting companies.* The requirements of this part apply to smaller reporting companies. A smaller reporting company may comply with either the requirements applicable to smaller reporting companies or the requirements applicable to other companies for each item, unless the requirements for smaller reporting companies specify that smaller reporting companies must comply with the smaller reporting company requirements. The following items of this part set forth requirements for smaller reporting companies that are different from requirements applicable to other companies:

- (1) *Definition of smaller reporting company.* As used in this part, the term smaller reporting company means an issuer that is not an investment company, an asset-backed issuer (as defined in § 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:
  - (i) Had a public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or
  - (ii) In the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than \$75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares; or
  - (iii) In the case of an issuer whose public float as calculated under paragraph (i) or (ii) of this definition was zero, had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available.
- (2) *Determination:* Whether or not an issuer is a smaller reporting company is determined on an annual basis.

- (i) For issuers that are required to file reports under section 13(a) or 15(d) of the Exchange Act, the determination is based on whether the issuer came within the definition of smaller reporting company, using the amounts specified in paragraph (f)(2)(iii) of this Item, as of the last business day of the second fiscal quarter of the issuer's previous fiscal year. An issuer in this category must reflect this determination in the information it provides in its quarterly report on Form 10-Q for the first fiscal quarter of the next year, indicating on the cover page of that filing, and in subsequent filings for that fiscal year, whether or not it is a smaller reporting company, except that, if a determination based on public float indicates that the issuer is newly eligible to be a smaller reporting company, the issuer may choose to reflect this determination beginning with its first quarterly report on Form 10-Q following the determination, rather than waiting until the first fiscal quarter of the next year.
- (ii) For determinations based on an initial Securities Act or Exchange Act registration statement under paragraph (f)(1)(ii) of this Item, the issuer must reflect the determination in the information it provides in the registration statement and must appropriately indicate on the cover page of the filing, and subsequent filings for the fiscal year in which the filing is made, whether or not it is a smaller reporting company. The issuer must redetermine its status at the end of its second fiscal quarter and then reflect any change in status as provided in paragraph (f)(2)(i) of this Item. In the case of a determination based on an initial Securities Act registration statement, an issuer that was not determined to be a smaller reporting company has the option to redetermine its status at the conclusion of the offering covered by the registration statement based on the actual offering price and number of shares sold.
- (iii) Once an issuer fails to qualify for smaller reporting company status, it will remain unqualified unless it determines that its public float, as calculated in accordance with paragraph (f)(1) of this Item, was less than \$50 million as of the last business day of its second fiscal quarter or, if that calculation results in zero because the issuer had no public equity outstanding or no market price for its equity existed, if the issuers had annual revenues of less than \$40 million during its previous fiscal year.

The alternative executive compensation disclosure rules applicable to smaller reporting companies are located in paragraphs (l) through (r) of Item 402 of Regulation S-K which read as follows:

**Regulation S-K, Item 402 (Executive Compensation).**

(l) *Smaller reporting companies.* A registrant that qualifies as a “smaller reporting company,” as defined by Item 10(f) (§ 229.10(f)(1)), may provide the scaled disclosure in paragraphs (m) through (r) instead of paragraphs (a) through (k) and (s) of this Item.

(m) *Smaller reporting companies – General*

(1) *All compensation covered.* This Item requires clear, concise and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers designated under paragraph (m)(2) of this Item, and directors covered by paragraph (r) of this Item, by any person for all services rendered in all capacities to the smaller reporting company and its subsidiaries, unless otherwise specifically excluded from disclosure in this Item. All such compensation shall be reported pursuant to this Item, even if also called for by another requirement, including transactions between the smaller reporting company and a third party where a purpose of the transaction is to furnish compensation to any such named executive officer or director. No amount reported as compensation for one fiscal year need be reported in the same manner as compensation for a subsequent fiscal year; amounts reported as compensation for one fiscal year may be required to be reported in a different manner pursuant to this Item.

(2) *Persons covered.* Disclosure shall be provided pursuant to this Item for each of the following (the “named executive officers”):

- (i) All individuals serving as the smaller reporting company's principal executive officer or acting in a similar capacity during the last completed fiscal year (“PEO”), regardless of compensation level;
- (ii) The smaller reporting company's two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year; and
- (iii) Up to two additional individuals for whom disclosure would have been provided pursuant to paragraph (m)(2)(ii) of this Item but for the fact that the individual was not serving as an executive officer of the smaller reporting company at the end of the last completed fiscal year.

**Instructions to Item 402(m)(2).**

1. *Determination of most highly compensated executive officers.* The determination as to which executive officers are most highly compensated shall be made by reference to total compensation for the last completed fiscal year (as required to be disclosed pursuant to paragraph (n)(2)(x) of this Item) reduced by the amount required to be disclosed pursuant to paragraph (n)(2)(viii) of this Item, *provided, however*, that no disclosure need be provided for any executive officer, other than the PEO, whose total compensation, as so reduced, does not exceed \$100,000.

2. *Inclusion of executive officer of a subsidiary.* It may be appropriate for a smaller reporting company to include as named executive officers one or more executive officers or other employees of subsidiaries in the disclosure required by this Item. See Rule 3b-7 under the Exchange Act (17 CFR 240.3b-7).

3. *Exclusion of executive officer due to overseas compensation.* It may be appropriate in limited circumstances for a smaller reporting company not to include in the disclosure required by this Item an individual, other than its PEO, who is one of the smaller reporting company's most highly compensated executive officers due to the payment of amounts of cash compensation relating to overseas assignments attributed predominantly to such assignments.

(3) *Information for full fiscal year.* If the PEO served in that capacity during any part of a fiscal year with respect to which information is required, information should be provided as to all of his or her compensation for the full fiscal year. If a named executive officer (other than the PEO) served as an executive officer of the smaller reporting company (whether or not in the same position) during any part of the fiscal year with respect to which information is required, information shall be provided as to all compensation of that individual for the full fiscal year.

(4) *Omission of table or column.* A table or column may be omitted if there has been no compensation awarded to, earned by, or paid to any of the named executive officers or directors required to be reported in that table or column in any fiscal year covered by that table.

(5) *Definitions.* For purposes of this Item:

(i) The term *stock* means instruments such as common stock, restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or any similar instruments that do not have option-like features, and the term *option* means instruments such as stock options, stock appreciation rights and similar instruments with option-like features. The term *stock appreciation rights* (“SARs”) refers to SARs payable in cash or stock, including SARs payable in cash or stock at the election of the smaller reporting company or a named executive officer. The term *equity* is used to refer generally to stock and/or options.

(ii) The term *plan* includes, but is not limited to, the following: Any plan, contract, authorization or arrangement, whether or not set forth in any formal document, pursuant to which cash, securities, similar instruments, or any other property may be received. A plan may be applicable to one person. Except with respect to disclosure required by paragraph (t) of this Item, smaller reporting companies may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the smaller reporting company and that are available generally to all salaried employees.

(iii) The term *incentive plan* means any plan providing compensation intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the smaller reporting company or an

affiliate, the smaller reporting company's stock price, or any other performance measure. An equity incentive plan is an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, as modified or supplemented ("FASB ASC 718"). A *non-equity incentive plan* is an incentive plan or portion of an incentive plan that is not an equity incentive plan. The term *incentive plan award* means an award provided under an incentive plan.

- (iv) The terms *date of grant* or *grant date* refer to the grant date determined for financial statement reporting purposes pursuant to FASB ASC 718.
- (v) *Closing market price* is defined as the price at which the smaller reporting company's security was last sold in the principal United States market for such security as of the date for which the closing market price is determined.

(n) *Smaller reporting companies - Summary compensation table.* (1) *General.* Provide the information specified in paragraph (n)(2) of this Item, concerning the compensation of the named executive officers for each of the smaller reporting company's last two completed fiscal years, in a Summary Compensation Table in the tabular format specified below:

**SUMMARY COMPENSATION TABLE**

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Nonequity Incentive Plan Compensation	Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
A									
B									

(2) The Table shall include:

- (i) The name and principal position of the named executive officer (column (a));
- (ii) The fiscal year covered (column (b));
- (iii) The dollar value of base salary (cash and non-cash) earned by the named executive officer during the fiscal year covered (column (c));

- (iv) The dollar value of bonus (cash and non-cash) earned by the named executive officer during the fiscal year covered (column (d));

**Instructions to Item 402(n)(2)(iii) and (iv).**

1. If the amount of salary or bonus earned in a given fiscal year is not calculable through the latest practicable date, a footnote shall be included disclosing that the amount of salary or bonus is not calculable through the latest practicable date and providing the date that the amount of salary or bonus is expected to be determined, and such amount must then be disclosed in a filing under Item 5.02(f) of Form 8-K (17 CFR 249.308).

2. Smaller reporting companies shall include in the salary column (column (c)) or bonus column (column (d)) any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based or other forms of non-cash compensation instead have been received by the named executive officer. However, the receipt of any such form of non-cash compensation instead of salary or bonus must be disclosed in a footnote added to the salary or bonus column and, where applicable, referring to the narrative disclosure to the Summary Compensation Table (required by paragraph (o) of this Item) where the material terms of the stock, option or non-equity incentive plan award elected by the named executive officer are reported.

- (v) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (e));
- (vi) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (f));

**Instruction 1 to Item 402(n)(2)(v) and (vi).**

For awards reported in columns (e) and (f), include a footnote disclosing all assumptions made in the valuation by reference to a discussion of those assumptions in the smaller reporting company's financial statements, footnotes to the financial statements, or discussion in the Management's Discussion and Analysis. The sections so referenced are deemed part of the disclosure provided pursuant to this Item.

**Instruction 2 to Item 402(n)(2)(v) and (vi).**

If at any time during the last completed fiscal year, the smaller reporting company has adjusted or amended the exercise price of options or SARs previously awarded to a named executive officer, whether through amendment, cancellation or replacement grants, or any other means ("repriced"), or otherwise has materially modified such awards, the smaller reporting company shall include, as awards required to be reported in column (f), the incremental fair value, computed as of the repricing or modification date in accordance with FASB ASC Topic 718, with respect to that repriced or modified award.

**Instruction 3 to Item 402(n)(2)(v) and (vi).**

For any awards that are subject to performance conditions, report the value at the grant date based upon the probable outcome of such conditions. This amount should be consistent with the estimate of aggregate compensation cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures. In a footnote to the table, disclose the value of the award at the grant date assuming that the highest level of performance conditions will be achieved if an amount less than the maximum was included in the table.

- (vii) The dollar value of all earnings for services performed during the fiscal year pursuant to awards under non-equity incentive plans as defined in paragraph (m)(5)(iii) of this Item, and all earnings on any outstanding awards (column (g));

**Instructions to Item 402(n)(2)(vii).**

1. If the relevant performance measure is satisfied during the fiscal year (including for a single year in a plan with a multi-year performance measure), the earnings are reportable for that fiscal year, even if not payable until a later date, and are not reportable again in the fiscal year when amounts are paid to the named executive officer.

2. All earnings on non-equity incentive plan compensation must be identified and quantified in a footnote to column (g), whether the earnings were paid during the fiscal year, payable during the period but deferred at the election of the named executive officer, or payable by their terms at a later date.

- (viii) Above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans (column (h))

**Instruction to Item 402(n)(2)(viii).**

Interest on deferred compensation is above-market only if the rate of interest exceeds 120% of the applicable federal long-term rate, with compounding (as prescribed under section 1274(d) of the Internal Revenue Code, (26 U.S.C. 1274(d))) at the rate that corresponds most closely to the rate under the smaller reporting company's plan at the time the interest rate or formula is set. In the event of a discretionary reset of the interest rate, the requisite calculation must be made on the basis of the interest rate at the time of such reset, rather than when originally established. Only the above-market portion of the interest must be included. If the applicable interest rates vary depending upon conditions such as a minimum period of continued service, the reported amount should be calculated assuming satisfaction of all conditions to receiving interest at the highest rate. Dividends (and dividend equivalents) on deferred compensation denominated in the smaller reporting company's stock ("deferred stock") are preferential only if earned at a rate higher than dividends on the smaller reporting company's common stock. Only the preferential portion of the dividends or equivalents must be included. Footnote or narrative disclosure may be provided explaining the smaller reporting company's criteria for determining any portion considered to be above-market.

- (ix) All other compensation for the covered fiscal year that the smaller reporting company could not properly report in any other column of the Summary Compensation Table (column (i)). Each compensation item that is not properly reportable in columns (c) through (h), regardless of the amount of the compensation item, must be included in column (i). Such compensation must include, but is not limited to:
- (A) Perquisites and other personal benefits, or property, unless the aggregate amount of such compensation is less than \$10,000;
  - (B) All “gross-ups” or other amounts reimbursed during the fiscal year for the payment of taxes;
  - (C) For any security of the smaller reporting company or its subsidiaries purchased from the smaller reporting company or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally, either to all security holders or to all salaried employees of the smaller reporting company, the compensation cost, if any, computed in accordance with FASB ASC 718;
  - (D) The amount paid or accrued to any named executive officer pursuant to a plan or arrangement in connection with:
    - (1) Any termination, including without limitation through retirement, resignation, severance or constructive termination (including a change in responsibilities) of such executive officer's employment with the smaller reporting company and its subsidiaries; or
    - (2) A change in control of the smaller reporting company;
  - (E) Smaller reporting company contributions or other allocations to vested and unvested defined contribution plans;
  - (F) The dollar value of any insurance premiums paid by, or on behalf of, the smaller reporting company during the covered fiscal year with respect to life insurance for the benefit of a named executive officer; and
  - (G) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (e) or (f); and

**Instructions to Item 402(n)(2)(ix).**

1. Non-equity incentive plan awards and earnings and earnings on stock or options, except as specified in paragraph (n)(2)(ix)(G) of this Item, are required to be reported elsewhere as provided in this Item and are not reportable as All Other Compensation in column (i).

2. Benefits paid pursuant to defined benefit and actuarial plans are not reportable as All Other Compensation in column (i) unless accelerated pursuant to a change in control; information concerning these plans is reportable pursuant to paragraph (q)(1) of this Item.

3. Reimbursements of taxes owed with respect to perquisites or other personal benefits must be included in the columns as tax reimbursements (paragraph (n)(2)(ix)(B) of this Item) even if the associated perquisites or other personal benefits are not required to be included because the aggregate amount of such compensation is less than \$10,000.

4. Perquisites and other personal benefits shall be valued on the basis of the aggregate incremental cost to the smaller reporting company.

5. For purposes of paragraph (n)(2)(ix)(D) of this Item, an accrued amount is an amount for which payment has become due.

- (x) The dollar value of total compensation for the covered fiscal year (column (j)). With respect to each named executive officer, disclose the sum of all amounts reported in columns (c) through (i).

#### **Instructions to Item 402(n).**

1. Information with respect to the fiscal year prior to the last completed fiscal year will not be required if the smaller reporting company was not a reporting company pursuant to section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) at any time during that year, except that the smaller reporting company will be required to provide information for any such year if that information previously was required to be provided in response to a Commission filing requirement.

2. All compensation values reported in the Summary Compensation Table must be reported in dollars and rounded to the nearest dollar. Reported compensation values must be reported numerically, providing a single numerical value for each grid in the table. Where compensation was paid to or received by a named executive officer in a different currency, a footnote must be provided to identify that currency and describe the rate and methodology used to convert the payment amounts to dollars.

3. If a named executive officer is also a director who receives compensation for his or her services as a director, reflect that compensation in the Summary Compensation Table and provide a footnote identifying and itemizing such compensation and amounts. Use the categories in the Director Compensation Table required pursuant to paragraph (r) of this Item.

4. Any amounts deferred, whether pursuant to a plan established under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), or otherwise, shall be included in the appropriate column for the fiscal year in which earned.

#### **Instruction to Item 402.**

Specify the applicable fiscal year in the title to each table required under this item which calls for disclosure as of or for a completed fiscal year.

(o) *Smaller reporting companies - Narrative disclosure to summary compensation table.* Provide a narrative description of any material factors necessary to an understanding of the information disclosed in the Table required by paragraph (n) of this Item. Examples of such factors may include, in given cases, among other things:

- (1) The material terms of each named executive officer's employment agreement or arrangement, whether written or unwritten;
- (2) If at any time during the last fiscal year, any outstanding option or other equity-based award was repriced or otherwise materially modified (such as by extension of exercise periods, the change of vesting or forfeiture conditions, the change or elimination of applicable performance criteria, or the change of the bases upon which returns are determined), a description of each such repricing or other material modification;
- (3) The waiver or modification of any specified performance target, goal or condition to payout with respect to any amount included in non-stock incentive plan compensation or payouts reported in column (g) to the Summary Compensation Table required by paragraph (n) of this Item, stating whether the waiver or modification applied to one or more specified named executive officers or to all compensation subject to the target, goal or condition;
- (4) The material terms of each grant, including but not limited to the date of exercisability, any conditions to exercisability, any tandem feature, any reload feature, any tax-reimbursement feature, and any provision that could cause the exercise price to be lowered;
- (5) The material terms of any non-equity incentive plan award made to a named executive officer during the last completed fiscal year, including a general description of the formula or criteria to be applied in determining the amounts payable and vesting schedule;
- (6) The method of calculating earnings on nonqualified deferred compensation plans including nonqualified defined contribution plans; and
- (7) An identification to the extent material of any item included under All Other Compensation (column (i)) in the Summary Compensation Table. Identification of an item shall not be considered material if it does not exceed the greater of \$25,000 or 10% of all items included in the specified category in question set forth in paragraph (n)(2)(ix) of this Item. All items of compensation are required to be included in the Summary Compensation Table without regard to whether such items are required to be identified.

**Instruction to Item 402(o).** The disclosure required by paragraph (o)(2) of this Item would not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.

(p) *Smaller reporting companies - Outstanding equity awards at fiscal year-end table.*

- (1) Provide the information specified in paragraph (p)(2) of this Item, concerning unexercised options; stock that has not vested; and equity incentive plan awards for each named executive officer outstanding as of the end of the smaller reporting company's last completed fiscal year in the following tabular format:

**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 Unearned 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 Unearned Shares, Units or Other Rights That Have Not Vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
A									
B									

(2) The Table shall include:

- (i) The name of the named executive officer (column (a));
- (ii) On an award-by-award basis, the number of securities underlying unexercised options, including awards that have been transferred other than for value, that are exercisable and that are not reported in column (d) (column (b));
- (iii) On an award-by-award basis, the number of securities underlying unexercised options, including awards that have been transferred other than for value, that are unexercisable and that are not reported in column (d) (column (c));
- (iv) On an award-by-award basis, the total number of shares underlying unexercised options awarded under any equity incentive plan that have not been earned (column (d));

- (v) For each instrument reported in columns (b), (c) and (d), as applicable, the exercise or base price (column (e));
- (vi) For each instrument reported in columns (b), (c) and (d), as applicable, the expiration date (column (f));
- (vii) The total number of shares of stock that have not vested and that are not reported in column (i) (column (g));
- (viii) The aggregate market value of shares of stock that have not vested and that are not reported in column (j) (column (h));
- (ix) The total number of shares of stock, units or other rights awarded under any equity incentive plan that have not vested and that have not been earned, and, if applicable the number of shares underlying any such unit or right (column (i)); and
- (x) The aggregate market or payout value of shares of stock, units or other rights awarded under any equity incentive plan that have not vested and that have not been earned (column (j)).

**Instructions to Item 402(p)(2).**

1. Identify by footnote any award that has been transferred other than for value, disclosing the nature of the transfer.
2. The vesting dates of options, shares of stock and equity incentive plan awards held at fiscal-year end must be disclosed by footnote to the applicable column where the outstanding award is reported.
3. Compute the market value of stock reported in column (h) and equity incentive plan awards of stock reported in column (j) by multiplying the closing market price of the smaller reporting company's stock at the end of the last completed fiscal year by the number of shares or units of stock or the amount of equity incentive plan awards, respectively. The number of shares or units reported in column (d) or (i), and the payout value reported in column (j), shall be based on achieving threshold performance goals, except that if the previous fiscal year's performance has exceeded the threshold, the disclosure shall be based on the next higher performance measure (target or maximum) that exceeds the previous fiscal year's performance. If the award provides only for a single estimated payout, that amount should be reported. If the target amount is not determinable, smaller reporting companies must provide a representative amount based on the previous fiscal year's performance.
4. Multiple awards may be aggregated where the expiration date and the exercise and/or base price of the instruments is identical. A single award consisting of a combination of options, SARs and/or similar option-like instruments shall be reported as separate awards with respect to each tranche with a different exercise and/or base price or expiration date.
5. Options or stock awarded under an equity incentive plan are reported in columns (d) or (i) and (j), respectively, until the relevant performance condition has been satisfied. Once the relevant

performance condition has been satisfied, even if the option or stock award is subject to forfeiture conditions, options are reported in column (b) or (c), as appropriate, until they are exercised or expire, or stock is reported in columns (g) and (h) until it vests.

(q) *Smaller reporting companies - Additional narrative disclosure.* Provide a narrative description of the following to the extent material:

- (1) The material terms of each plan that provides for the payment of retirement benefits, or benefits that will be paid primarily following retirement, including but not limited to tax-qualified defined benefit plans, supplemental executive retirement plans, tax-qualified defined contribution plans and nonqualified defined contribution plans.
- (2) The material terms of each contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) to a named executive officer at, following, or in connection with the resignation, retirement or other termination of a named executive officer, or a change in control of the smaller reporting company or a change in the named executive officer's responsibilities following a change in control, with respect to each named executive officer.

(r) *Smaller reporting companies - Compensation of directors.*

- (1) Provide the information specified in paragraph (r)(2) of this Item, concerning the compensation of the directors for the smaller reporting company's last completed fiscal year, in the following tabular format:

**DIRECTOR COMPENSATION**

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

- (2) The Table shall include:

- (i) The name of each director unless such director is also a named executive officer under paragraph (m) of this Item and his or her compensation for service as a director is fully reflected in the Summary Compensation Table pursuant to paragraph (n) of this Item and otherwise as required pursuant to paragraphs (o) through (q) of this Item (column (a));
- (ii) The aggregate dollar amount of all fees earned or paid in cash for services as a director, including annual retainer fees, committee and/or chairmanship fees, and meeting fees (column (b));
- (iii) For awards of stock, the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (c));
- (iv) For awards of options, with or without tandem SARs (including awards that subsequently have been transferred), the aggregate grant date fair value computed in accordance with FASB ASC Topic 718 (column (d));

**Instruction to Item 402(r)(2)(iii) and (iv).** For each director, disclose by footnote to the appropriate column, the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year end.

- (v) The dollar value of all earnings for services performed during the fiscal year pursuant to non-equity incentive plans as defined in paragraph (m)(5)(iii) of this Item, and all earnings on any outstanding awards (column (e));
- (vi) Above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified defined contribution plans (column (f));
- (vii) All other compensation for the covered fiscal year that the smaller reporting company could not properly report in any other column of the Director Compensation Table (column (g)). Each compensation item that is not properly reportable in columns (b) through (f), regardless of the amount of the compensation item, must be included in column (g) and must be identified and quantified in a footnote if it is deemed material in accordance with paragraph (o)(7) of this Item. Such compensation must include, but is not limited to:
  - (A) Perquisites and other personal benefits, or property, unless the aggregate amount of such compensation is less than \$10,000;
  - (B) All “gross-ups” or other amounts reimbursed during the fiscal year for the payment of taxes;
  - (C) For any security of the smaller reporting company or its subsidiaries purchased from the smaller reporting company or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally, either to all security holders or to all salaried employees of the

smaller reporting company, the compensation cost, if any, computed in accordance with FASB ASC 718;

- (D) The amount paid or accrued to any director pursuant to a plan or arrangement in connection with:
  - (1) The resignation, retirement or any other termination of such director;  
or
  - (2) A change in control of the smaller reporting company;
- (E) Smaller reporting company contributions or other allocations to vested and unvested defined contribution plans;
- (F) Consulting fees earned from, or paid or payable by the smaller reporting company and/or its subsidiaries (including joint ventures);
- (G) The annual costs of payments and promises of payments pursuant to director legacy programs and similar charitable award programs;
- (H) The dollar value of any insurance premiums paid by, or on behalf of, the smaller reporting company during the covered fiscal year with respect to life insurance for the benefit of a director; and
- (I) The dollar value of any dividends or other earnings paid on stock or option awards, when those amounts were not factored into the grant date fair value required to be reported for the stock or option award in column (c) or (d); and

**Instruction to Item 402(r)(2)(vii).** Programs in which smaller reporting companies agree to make donations to one or more charitable institutions in a director's name, payable by the smaller reporting company currently or upon a designated event, such as the retirement or death of the director, are charitable awards programs or director legacy programs for purposes of the disclosure required by paragraph (r)(2)(vii)(G) of this Item. Provide footnote disclosure of the total dollar amount payable under the program and other material terms of each such program for which tabular disclosure is provided.

- (viii) The dollar value of total compensation for the covered fiscal year (column (h)). With respect to each director, disclose the sum of all amounts reported in columns (b) through (g).

**Instruction to Item 402(r)(2).** Two or more directors may be grouped in a single row in the Table if all elements of their compensation are identical. The names of the directors for whom disclosure is presented on a group basis should be clear from the Table.

- (3) *Narrative to director compensation table.* Provide a narrative description of any material factors necessary to an understanding of the director compensation disclosed in this Table. While material factors will vary depending upon the facts, examples of such factors may include, in given cases, among other things:

- (i) A description of standard compensation arrangements (such as fees for retainer, committee service, service as chairman of the board or a committee, and meeting attendance); and
- (ii) Whether any director has a different compensation arrangement, identifying that director and describing the terms of that arrangement.

**Instruction to Item 402(r).** In addition to the Instruction to paragraph (r)(2)(vii) of this Item, the following apply equally to paragraph (r) of this Item: Instructions 2 and 4 to paragraph (n) of this Item; the Instructions to paragraphs (n)(2)(iii) and (iv) of this Item; the Instructions to paragraphs (n)(2)(v) and (vi) of this Item; the Instructions to paragraph (n)(2)(vii) of this Item; the Instruction to paragraph (n)(2)(viii) of this Item; the Instructions to paragraph (n)(2)(ix) of this Item; and paragraph (o)(7) of this Item. These Instructions apply to the columns in the Director Compensation Table that are analogous to the columns in the Summary Compensation Table to which they refer and to disclosures under paragraph (r) of this Item that correspond to analogous disclosures provided for in paragraph (n) of this Item to which they refer.

## Adopting Release and Interpretive Guidance

An electronic copy of the adopting release for the amendments to the smaller reporting company rules can be found at <http://www.sec.gov/rules/final/2007/33-8876.pdf>.

A copy of the SEC's Smaller Reporting Company Compliance & Disclosure Interpretations dated March 5, 2008 is located at [Appendix T-I](#).

## Practice Pointers

### Smaller Reporting Company Determination

- See [Appendix T-1](#), *Smaller Reporting Company Compliance & Disclosure Interpretations* for interpretative guidance on how smaller reporting company status is determined.
- See also [Appendix B-III](#), *SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Questions 102.01 to 102.04*.

### Compensation Committee Interlocks Disclosures and Compensation Committee Report

- Smaller reporting companies are not required to make the Compensation Committee Interlocks and Insider Participation disclosures or prepare a Compensation Committee Report.
  - See [Part Q](#), *Compensation Committee Disclosures and Compensation Committee Report*.

### Related Person Transaction Disclosures

- Smaller reporting companies are required to provide the related person transaction disclosures called for by paragraph (d) of Item 404.
  - Note, unlike Item 404(a) which only covers the last fiscal year, Item 404(d) covers the prior two fiscal years.
  - See [Part O](#), *Related Person Transactions*.

### All Compensation Covered

- Other than a few very narrowly defined exceptions specifically discussed in the adopting release (e.g., perquisites for a named executive officer below \$10,000 in total value and benefits under non-discriminatory group life, health, hospitalization and medical reimbursement plans), the Summary Compensation Table is required to disclose all elements of compensation.
  - See John W. White, *Principles Matter*, Address at the Practising Law Institute Conference (September 6, 2006), a copy of which is located at [Appendix B-VI](#).
  - See [Part B](#), *The Rules*.

## **Report Salary or Bonus Not Determined as of Proxy Statement Date on Form 8-K**

- If a named executive officer's salary or bonus was not determinable when the registrant filed its proxy statement (or Form 10-K), when such officer's salary or bonus becomes determinable the registrant must file a Form 8-K disclosing under Item 5.02(e) the amount awarded as salary or bonus.
  - *See Part S. Amendments to Form 8-K.*

## **Report Deferred Compensation**

- Compensation that is earned during a fiscal year is reportable in the Summary Compensation Table for the year earned, even if deferred.

## **Do Not Report Compensation for Years Prior to NEO Status**

- If a named executive officer was not a named executive officer in a prior fiscal year, compensation information for such prior fiscal year is not required to be included in the Summary Compensation Table.
  - *See Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.01.*

## **Distinction Between Bonus and Non-Equity Incentive Plan Compensation**

- The Summary Compensation Table distinguishes between bonus (reported in column (d)) and non-equity incentive plan compensation (reported in column (g)). In general, annual cash awards that are based on the achievement of pre-determined performance goals must now be reported in the Summary Compensation Table as non-equity incentive plan compensation for the year earned and in the Grants of Plan Based Awards table as of the date of grant. Guaranteed or discretionary cash bonuses must be reported in the bonus column of the Summary Compensation Table for the year earned.
  - *See adopting release (excerpted above) for a discussion of how to distinguish between a bonus and a non-equity incentive plan award.*
  - *See also Part D. Definitions.*

## **Distinction Between Stock Awards and Option Awards**

- The Summary Compensation Table distinguishes between stock awards (reported in column (e)) and option awards (reported in column (f)).
  - *See Part D. Definitions.*

## **Report Stock and Option Awards in Dollars Based on Grant Date Fair Value**

- The rule changes adopted by the SEC in December 2009 (the “Amendments”) changed the way compensation related to stock options, restricted stock and other equity grants is reported in the Summary Compensation Table. Equity awards must now be reflected in the year awarded based on their full aggregate grant date fair value computed in accordance with FASB Accounting Standards Codification Topic 718 (“FASB ASC 718”), rather than based on the expense attributable to them in the applicable fiscal year.
  - Also, the Amendments require that the value of performance-based awards be based on the “probable outcome of such conditions(s).” Footnote disclosure is required to show the value of the performance-based award assuming that the highest level of performance will be achieved if an amount less than the maximum was included in the table.
  - This new manner of disclosure applies to all disclosures made after December 20, 2009 and will be required for awards made in prior years. That is, amounts in the Summary Compensation Table will need to be recomputed for prior years, but the recomputations are for informational purposes only and do not require the company to change the individuals reported as its named executive officers for any preceding year or amend any earlier filing.
  - The grant date fair value amounts included in the Summary Compensation Table will also appear, on a grant-by-grant basis, in the Grant of Plan Based Awards table.
  - Amounts are included in the Summary Compensation Table in the year of grant, even if the equity award was part of annual compensation awarded for performance in the year prior to grant (a common practice at many companies). The timing of reporting grant date values for equity awards thus differs from cash incentive awards, which are reported for the year earned, even if the award is not determined until the following year (as is typical). Consequently, the Summary Compensation Table may not accurately reflect compensation decisions made for the year. For example, if a large cash incentive award and equity award are granted in early 2009 based on 2008 performance, the cash award will appear in the 2008 row of the Summary Compensation Table but the grant date fair value of the equity award will be included in the 2009 row. In this case, supplemental disclosure in the CD&A should be considered.

## **Reporting Equity Taken in Lieu of Salary or Bonus**

- Generally companies are to include in the Salary column or the Bonus column any amount of salary or bonus forgone at the election of a named executive officer under which stock, equity-based, or other forms of non-cash compensation have been received instead by the named executive officer. Any stock, option or other non-cash award accepted in lieu of salary or bonus should be reported in the Grants of Plan-Based Awards Table and the Summary Compensation Table should include footnote disclosure regarding the receipt of non-cash compensation in lieu of salary or bonus that refers to the Grants of Plan-Based Awards Table where the award is reported.
- However, if the amount of salary or bonus foregone at the election of the named executive officer was less than the value of the equity-based compensation received, the incremental

value of an equity award would be reported in the Stock Awards or Option Awards columns. If the agreement pursuant to which the named executive officer had the option to elect settlement in stock or equity-based compensation was within the scope of FASB ASC 718 (e.g., the right to stock settlement is embedded in the terms of the award) the award would be reported in the Stock Awards or Option Awards columns.

- See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.03.*

### **Earnings on Equity Awards**

- The right to receive dividends or other earnings on equity awards is generally factored into the grant date fair value of the awards computed under FASB ASC 718, and therefore included in the FASB ASC 718 expense. As a result, in most circumstances, dividends or other earnings on equity awards are not required to be reported in the Summary Compensation Table. However, in cases where the right to receive dividends is not factored into the grant date fair value of an equity award, any earnings on such award must be reported in the All Other Compensation column of the Summary Compensation Table.

### **Use of Supplemental Table to Report Elements of “All Other Compensation”**

- If the “All Other Compensation” provided to the executive officers is comprised of a number of different items, companies may want to disclose the items in a separate table accompanying the Summary Compensation Table.
  - See *Appendix M-I. Sample Table Disclosing Components of All Other Compensation.*
  - See also *Part R. Plain English Requirement.*

### **Disclosure of Accrued Severance**

- The amount accrued to a named executive officer in connection with termination of such executive officer’s employment or a change in control is reportable in the “All Other Compensation” column. An amount is accrued, and thus reportable, if the named executive officer’s performance necessary to earn the amount is complete.
  - For example, if the named executive officer has completed all performance to earn an amount, but payment is subject to a six-month deferral in order to comply with Internal Revenue Code Section 409A, the amount would be an accrued amount required to be disclosed.
  - In contrast, if an amount will be payable two years after termination if the named executive officer cooperates with (or complies with a covenant not to compete with) the company during that period, the amount is not reportable because the executive officer’s performance is still necessary for the payment to become due.
  - See *Appendix B-III. SEC Compliance & Disclosure Interpretations Regarding Regulation S-K, Question 119.13.*

## **Perquisites**

- For information regarding the disclosure of perquisites and personal benefits in the Summary Compensation Table, *see Part G Perquisites.*

## **Narrative Disclosure**

- Per Item 402(o) of Regulation S-K, the Summary Compensation Table and Grants of Plan-Based Awards tables are required to be accompanied by a narrative discussion describing any material factors necessary to an understanding of the information disclosed in the table. Examples would include a discussion of:
  - the material terms of employment agreements; and
  - the material terms of equity and non-equity incentive plan awards, including a description of the vesting schedules and formulas for determining the amounts payable.
    - As with CD&A, performance targets are not required to be disclosed if such targets qualify for non-disclosure under the SEC’s existing standards for confidential treatment requests. For additional information *see Part E. Compensation Discussion and Analysis, “Potential Disclosure of Performance Targets.”*
- In addition, companies should consider explaining the amount of salary and bonus paid to named executive officers in proportion to total compensation if other items of compensation significantly influenced the determination of the named executive officers salary and bonus.
- As discussed in the adopting release, to avoid “double counting” in light of the fact that some items disclosed in the Summary Compensation Table are also disclosed in other required tables, companies should use the narrative following the tables to explain how disclosures relate to each other in their particular circumstances.

## **Outstanding Equity Awards at Fiscal Year-End Table**

- For practice pointers regarding the Outstanding Equity Awards at Fiscal Year-End Table, *see Part I. Outstanding Equity Awards at Fiscal Year-End Table.*

## **Director Compensation Table**

- For practice pointers regarding the Director Compensation Table, *see Part N. Director Compensation Table.*

**APPENDIX T-I**

***Smaller Reporting Company Compliance & Disclosure  
Interpretations (March 5, 2008)***



## Smaller Reporting Company<sup>1</sup> Compliance and Disclosure Interpretations

1. Do all current reporting companies have an opportunity to determine if they qualify for treatment as a smaller reporting company applying the \$75 million public float test as of the end of the second quarter in the fiscal year next ending after December 15, 2007, or the alternative \$50 million annual revenue test for companies that cannot calculate their public float?

Yes. All reporting companies as of the effective date of the new rules can determine if they qualify for smaller reporting company status based on the \$75 million in public float or \$50 million in annual revenue test in paragraphs (i) and (iii) of new Item 10(f)(1) of Regulation S-K. The language in paragraph (iii) of new Item 10(f)(2) of Regulation S-K, requiring companies to have a public float below \$50 million or revenues below \$40 million to qualify for smaller reporting company status "[o]nce an issuer fails to qualify" for that status, will not apply in determining smaller reporting company status in the first year after the effective date of the new rules, because this is the initial determination as to smaller reporting company status for all current reporting companies. No issuer previously will have failed to qualify for smaller reporting company status within the meaning of paragraph (iii) of Item 10(f)(2).

2. Could a company with a fiscal year ended December 31, 2007 be both a smaller reporting company and an accelerated filer for 2008 if it was an accelerated filer with respect to filings due in 2007 and had a public float of \$60 million on the last business day of its second fiscal quarter of 2007?

Yes. A company must look to the definitions of "smaller reporting company" and "accelerated filer" in Rule 12b-2 under the Exchange Act to determine if it qualifies as a smaller reporting company and non-accelerated filer for each year. This company will qualify as a smaller reporting company for filings in 2008, because fiscal year 2007 is the initial determination year for the company to qualify for smaller reporting company status, and it had less than \$75 million in public float on the last business day of its second fiscal quarter.<sup>2</sup> Since the company first determined it was an accelerated filer in an earlier year, however, it is required to have less than \$50 million in public float on the last business day of its second fiscal quarter in 2007 to exit accelerated filer status in 2008, as provided in paragraph (3)(ii) of the definition of "accelerated filer" in Rule 12b-2. This company had a public float of \$60 million on the last business day of its second fiscal quarter of 2007, and therefore is unable to transition to non-accelerated filer status. As this example illustrates, due to the application of the transition rules for accelerated filers, a company can be both an accelerated filer and a smaller reporting company simultaneously. Such a company may use the scaled disclosure rules for smaller reporting companies in its annual report on Form 10-K, but the report is due 75 days after the end of the its fiscal year and must include the Sarbanes-Oxley Section 404 auditor attestation report described in Item 308(b) of Regulation S-K.

3. Will a company that does not qualify as a smaller reporting company this year be able to qualify as a smaller reporting company if its public float falls below \$75 million at the end of its second fiscal quarter in a future fiscal year?

Any reporting company that can calculate its public float and did not qualify as a smaller reporting company previously will not qualify as a smaller reporting company in the future unless its public float falls below \$50 million as of the last business day of its second fiscal quarter. This is provided for in Item 10(f)(2)(iii) of Regulation S-K and follows the rule for exiting accelerated filer status. Companies that cannot calculate their public float would need to fall below \$40 million in annual revenue to qualify as smaller reporting companies in the future.

4. The version of the adopting release on smaller reporting company regulatory relief and simplification currently posted on the Commission's Web site states on page 24 that the Commission added Item 407(g) to Regulation S-K to provide that smaller reporting companies are not "required to provide an Audit Committee [Financial Expert]\* Report until the first annual report after their initial registration statement is filed with the Commission and becomes effective." An asterisked footnote indicates that the bracketed language was inadvertently omitted from the release when initially published. The initial version of the release indicated that smaller reporting companies are not required to provide an audit committee report under the circumstances described. Are smaller reporting companies required to provide an audit committee report?

Yes. All smaller reporting companies are required to provide the audit committee report required by Item 407(d)(3) of Regulation S-K. The text of Item 407(g) referred to in the release does not discuss the audit committee report. It states, among other things, that smaller reporting companies are not required to provide the audit committee financial expert disclosure required in paragraph (d)(5) of Item 407 until their first annual report after their initial registration statement under the Securities Act or Exchange Act becomes effective. The omission of the words "Financial Expert" from the original version of the release was inadvertent.

5. Do the new disclosure requirements available to smaller reporting companies apply to the Schedule 14A disclosure requirements that refer registrants to specific paragraphs of items in Regulation S-K?

Yes. Where any schedule or form, including Schedule 14A, refers a registrant to a disclosure item or a specific paragraph of a disclosure item found in Regulation S-K (17 CFR §§ 229.10-229.1123) and the registrant meets the definition of "smaller reporting company" under Rule 405 of the Securities Act or Rule 12b-2 of the Exchange Act, whichever is applicable to the filing, the registrant may use the disclosure requirements available to smaller reporting companies under that item. These requirements usually may be found in a separate paragraph of the Regulation S-K item entitled "Smaller reporting companies." If the requirements for smaller reporting companies in an item specify that smaller reporting companies *must* comply with the smaller reporting company requirements, the smaller reporting company must comply. For example, a registrant that is a smaller reporting company must furnish the disclosure required by Item 404(d)(1) of Regulation S-K, rather than merely the disclosure required by Item 404(a), even though Item 7(b) of Schedule 14A refers to Item 404(a) only. Item 404(d)(1) specifies that smaller reporting companies must provide

certain information in order to comply with Item 404(a).

6. Is a smaller reporting company required to describe its policies and procedures for review, approval or ratification of transactions with related persons as specified by Item 404(b) of Regulation S-K if a schedule or form being used for a filing requires the company to furnish the information required by Item 404(b)?

No. Smaller reporting companies are not required to furnish Item 404(b) disclosure in these circumstances. Smaller reporting companies comply with the requirements of Item 404 by furnishing the information called for by Item 404(d) of Regulation S-K, the paragraph of Item 404 labeled "Smaller reporting companies," which does not require Item 404(b) disclosure.

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<sup>1</sup> The SEC adopted its smaller reporting company rules in Release 33-8876 (Dec. 19, 2007) [73 FR 934].

<sup>2</sup> This assumes that the company was not an investment company, asset-backed issuer, or majority-owned subsidiary of a parent that is not a smaller reporting company, none of which are eligible to be a smaller reporting company.

<http://www.sec.gov/info/smallbus/src-cdinterps.htm>

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Modified: 03/05/2008

## U. RISK DISCLOSURE

On December 16, 2009, the SEC adopted amendments to its executive compensation and corporate governance disclosure requirements which among other things require a new narrative disclosure that describes how a company's overall compensation policies and practices create incentives that affect the company's risk and management of risk.

### Rules

The rule that requires disclosure regarding how a company's overall compensation policies and practices create incentives that affect the company's risk and management of risk is located in paragraph (s) of Regulation S-K which reads as follows:

(s) *Narrative disclosure of the registrant's compensation policies and practices as they relate to the registrant's risk management.* To the extent that risks arising from the registrant's compensation policies and practices for its employees are reasonably likely to have a material adverse effect on the registrant, discuss the registrant's policies and practices of compensating its employees, including non-executive officers, as they relate to risk management practices and risk-taking incentives. While the situations requiring disclosure will vary depending on the particular registrant and compensation policies and practices, situations that may trigger disclosure include, among others, compensation policies and practices: at a business unit of the company that carries a significant portion of the registrant's risk profile; at a business unit with compensation structured significantly differently than other units within the registrant; at a business unit that is significantly more profitable than others within the registrant; at a business unit where compensation expense is a significant percentage of the unit's revenues; and that vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the registrant from the task extend over a significantly longer period of time. The purpose of this paragraph (s) is to provide investors material information concerning how the registrant compensates and incentivizes its employees that may create risks that are reasonably likely to have a material adverse effect on the registrant. While the information to be disclosed pursuant to this paragraph (s) will vary depending upon the nature of the registrant's business and the compensation approach, the following are examples of the issues that the registrant may need to address for the business units or employees discussed:

- (1) The general design philosophy of the registrant's compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by employees on behalf of the registrant, and the manner of their implementation;
- (2) The registrant's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation;
- (3) How the registrant's compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;

- (4) The registrant's policies regarding adjustments to its compensation policies and practices to address changes in its risk profile;
- (5) Material adjustments the registrant has made to its compensation policies and practices as a result of changes in its risk profile; and
- (6) The extent to which the registrant monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.

## Adopting Release Excerpts

- A copy of the release adopting the December 2009 changes is located at Appendix B-V.
  - An electronic copy of the December 2009 release can be found at <http://www.sec.gov/rules/final/2009/33-9089.pdf>

Excerpts from the adopting release include:

- The final rule requires a company to address its compensation policies and practices for all employees, including non-executive officers, if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company. As noted above, the proposed rules would have required discussion and analysis of compensation policies if risks arising from those compensation policies “may have a material effect on the company.” We agree with the suggestions of several commenters that the new requirements should have a “reasonably likely” disclosure threshold. Companies are familiar with the “reasonably likely” disclosure threshold used in our Management Discussion and Analysis (“MD&A”) rules, and this approach would parallel the MD&A requirement, which requires risk-oriented disclosure of known trends and uncertainties that are material to the business. We believe that the “reasonably likely” threshold also addresses concerns of some commenters that the proposed requirements might have caused companies attempting compliance to burden shareholders and investors with voluminous disclosure of potentially insignificant and unnecessarily speculative information about their compensation policies. By focusing on risks that are “reasonably likely to have a material adverse effect” on the company, the amendments are intended to elicit disclosure about incentives in the company’s compensation policies and practices that would be most relevant to investors. This change from the proposal also addresses concerns some commenters raised that the proposal did not allow companies to consider compensating or offsetting steps or controls designed to limit risks of certain compensation arrangements. If a company has compensation policies and practices for different groups that mitigate or balance incentives, these could be considered in deciding whether risks arising from the company’s compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company as a whole.
- In addition, we have modified the proposal to provide that disclosure is only required if the compensation policies and practices are reasonably likely to have a material “adverse” effect on the company, as opposed to any “material effect” as proposed. As noted in the Proposing Release, well-designed compensation policies can enhance a company’s business interests by encouraging innovation and appropriate levels of risk-taking. By focusing the disclosure on material adverse effects, the final rule should help avoid voluminous and unnecessary discussion of compensation arrangements that may mitigate inappropriate risk-taking incentives.
- We are also moving the new requirements into a separate paragraph in Item 402 of Regulation S-K. As adopted, the new disclosure requirements will not be a part of the CD&A. We were persuaded by commenters who asserted that it would be potentially confusing to expand the CD&A beyond the named executive officers to include disclosure of the company’s broader compensation policies and practices for employees. CD&A provides discussion and analysis

of the compensation of the named executive officers and the information contained in the Summary Compensation Table and other required tables, and the new disclosure requirements would be inconsistent with that approach because they would cover all employees, not just the named executive officers.

- We are adopting, as proposed, the illustrative examples of the issues that would potentially be appropriate for a company to address. As we stated in the Proposing Release, the examples are non-exclusive and that the application of an example should be tailored to the facts and circumstances of the company. We believe that a principles-based approach, similar to our CD&A requirements, utilizing illustrative examples strikes an appropriate balance that will effectively elicit meaningful disclosure. If a company determines that disclosure is required, we believe examples of the issues that companies may need to address regarding their compensation policies or practices include the following:
  - The general design philosophy of the company’s compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by those employees on behalf of the company, and the manner of their implementation;
  - The company’s risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation;
  - How the company’s compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring claw backs or imposing holding periods;
  - The company’s policies regarding adjustments to its compensation policies and practices to address changes in its risk profile;
  - Material adjustments the company has made to its compensation policies and practices as a result of changes in its risk profile; and
  - The extent to which the company monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.

In the Proposing Release, we requested comment on whether we should require a company to affirmatively state that it has determined that the risks arising from its compensation policies are not reasonably expected to have a material effect on the company if it has concluded that disclosure was not required. Commenters were mixed in their response to this request. Several commenters believed that companies should be required to affirmatively state that they have determined that the risks arising from their broader compensation policies are not reasonably expected to have a material effect. Others believed that the proposed amendments should not require an affirmative statement because it would not provide investors with useful information and would create potential liability for companies. Another commenter noted that our disclosure rules have not traditionally required companies to address affirmatively matters that the company has determined are not applicable to it. We believe an approach consistent with our prior practice is appropriate and the final rule does not require a company to make an affirmative statement that

it has determined that the risks arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company.

## Practice Pointers

### All Employees Covered

- Unlike almost all other compensation disclosure rules which apply only to executives and directors, the rule requiring discussion of the extent to which compensation creates incentives to expose the company to risks will apply to all employees.
  - While some companies may already have considered risk with respect to certain aspects of their incentive compensation arrangements for named executive officers, it is likely that few companies have addressed risk throughout their compensation arrangements. Consequently, compliance will likely require a comprehensive risk analysis of a company's compensation structure throughout its entire organization.

### Disclosure Only Required if Risks are Reasonably Likely to Have Material Adverse Effect

- Disclosure is only required if compensation policies and practices are reasonably likely to have a “material adverse effect” on the company.
  - A company is not required to include an affirmative statement that it has determined that the risk arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company.
- Nevertheless, to head off a comment from the SEC staff issuers that have concluded that no material adverse risk arising from compensation policies and practices exists should consider so stating in the proxy statement and describing the process that the company went through to make this determination.

### Separate Disclosure; Not Contained in CD&A

- To avoid confusion with the discussion of named executive officer compensation risk disclosure, if required, will not be included in the Compensation Discussion and Analysis but rather as a separate stand-alone disclosure within the compensation disclosures.
- *See Appendix B-III. SEC Compliance & Disclosure Interpretations regarding Regulation S-K, Section 128A* which states:
  - The new rules do not specify where the disclosure should be presented. However, to ease investor understanding, the staff recommends that Item 402(s) disclosure be presented together with the registrant's other Item 402 disclosure. The staff would have concerns if the Item 402(s) disclosure is difficult to locate or is presented in a fashion that obscures it.

### Smaller Reporting Companies Not Subject to Disclosure Requirement

- Smaller reporting companies are not subject to the risk disclosure requirement.

## V. SAY-ON-PAY

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted. The Dodd-Frank Act amended the Securities Exchange Act of 1934 to add a requirement that issuers conduct an advisory say-on-pay vote at least once every three years. On January 25, 2011, the SEC adopted rules implementing the Dodd-Frank Act's say-on-pay requirements.

Note: The Dodd-Frank Act also added a requirement to conduct a shareholder vote covering executive compensation arrangements involved in certain significant transactions (commonly referred to as "golden parachute" compensation). Discussion about this requirement is beyond the scope of this guidebook.

### Rules

The say-on-pay requirement for the annual meeting is contained in paragraphs (a) and (c) of Section 14A of the Exchange Act, paragraphs (a) and (b) of Rule 14a-21 and Item 24 of Schedule 14A which read as follows:

#### **Section 14A. Shareholder Approval Of Executive Compensation.**

(a) *Separate Resolution Required.*

- (1) In general. Not less frequently than once every 3 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the compensation of executives, as disclosed pursuant to section 229.402 of title 17, Code of Federal Regulations, or any successor thereto.
- (2) Frequency of vote. Not less frequently than once every 6 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to determine whether votes on the resolutions required under paragraph (1) will occur every 1, 2, or 3 years.
- (3) Effective date. The proxy or consent or authorization for the first annual or other meeting of the shareholders occurring after the end of the 6-month period beginning on the date of enactment of this section shall include:
  - (A) the resolution described in paragraph (1); and
  - (B) a separate resolution subject to shareholder vote to determine whether votes on the resolutions required under paragraph (1) will occur every 1, 2, or 3 years.

(b) [Omitted]

(c) *Rule of Construction.* The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed:

- (1) as overruling a decision by such issuer or board of directors;
- (2) to create or imply any change to the fiduciary duties of such issuer or board of directors;
- (3) to create or imply any additional fiduciary duties for such issuer or board of directors; or
- (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.

**§240.14a-21 Shareholder approval of executive compensation, frequency of votes for approval of executive compensation and shareholder approval of golden parachute compensation.**

(a) If a solicitation is made by a registrant and the solicitation relates to an annual or other meeting of shareholders at which directors will be elected and for which the rules of the Commission require executive compensation disclosure pursuant to Item 402 of Regulation S-K (§229.402 of this chapter), the registrant shall, for the first annual or other meeting of shareholders on or after January 21, 2011, or for the first annual or other meeting of shareholders on or after January 21, 2013 if the registrant is a smaller reporting company, and thereafter no later than the annual or other meeting of shareholders held in the third calendar year after the immediately preceding vote under this subsection, include a separate resolution subject to shareholder advisory vote to approve the compensation of its named executive officers, as disclosed pursuant to Item 402 of Regulation S-K.

**Instruction to §240.14a-21(a):**

The registrant's resolution shall indicate that the shareholder advisory vote under this subsection is to approve the compensation of the registrant's named executive officers as disclosed pursuant to Item 402 of Regulation S-K (§229.402 of this chapter). The following is a non-exclusive example of a resolution that would satisfy the requirements of this subsection: "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED."

(b) If a solicitation is made by a registrant and the solicitation relates to an annual or other meeting of shareholders at which directors will be elected and for which the rules of the Commission require executive compensation disclosure pursuant to Item 402 of Regulation S-K (§229.402 of this chapter), the registrant shall, for the first annual or other meeting of shareholders on or after January 21, 2011, or for the first annual or other meeting of shareholders on or after January 21, 2013 if the registrant is a smaller reporting company, and thereafter no later than the annual or other meeting of shareholders held in the sixth calendar year after the immediately preceding vote under this subsection, include a separate resolution subject to shareholder advisory vote as to whether the shareholder vote required by paragraph (a) of this section should occur every 1, 2 or 3 years. Registrants required to provide a separate shareholder vote pursuant to §240.14a-20 of this chapter shall include the separate resolution

required by this section for the first annual or other meeting of shareholders after the registrant has repaid all obligations arising from financial assistance provided under the TARP, as defined in section 3(8) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5202(8)), and thereafter no later than the annual or other meeting of shareholders held in the sixth calendar year after the immediately preceding vote under this subsection.

**Instructions to §240.14a-21:**

1. Disclosure relating to the compensation of directors required by Item 402(k) (§229.402(k) of this chapter) and Item 402(r) of Regulation S-K (§229.402(r) of this chapter) is not subject to the shareholder vote required by paragraph (a) of this section. If a registrant includes disclosure pursuant to Item 402(s) of Regulation S-K (§229.402(s) of this chapter) about the registrant's compensation policies and practices as they relate to risk management and risk-taking incentives, these policies and practices would not be subject to the shareholder vote required by paragraph (a) of this section. To the extent that risk considerations are a material aspect of the registrant's compensation policies or decisions for named executive officers, the registrant is required to discuss them as part of its Compensation Discussion and Analysis under §229.402(b) of this chapter, and therefore such disclosure would be considered by shareholders when voting on executive compensation.
2. If a registrant includes disclosure of golden parachute compensation arrangements pursuant to Item 402(t) (§229.402(t) of this chapter) in an annual meeting proxy statement, such disclosure would be subject to the shareholder advisory vote required by paragraph (a) of this section.
3. Registrants that are smaller reporting companies entitled to provide scaled disclosure in accordance with Item 402(l) of Regulation S-K (§229.402(l) of this chapter) are not required to include a Compensation Discussion and Analysis in their proxy statements in order to comply with this section. For smaller reporting companies, the vote required by paragraph (a) of this section must be to approve the compensation of the named executive officers as disclosed pursuant to Item 402(m) through (q) of Regulation S-K (§229.402(m) through (q) of this chapter).

**§240.14a-101 Schedule 14A. Information required in proxy statement.**

*Item 24. Shareholder Approval of Executive Compensation.* Registrants required to provide any of the separate shareholder votes pursuant to §240.14a-21 of this chapter shall disclose that they are providing each such vote as required pursuant to section 14A of the Securities Exchange Act (15 U.S.C. 78n-1), briefly explain the general effect of each vote, such as whether each such vote is non-binding, and, when applicable, disclose the current frequency of shareholder advisory votes on executive compensation required by Rule 14a- 21(a) and when the next such shareholder advisory vote will occur.

## Adopting Release Excerpts

- A copy of the release adopting the say-on-pay rules is located at Appendix V-I.
  - An electronic copy of the adopting release can be found at <http://www.sec.gov/rules/final/2011/33-9178.pdf>.

Excerpts from the adopting release include:

- Though we have considered the views of commentators that prescribed language would be helpful, the final rule does not require issuers to use any specific language or form of resolution to be voted on by shareholders. This is consistent with the approach taken by the Commission in adopting Rule 14a-20 to implement the shareholder advisory vote on executive compensation for companies subject to the Emergency Economic Stabilization Act of 2008, or EESA. We believe that issuers should retain flexibility to craft the resolution language. As we noted in the Proposing Release, however, the shareholder advisory vote must relate to all executive compensation disclosed pursuant to Item 402 of Regulation S-K. Section 14A(a)(1) of the Exchange Act requires that the shareholder advisory vote must be “to approve the compensation of executives, as disclosed pursuant to [Item 402 of Regulation S-K] or any successor thereto.” We have added an instruction to Rule 14a-21(a) to indicate that this language from Section 14A(a)(1) should be included in an issuer’s resolution for the say-on-pay vote and to provide a non-exclusive example of a resolution that would satisfy the applicable requirements. A vote to approve a proposal on a different subject matter, such as a vote to approve only compensation policies and procedures, would not satisfy the requirement of Section 14A(a)(1) or final Rule 14a-21(a). We note that issuers are not limited to the required shareholder advisory vote under Rule 14a-21(a) and may solicit shareholder votes on a range of compensation matters to obtain more specific feedback on the issuer’s compensation policies and programs.
- In accordance with Section 14A(a)(1), shareholders would vote to approve the compensation of the issuer’s named executive officers, as such compensation is disclosed pursuant to Item 402 of Regulation S-K, including the CD&A, the compensation tables and other narrative executive compensation disclosures required by Item 402. We have included an instruction to Rule 14a-21 to specify that Rule 14a-21 does not change the scaled disclosure requirements for smaller reporting companies and that smaller reporting companies will not be required to provide a CD&A in order to comply with Rule 14a-21. We understand that smaller reporting companies may wish to include supplemental disclosure to facilitate shareholder understanding of their compensation arrangements in connection with say-on-pay votes. We do not believe, however, that this possibility supports exempting smaller reporting companies from the say-on-pay votes. As more fully discussed in Section II.E below, in order to ease compliance burdens for smaller reporting companies, we are adopting a two-year temporary exemption before these companies are required to conduct a shareholder advisory vote to approve executive compensation to permit these companies additional time to prepare for the new shareholder advisory votes.
- The final rule amends Item 402(b)(1) to require issuers to address in CD&A whether and, if so, how their compensation policies and decisions have taken into account the results of the

most recent shareholder advisory vote on executive compensation. Although it is not mandated by Section 951 of the Act, we continue to believe that including this mandatory topic in CD&A will facilitate better investor understanding of issuers' compensation decisions. Because the shareholder advisory vote will apply to all issuers, we view information about how issuers have responded to such votes as more in the nature of a mandatory principles-based topic than an example. The manner in which individual issuers may respond to such votes in determining executive compensation policies and decisions will likely vary depending upon facts and circumstances. We expect that this variation will be reflected in the CD&A disclosures.

- Following consideration of the comments received, we have decided to limit the mandatory topic to whether, and if so, how the issuer has considered the results of the most recent say-on-pay vote in determining compensation policies and decisions, and if so, how that consideration has affected the issuer's executive compensation policies and decisions. This modification reflects that, in making voting and investment decisions, shareholders will benefit from understanding what consideration the issuer has given to the most recent say-on-pay vote. Limiting the mandatory topic to the most recent shareholder vote should also focus the disclosure so there should not be lengthy boilerplate discussions of all previous votes. Although we have added issuer consideration of the most recent say-on-pay vote to the mandatory topics, we believe that, consistent with the principles-based nature of CD&A, issuers should address their consideration of the results of earlier say-on-pay votes to the extent such consideration is material to the compensation policies and decisions discussed.
- Smaller reporting companies are subject to scaled disclosure requirements in Item 402 of Regulation S-K and are not required to include a CD&A. We are not adding a specific requirement for smaller reporting companies to provide disclosure about how previous votes pursuant to Section 14A affected compensation policies and decisions because we believe such information would not be as valuable outside the context of a complete CD&A covering the full range of matters required to be addressed by Item 402(b). However, we note that pursuant to Item 402(o) of Regulation S-K, 102 smaller reporting companies are required to provide a narrative description of any material factors necessary to an understanding of the information disclosed in the Summary Compensation Table. If consideration of prior say-on-pay votes is such a factor for a particular issuer, disclosure would be required pursuant to Item 402(o).

## Practice Pointers

### Vote Required for Approval

- The rules do not specify particular voting thresholds that must be reached to determine the outcome of the say-on-pay or say-on-frequency proposal.
  - Consistent with typical issuer bylaws, many issuers state in the proxy statement that the say-on-pay proposal will be approved if a majority of votes cast are cast in favor of the proposal.
  - Similarly, although it is possible that none of the three choices (every year, every two years or every three years) receives majority approval, many issuers state in the proxy statement

that only a choice that is approved by a majority of votes cast will be deemed the recommendation of the shareholders on the advisory vote regarding the frequency of future say-on-pay votes (although regardless whether any of the choices received majority support presumably the Board of Directors would take into account the different levels of support received by the various choices in determining the frequency of future say-on-pay votes).

- In light of the fact that for 2011 and 2012 the average level of support for the say-on-pay proposal was just over 90%, issuers typically seek a level of support significantly exceeding 50%.
  - Institutional Shareholder Services (ISS) has stated that if the company's say-on-pay vote received less than 70% of stockholder support, ISS will closely scrutinize the company's responsiveness to stockholder concerns, and depending on that review potentially recommend voting against compensation committee members and the company's next say-on-pay vote and/or compensation committee members. Glass Lewis, another major proxy advisory firm, triggers heightened scrutiny if there is less than 75% support..

### **Consequences of Failed Say-on-Pay Vote**

- The rules mandate that the say-on-pay vote is non-binding but for many reasons a failed say-on-pay vote is an outcome no issuer wants to face. Harmful impacts include:
  - Given that in the first two years shareholders overwhelmingly approved their company's say-on-pay proposals, companies with failed say-on-pay votes stand out in a negative and high profile way.
  - Since a failed say-on-pay vote signals that investors are dissatisfied with compensation decisions for senior management, issuers that do not receive support for their say-on-pay proposal should reach out to investors to determine what caused the negative outcome and then consider whether to take any actions (e.g. modifying governance practices, compensation arrangements or related disclosures) to address investors' concerns.
  - Companies with negative say-on-pay outcomes will receive greater scrutiny from proxy advisory firms.
  - As discussed below, companies that receive failed say-on-pay votes may face greater risk of say-on-pay lawsuits.

### **Say-on-Pay Lawsuits**

- A number of companies with failed say-on-pay votes during 2011 and 2012 have been sued. In general, these actions allege that the company's proxy statement was false and misleading because, notwithstanding the company's assertion that it pays for performance, the company paid excessive compensation as evidenced by the failed say-on-pay vote. These lawsuits generally should be meritless because the Dodd-Frank Act, which added the say-on-pay vote requirement, expressly states that the existence of the say-on-pay vote requirement does not "create or imply any additional fiduciary duties" for the board of directors of a company. As

long as compensation committees act in good faith following a reasonable review process, courts should not be able to second-guess their compensation decisions. Nevertheless, companies with failed say-on-pay votes continue to be in the firing line for these lawsuits, possibly having implications not only for the company itself but also its officers and directors.

- In 2012 an additional wave of lawsuits was initiated under which the plaintiff sought to enjoin the company from proceeding with the annual meeting and shareholder approval on the say-on-pay proposal (or proposals seeking an increase in shares available under equity incentive plans) until the company publicly filed supplemental disclosures. Clearly the intent of these lawsuits is to extract a settlement under which the company agrees to provide additional disclosures and the plaintiff's attorneys receive legal fees. Although plaintiffs in these cases may not ultimately have much success getting courts to issue the requested injunctions, in at least a few cases the issuers have agreed to settlements. The advent of these lawsuits puts even more of a premium on the need for good compensation disclosures (and especially Compensation, Discussion & Analysis) in the proxy statement for the annual meeting, although in some cases these suits have been filed in the face of what otherwise appears to be good disclosures.

### **Form 8-K Disclosure Requirement Regarding Say-on-Frequency Determination**

- The say-on-pay rules included a revision to Form 8-K under which issuers are required to disclose the company's decision in light of the outcome of the say-on-frequency vote as to how frequently the company will conduct the say-on-pay vote.
  - *See Part S – Amendments to Form 8-K.*

### **Smaller Reporting Companies**

- Smaller reporting companies are subject to the say-on-pay rules. However, smaller reporting companies are not required to provide Compensation, Discussion and Analysis in the proxy statement. Accordingly, an instruction to Rule 14a-21 specifies that for smaller reporting companies the say-on-pay proposal pertains to the compensation of the named executive officers as disclosed pursuant to Item 402(m) through (q) of Regulation S-K (which excludes the Compensation, Discussion and Analysis disclosure requirement contained in Item 402(b)). Nevertheless, to maximize the level of shareholder support received for the say-on-pay proposal, smaller reporting companies should be sure to provide thorough compensation disclosures in the annual proxy statement which in some cases may go beyond what is strictly required by the disclosure requirements for smaller reporting companies.

**APPENDIX V-I**

*January 2011 SEC Release adopting Say-on-Pay Rules*

**SECURITIES AND EXCHANGE  
COMMISSION****17 CFR Parts 229, 240 and 249**

[Release Nos. 33-9178; 34-63768; File No. S7-31-10]

RIN 3235-AK68

**Shareholder Approval of Executive  
Compensation and Golden Parachute  
Compensation****AGENCY:** Securities and Exchange  
Commission.**ACTION:** Final rule.

**SUMMARY:** We are adopting amendments to our rules to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to shareholder approval of executive compensation and “golden parachute” compensation arrangements. Section 951 of the Dodd-Frank Act amends the Securities Exchange Act of 1934 by adding Section 14A, which requires companies to conduct a separate shareholder advisory vote to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K or any successor to Item 402. Section 14A also requires companies to conduct a separate shareholder advisory vote to determine how often an issuer will conduct a shareholder advisory vote on executive compensation. In addition, Section 14A requires companies soliciting votes to approve merger or acquisition transactions to provide disclosure of certain “golden parachute” compensation arrangements and, in certain circumstances, to conduct a separate shareholder advisory vote to approve the golden parachute compensation arrangements.

**DATES:** *Effective Date:* April 4, 2011.

*Compliance Date:* April 4, 2011, except that issuers must comply with Exchange Act Section 14A(b) and Rule 14a-21(c) and the amendments to Item 5 of Schedule 14A, Item 3 of Schedule 14C, Item 1011 of Regulation M-A, Item 11 of Schedule TO, Item 15 of Schedule 13E-3, and Item 8 of Schedule 14D-9 for initial preliminary proxy and information statements, Schedules TO, 13E-3, and 14D-9 and Forms S-4 and F-4 filed on or after April 25, 2011.

Companies that qualify as “smaller reporting companies” (as defined in 17 CFR 240.12b-2) as of January 21, 2011, including newly public companies that qualify as smaller reporting companies after January 21, 2011, will not be subject to Exchange Act Section 14A(a) and Rule 14a-21(a) and (b) until the first annual or other meeting of shareholders

at which directors will be elected and for which the rules of the Commission require executive compensation disclosure pursuant to Item 402 of Regulation S-K (17 CFR 229.402) occurring on or after January 21, 2013.

**FOR FURTHER INFORMATION CONTACT:**

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**SUPPLEMENTARY INFORMATION:** We are adopting new Rule 14a-21 and amendments to Rules 14a-4,<sup>1</sup> 14a-6,<sup>2</sup> 14a-8<sup>3</sup> and a new Item 24 and amendments to Item 5 of Schedule 14A<sup>4</sup> and amendments to Item 3 of Schedule 14C<sup>5</sup> under the Securities Exchange Act of 1934 (“Exchange Act”).<sup>6</sup> We are also adopting amendments to Item 402<sup>7</sup> of Regulation S-K,<sup>8</sup> Item 1011<sup>9</sup> of Regulation M-A,<sup>10</sup> Item 15 of Schedule 13E-3,<sup>11</sup> Item 8 of Schedule 14D-9,<sup>12</sup> Item 11 of Schedule TO,<sup>13</sup> and amendments to Item 5.07 of Form 8-K.<sup>14</sup>

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## I. Background and Summary

On October 18, 2010, we proposed a number of amendments to our rules relating to the shareholder approval of executive compensation and golden parachute compensation.<sup>15</sup> We proposed these rules to implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”).<sup>16</sup> As discussed in detail below, we have taken into consideration the comments received on the proposed amendments and are adopting several amendments to our rules.<sup>17</sup>

The Act amends the Exchange Act by adding new Section 14A. New Section 14A(a)(1) requires that “[n]ot less frequently than once every 3 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the

compensation of executives,”<sup>18</sup> as disclosed pursuant to Item 402 of Regulation S-K, or any successor to Item 402 (a “say-on-pay vote”). The shareholder vote to approve executive compensation required by Section 14A(a)(1) “shall not be binding on the issuer or the board of directors of an issuer.”<sup>19</sup>

Section 951 of the Act also adds new Section 14A(a)(2) to the Exchange Act, requiring that, “[n]ot less frequently than once every 6 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to determine whether [the say-on-pay vote] will occur every 1, 2, or 3 years.”<sup>20</sup> As discussed below, this shareholder vote “shall not be binding on the issuer or the board of directors of an issuer.”<sup>21</sup>

In addition, Section 951 of the Act amends the Exchange Act by adding new Section 14A(b)(1), which requires that, in any proxy or consent solicitation material for a meeting of shareholders “at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of an issuer, the person making such solicitation shall disclose in the proxy or consent solicitation material, in a clear and simple form in accordance with regulations to be promulgated by the Commission, any agreements or understandings that such person has with any named executive officers of such issuer (or of the acquiring issuer, if such issuer is not the acquiring issuer) concerning any type of

compensation (whether present, deferred, or contingent) that is based on or otherwise relates to the acquisition, merger, consolidation, sale or other disposition of all or substantially all of the assets of the issuer[\* \* \*].”<sup>22</sup> These compensation arrangements are often referred to as “golden parachute” compensation. Such disclosure must include the aggregate total of all such compensation that may be paid or become payable to or on behalf of such named executive officer, and the conditions upon which it may be paid or become payable.<sup>23</sup> Under Section 14A(b)(2), “unless such agreements or understandings have been subject to [the periodic shareholder vote described in Section 14A(a)(1)],”<sup>24</sup> a separate shareholder vote to approve such agreements or understandings and compensation as disclosed is also required.<sup>25</sup> As with the say-on-pay vote and the shareholder vote on the frequency of such votes, this shareholder vote “shall not be binding on the issuer or the board of directors of an issuer.”<sup>26</sup>

In addition to their non-binding status, none of the shareholder votes required pursuant to Section 14A is to be construed “as overruling a decision by such issuer or board of directors.”<sup>27</sup> These shareholder votes also do not “create or imply any change to the fiduciary duties of such issuer or board of directors”<sup>28</sup> nor do they “create or imply any additional fiduciary duties for such issuer or board of directors.”<sup>29</sup> Further, these votes will not be construed “to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.”<sup>30</sup> Section 14A also provides that “the Commission may, by rule or order, exempt an issuer or class of issuers” from the shareholder

<sup>18</sup> Exchange Act Section 14A(a)(1). Section 951 of the Act includes the language “or other meeting of the shareholders,” which is similar to corresponding language in Section 111(e)(1) of the Emergency Economic Stabilization Act of 2008, or EESA, 12 U.S.C. 5221. As noted in the Proposing Release, we have previously considered this language in connection with companies required to provide a separate shareholder vote on executive compensation so long as the company has outstanding obligations under the Troubled Asset Relief Program, or TARP. See *Shareholder Approval of Executive Compensation of TARP Recipients*, Release No. 34–61335 (Jan. 12, 2010) [75 FR 2789] (hereinafter, the “TARP Adopting Release”). We continue to view this provision to require a separate shareholder vote on executive compensation only with respect to an annual meeting of shareholders for which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting. Similarly, Rules 14a–21(a) and (b) are intended to result in issuers conducting the required advisory votes in connection with the election of directors, the proxy materials for which are required to include disclosure of executive compensation.

<sup>19</sup> Exchange Act Section 14A(c).

<sup>20</sup> Exchange Act Section 14A(a)(2).

<sup>21</sup> Exchange Act Section 14A(c).

<sup>22</sup> Exchange Act Section 14A(b)(1).

<sup>23</sup> Exchange Act Section 14A(b)(1).

<sup>24</sup> Exchange Act Section 14A(b)(2).

<sup>25</sup> Exchange Act Section 14A(b)(2).

<sup>26</sup> Exchange Act Section 14A(c).

<sup>27</sup> Exchange Act Section 14A(c)(1).

<sup>28</sup> Exchange Act Section 14A(c)(2).

<sup>29</sup> Exchange Act Section 14A(c)(3).

<sup>30</sup> Exchange Act Section 14A(c)(4). In addition, Exchange Act Section 14A(d) provides that every institutional manager subject to Exchange Act Section 13(f) [15 U.S.C. 78m(f)] shall report at least annually how it voted on any shareholder vote required by Section 951 of the Act, including the shareholder vote on executive compensation, the shareholder vote on the frequency of shareholder votes on executive compensation, and the golden parachute compensation vote, unless such vote is otherwise required to be reported publicly by rule or regulation of the Commission. Amendments to our rules to implement this requirement were proposed in a separate rulemaking. See *Reporting of Proxy Votes on Executive Compensation and Other Matters*, Release No. 34–63123 (Oct. 18, 2010) [75 FR 66622].

<sup>15</sup> See Release No. 33–9153 (October 18, 2010) [75 FR 66590] (the “Proposing Release”).

<sup>16</sup> Public Law 111–203 (July 21, 2010).

<sup>17</sup> The public comments we received on the Proposing Release are available on our Web site at <http://www.sec.gov/comments/s7-31-10/s73110.shtml>. In addition, to facilitate public input on the Act, the Commission provided a series of e-mail links, organized by topic, on its Web site at <http://www.sec.gov/spotlight/regreformcomments.shtml>. The public comments we received on Section 951 of the Act are available on our Web site at <http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml>.

advisory votes required by Section 14A.<sup>31</sup> In determining whether to make an exemption, the Commission is directed to take into account, among other considerations, whether the requirements of Section 14A(a) and (b) disproportionately burden small issuers.<sup>32</sup>

Section 14A(a)(3) requires that both the initial shareholder vote on executive compensation and the initial vote on the frequency of votes on executive compensation be included in proxy statements “for the first annual or other meeting of the shareholders occurring after the end of the 6-month period beginning on the date of enactment” of the Act.<sup>33</sup> Thus, the statute requires separate resolutions subject to shareholder vote to approve executive compensation and to approve the frequency of say-on-pay votes for proxy statements relating to an issuer’s first annual or other meeting of the shareholders occurring on or after January 21, 2011, whether or not the Commission has adopted rules to implement Section 14A(a). Because Section 14A(a) applies to shareholder meetings taking place on or after January 21, 2011, any proxy statement that is required to include executive compensation disclosure pursuant to Item 402 of Regulation S–K, whether in preliminary or definitive form, even if filed prior to this date, for meetings taking place on or after January 21, 2011, must include the separate resolutions for shareholders to approve executive compensation and the frequency of say-on-pay votes required by Section 14A(a) without regard to whether the amendments in this release are in effect by that time.<sup>34</sup>

With respect to the disclosure of golden parachute arrangements in accordance with Commission regulations in merger proxy statements required by Section 14A(b)(1), we note that the statute similarly references a 6-month period beginning on the date of enactment of the Act. However, because the statute requires such disclosure to be “in accordance with regulations to be promulgated by the Commission,”<sup>35</sup> the golden parachute compensation arrangements disclosure under proposed new Item 402(t) and a separate resolution to approve golden parachute compensation arrangements pursuant to Rule 14a–21(c) will not be required for merger proxy statements relating to a

meeting of shareholders until the effective date of our rules implementing Section 14A(b)(1). The rule amendments we adopt today with respect to new Rule 14a–21(c) and the amendments to the disclosure requirements in Item 5 of Schedule 14A, Item 3 of Schedule 14C, Item 1011 of Regulation M–A, Item 11 of Schedule TO, Item 15 of Schedule 13E–3, and Item 8 of Schedule 14D–9, are effective for initial filings on or after April 25, 2011.

We received over 60 comment letters in response to the proposed amendments. In addition, we received over a dozen letters relating to Section 951 of the Act.<sup>36</sup> These letters came from corporations, pension funds, professional associations, trade unions, law firms, consultants, academics, individual investors, and other interested parties. In general, the commentators supported the proposed amendments that would implement Section 951 of the Act. Some commentators, however, opposed some of the proposed amendments and suggested modifications or alternatives to the proposals.

We have reviewed and considered all of the comments that we received relating to the proposed amendments. The adopted rules reflect changes made in response to many of these comments. We discuss our revisions with respect to each proposed rule amendment in more detail throughout this release.

We are adopting Rule 14a–21 to provide a separate shareholder vote to approve executive compensation, to approve the frequency of such votes on executive compensation and to approve golden parachute compensation arrangements in connection with certain extraordinary business transactions. We are also adopting a new Item 24 of Schedule 14A to provide disclosure regarding the effect of the shareholder votes required by Rule 14a–21, such as whether each vote is non-binding. In addition, our amendments to Item 5 of Schedule 14A, Item 3 of Schedule 14C, Item 1011 of Regulation M–A, Item 8 of Schedule 14D–9, and Item 15 of Schedule 13E–3 will require additional disclosure regarding golden parachute arrangements in connection with certain extraordinary business transactions, Rule 13e–3<sup>37</sup> going-private transactions and tender offers.

We are also adopting amendments to Item 402 of Regulation S–K to require disclosure of an issuer’s consideration of the say-on-pay vote in its

Compensation Discussion and Analysis, and to prescribe disclosure about golden parachute compensation arrangements in new Item 402(t). In addition, we are adopting an instruction to Rule 14a–8 to clarify the treatment of shareholder proposals relating to the shareholder advisory votes required by Rule 14a–21. Finally, we are adopting amendments to Form 8–K to facilitate disclosure of the results of the shareholder advisory vote on the frequency of say-on-pay votes, and to require disclosure about whether and how the issuer will implement the results of the shareholder advisory vote on the frequency of say-on-pay votes.

## II. Discussion of the Amendments

### A. Shareholder Approval of Executive Compensation

#### 1. Rule 14a–21(a)

Proposed Rule 14a–21(a) would require issuers,<sup>38</sup> not less frequently than once every three years, to include in their proxy statements a separate shareholder advisory vote to approve the compensation of executives. We are adopting the rule substantially as proposed with some changes in response to comments.

#### a. Proposed Rule

Under our proposed rule, an issuer would be required, not less frequently than once every three years, to provide a separate shareholder advisory vote in proxy statements to approve the compensation of its named executive officers, as defined in Item 402(a)(3)<sup>39</sup> of Regulation S–K. Rule 14a–21(a), as proposed, would specify that the separate shareholder vote on executive compensation is required only when proxies are solicited for an annual or other meeting of security holders for which our rules require the disclosure of executive compensation pursuant to Item 402 of Regulation S–K. Proposed Rule 14a–21(a) would require a separate shareholder vote to approve the compensation of executives for the first annual or other such meeting of shareholders occurring on or after January 21, 2011, the first day after the end of the 6-month period beginning on the date of enactment of the Act.

In accordance with Section 14A(a)(1), shareholders would vote to approve the compensation of the issuer’s named

<sup>38</sup> Our rules as adopted apply to issuers who have a class of equity securities registered under Section 12 [15 U.S.C. 78j] of the Exchange Act and are subject to our proxy rules. Foreign private issuers, as defined in Rule 3b–4(c) [17 CFR 240.3b–4(c)], are not required under Section 14A or the rules we are adopting today to conduct a shareholder advisory vote on executive compensation nor a shareholder advisory vote on the frequency of such votes.

<sup>39</sup> 17 CFR 229.402(a)(3).

<sup>31</sup> Exchange Act Section 14A(e).

<sup>32</sup> Exchange Act Section 14A(e).

<sup>33</sup> Exchange Act Section 14A(a)(3).

<sup>34</sup> See Section II.E below for a discussion of a temporary exemption for smaller reporting companies.

<sup>35</sup> Exchange Act Section 14A(b)(1).

<sup>36</sup> These comment letters were received prior to publication of the Proposing Release. See note 17 above.

<sup>37</sup> 17 CFR 240.13e–3.

executive officers, as such compensation is disclosed pursuant to Item 402<sup>40</sup> of Regulation S–K, including the Compensation Discussion and Analysis (“CD&A”), the compensation tables and other narrative executive compensation disclosures required by Item 402. We also proposed an instruction to Rule 14a–21 to specify that the rule does not change the scaled disclosure requirements for smaller reporting companies and that smaller reporting companies would not be required to provide a CD&A in order to comply with Rule 14a–21.

#### b. Comments on the Proposed Rule

Commentators were generally supportive of the proposal. Many commentators agreed with the approach, as proposed, not to designate specific language to be used or require issuers to frame the shareholder vote to approve executive compensation in the form of a standard resolution.<sup>41</sup> Some commentators indicated that issuers should have flexibility in drafting the resolution.<sup>42</sup> Commentators noted that flexibility would permit issuers to tailor the resolution to the issuer’s individual circumstances.<sup>43</sup> Others stated that we should designate specific language for the resolution<sup>44</sup> or at least establish clear, minimum guidelines,<sup>45</sup> principles-based guidelines,<sup>46</sup> or model language,<sup>47</sup> while other commentators

suggested we include language for a resolution in the form of non-exclusive examples<sup>48</sup> or a safe harbor.<sup>49</sup> Commentators indicated that it would be helpful to have an example of resolution language that would comply with the rule<sup>50</sup> and that sample language would simplify the drafting process for issuers and promote efficiency.<sup>51</sup>

Many commentators agreed with our proposed approach not to exempt smaller reporting companies from Rule 14a–21(a) and Exchange Act Section 14A(a)(1).<sup>52</sup> Some commentators did suggest that smaller reporting companies should be exempt from the say-on-pay vote<sup>53</sup> or required to conduct a say-on-pay vote on a triennial basis beginning in 2013.<sup>54</sup>

Some commentators suggested that we clarify the relationship between the federally created right and state law voting rights.<sup>55</sup> Most commentators, however, indicated there was no need for the Commission to adopt rules as to which shares are entitled to vote.<sup>56</sup> One commentator asserted that the issue as to which shares are entitled to vote is traditionally a state law matter that we do not need to address in our rulemaking.<sup>57</sup>

#### c. Final Rule

After considering the comments, we are adopting Rule 14a–21(a) substantially as proposed with some modifications. Under the final rule, issuers will be required, not less frequently than once every three years, to provide a separate shareholder advisory vote in proxy statements to approve the compensation of their named executive officers, as defined in Item 402(a)(3) of Regulation S–K. Rule 14a–21(a) specifies that the separate shareholder vote on executive compensation is required only when proxies are solicited for an annual or other meeting of security holders for

which our rules require the disclosure of executive compensation pursuant to Item 402 of Regulation S–K. We have modified the proposal to clarify in the rule that the shareholder vote on executive compensation required by Exchange Act Section 14A(a)(1) and Rule 14a–21(a) is required with respect to an annual meeting of shareholders at which proxies will be solicited for the election of directors, or a special meeting in lieu of such annual meeting.<sup>58</sup> In addition, we have modified the rule to clarify that a say-on-pay vote is required at least once every three calendar years. Commentators expressed the view that as proposed, the rule would have required a say-on-pay vote within three years of the date of the most recent say-on-pay vote, which in some cases could have required a say-on-pay vote more frequently than once every three calendar years.<sup>59</sup>

As adopted, Rule 14a–21(a) requires a separate shareholder vote to approve the compensation of executives for the first annual or other meeting of shareholders occurring on or after January 21, 2011, the first day after the end of the 6-month period beginning on the date of enactment of the Act. In accordance with Section 14A(a)(1), shareholders would vote to approve the compensation of the issuer’s named executive officers, as such compensation is disclosed pursuant to Item 402<sup>60</sup> of Regulation S–K, including the CD&A, the compensation tables and other narrative executive compensation disclosures required by Item 402.<sup>61</sup> We have included an instruction to Rule 14a–21 to specify that Rule 14a–21 does not change the scaled disclosure requirements for smaller reporting companies and that smaller reporting companies will not be required to provide a CD&A in order to comply with Rule 14a–21. We understand that smaller reporting companies may wish to include supplemental disclosure to facilitate shareholder understanding of

<sup>40</sup> We proposed that if disclosure of golden parachute compensation arrangements pursuant to proposed Item 402(t) is included in an annual meeting proxy statement, such disclosure would be included in the disclosure subject to the shareholder advisory vote under Rule 14a–21(a). Such disclosure under Item 402(t), however, would not be required to be included in annual meeting proxy statements.

<sup>41</sup> See, e.g., letters from American Federation of State, County and Municipal Employees (“AFSCME”), Center on Executive Compensation (“Center on Exec. Comp.”), Compensia (“Compensia”), Davis Polk & Wardwell LLP (“Davis Polk”), the Financial Services Roundtable (“FSR”), Pfizer Inc. (“Pfizer”), Protective Life Corporation (“Protective Life”), and United Brotherhood of Carpenters (“UBC”).

<sup>42</sup> See, e.g., letters from Business Roundtable (“Business Roundtable”) and Towers Watson (“Towers Watson”).

<sup>43</sup> See letter from Business Roundtable.

<sup>44</sup> See, e.g., letters from National Association of Corporate Directors (“NACD”), PGGM Investments (“PGGM”), Public Citizen (“Public Citizen”), and WorldatWork (“WorldatWork”).

<sup>45</sup> See, e.g., letters from Boston Common Asset Management (“Boston Common”), First Affirmative Financial Network, LLC (“First Affirmative”), Glass Lewis & Co. (“Glass Lewis”), Social Investment Forum (“Social Investment”), and Walden Asset Management (“Walden”).

<sup>46</sup> See, e.g., letters from International Corporate Governance Network (“ICGN”) and Teachers Insurance and Annuities Association of America and College Retirement Equities Fund (“TIAA–CREF”).

<sup>47</sup> See, e.g., letter from Calvert Group, Ltd. (“Calvert”).

<sup>48</sup> See, e.g., letters from Society of Corporate Secretaries and Governance Professionals (“Society of Corp. Sec.”) and Sullivan & Cromwell LLP (“Sullivan”).

<sup>49</sup> See, e.g., letters from The Boeing Company (“Boeing”) and Pearl Meyer & Partners (“PM&P”).

<sup>50</sup> See letter from Society of Corp. Sec.

<sup>51</sup> See letter from Sullivan.

<sup>52</sup> See, e.g., letters from California Public Employees Retirement System (“CalPERS”), Council of Institutional Investors (“CII”), Glass Lewis, ICGN, PGGM, and the State Board of Administration of Florida (“SBA of Florida”).

<sup>53</sup> See, e.g., letters from NACD and UBC.

<sup>54</sup> See letter from the Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association (“ABA”).

<sup>55</sup> See, e.g., letter from the ABA.

<sup>56</sup> See, e.g., letters from Business Roundtable, FSR, Pfizer, PGGM, and Protective Life.

<sup>57</sup> See letter from Business Roundtable.

<sup>58</sup> See the discussion in Note 18 above.

<sup>59</sup> See letter from ABA.

<sup>60</sup> If disclosure of golden parachute compensation arrangements pursuant to Item 402(t) is included in an annual meeting proxy statement, such disclosure would be included in the disclosure subject to the shareholder advisory vote under Rule 14a–21(a). Such disclosure under Item 402(t), however, is not required to be included in all annual meeting proxy statements.

<sup>61</sup> While not required, our rules “would not preclude an issuer from seeking more specific shareholder opinion through separate votes on cash compensation, golden parachute policy, severance or other aspects of compensation.” See Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010, S. Rep. No. 111–176 at 133 (2010).

their compensation arrangements in connection with say-on-pay votes.<sup>62</sup> We do not believe, however, that this possibility supports exempting smaller reporting companies from the say-on-pay votes. As more fully discussed in Section II.E below, in order to ease compliance burdens for smaller reporting companies, we are adopting a two-year temporary exemption before these companies are required to conduct a shareholder advisory vote to approve executive compensation to permit these companies additional time to prepare for the new shareholder advisory votes.

As noted in the Proposing Release, consistent with Section 14A, the compensation of directors, as disclosed pursuant to Item 402(k)<sup>63</sup> or Item 402(r)<sup>64</sup> is not subject to the shareholder advisory vote. In addition, if an issuer includes disclosure pursuant to Item 402(s)<sup>65</sup> of Regulation S-K about the issuer's compensation policies and practices as they relate to risk management and risk-taking incentives, these policies and practices will not be subject to the shareholder advisory vote required by Section 14A(a)(1) as they relate to the issuer's compensation for employees generally. We note, however, that to the extent that risk considerations are a material aspect of the issuer's compensation policies or decisions for named executive officers, the issuer is required to discuss them as part of its CD&A,<sup>66</sup> and therefore such disclosure would be considered by shareholders when voting on executive compensation.

Though we have considered the views of commentators that prescribed language would be helpful, the final rule does not require issuers to use any specific language or form of resolution to be voted on by shareholders. This is consistent with the approach taken by the Commission in adopting Rule 14a-20 to implement the shareholder advisory vote on executive compensation for companies subject to the Emergency Economic Stabilization Act of 2008, or EESA. We believe that issuers should retain flexibility to craft the resolution language. As we noted in the Proposing Release, however, the shareholder advisory vote must relate to all executive compensation disclosure

<sup>62</sup> See letter from Society of Corp. Sec., which notes that smaller reporting companies may "feel compelled to include CD&A to provide additional disclosure so as to reduce the potential for an unfavorable shareholder vote."

<sup>63</sup> 17 CFR 229.402(k).

<sup>64</sup> 17 CFR 229.402(r).

<sup>65</sup> 17 CFR 229.402(s).

<sup>66</sup> See *Proxy Disclosure Enhancements*, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334] at note 38.

disclosed pursuant to Item 402 of Regulation S-K. Section 14A(a)(1) of the Exchange Act requires that the shareholder advisory vote must be "to approve the compensation of executives, as disclosed pursuant to [Item 402 of Regulation S-K] or any successor thereto."<sup>67</sup> We have added an instruction to Rule 14a-21(a) to indicate that this language from Section 14A(a)(1) should be included in an issuer's resolution for the say-on-pay vote and to provide a non-exclusive example of a resolution that would satisfy the applicable requirements.<sup>68</sup> A vote to approve a proposal on a different subject matter, such as a vote to approve only compensation policies and procedures, would not satisfy the requirement of Section 14A(a)(1) or final Rule 14a-21(a). We note that issuers are not limited to the required shareholder advisory vote under Rule 14a-21(a) and may solicit shareholder votes on a range of compensation matters to obtain more specific feedback on the issuer's compensation policies and programs.

## 2. Item 24 to Schedule 14A

We proposed a new Item 24 to Schedule 14A, to require disclosure in any proxy statement in which an issuer is providing a separate shareholder vote on executive compensation to briefly explain the general effect of the vote, such as whether the vote is non-binding. We are adopting this amendment to Schedule 14A as proposed with some modifications.

### a. Proposed Amendments

Pursuant to proposed new Item 24 of Schedule 14A, issuers would be required to disclose in a proxy statement for an annual meeting (or other meeting of shareholders for which our rules require executive compensation disclosure) that they are providing a separate shareholder vote on executive compensation and to briefly explain the general effect of the vote, such as whether the vote is non-binding.<sup>69</sup> This was similar to the approach taken by the Commission in connection with disclosure

<sup>67</sup> Exchange Act Section 14A(a)(1).

<sup>68</sup> Instruction to Rule 14a-21(a) provides the following non-exclusive example that would satisfy Rule 14a-21(a): "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED."

<sup>69</sup> Section 14A(a) does not require additional disclosure with respect to the non-binding nature of the vote. We proposed to require additional disclosure so that information about the advisory nature of the vote is available to shareholders before they vote. We continue to believe this information should be available to shareholders.

requirements about the shareholder vote on executive compensation for companies subject to the EESA.<sup>70</sup>

### b. Comments on the Proposed Amendments

Commentators were generally supportive of proposed Item 24 of Schedule 14A. We requested comment regarding whether any additional disclosures should be provided by issuers that would be useful to shareholders. Two commentators indicated that we should amend the proposal to require disclosure of the results of previous votes on executive compensation.<sup>71</sup> Another commentator suggested that we should remove the reference to the "general effect" of the vote as it would lead to boilerplate disclosure and remove the word "whether" from the rule given the non-binding nature of the vote.<sup>72</sup>

### c. Final Rule

After considering the comments, we are adopting Item 24 to Schedule 14A as proposed with some modifications.<sup>73</sup> Though we agree that the disclosure of previous results would be useful to shareholders, these results are required to be disclosed pursuant to Item 5.07 of Form 8-K immediately following the votes. Consequently, we do not believe it is necessary to mandate such disclosure in Item 24 of Schedule 14A. As discussed below, we have modified the proposal to require disclosure of the current frequency of say-on-pay votes and to require disclosure of when the next say-on-pay vote will occur.

Item 24 is consistent with the approach taken by the Commission in Item 20 of Schedule 14A in connection with disclosure requirements about the shareholder advisory vote on executive compensation for companies subject to EESA. Based on our experience with these votes, we believe that such requirements will lead to disclosure of useful information about the nature and effect of the vote for shareholders to consider, such as whether the vote is non-binding. We note that although not required, issuers may choose to provide additional disclosure in their proxy materials.

## 3. Amendments to Item 402(b) of Regulation S-K

Item 402 requires the disclosure of executive compensation and includes

<sup>70</sup> See Item 20 of Schedule 14A; TARP Adopting Release, *supra* note 18, at 75 FR 2790.

<sup>71</sup> See letters from ICGN and PGGM.

<sup>72</sup> See letter from ABA.

<sup>73</sup> See discussion of the modification to the proposed Item 24 relating to the frequency of say-on-pay votes below at Section II.B.2.c.

requirements prescribing narrative and tabular disclosure, as well as separate scaled disclosure requirements for smaller reporting companies.<sup>74</sup> Item 402(b)<sup>75</sup> contains the requirement for CD&A, which is intended to be a narrative overview that puts into context the executive compensation disclosure provided elsewhere in response to the requirements of Item 402. The CD&A disclosure requirement is principles-based, in that it identifies the disclosure concept and provides several non-exclusive examples. Under Item 402(b)(1), issuers must explain all material elements of their named executive officers' compensation by addressing mandatory principles-based topics in their CD&A.<sup>76</sup> Item 402(b)(2) of Regulation S-K sets forth certain non-exclusive examples of the kind of information that an issuer should address in its CD&A, depending upon the facts and circumstances.

In connection with our implementation of Section 14A(a)(1), we proposed amendments to require disclosure in CD&A regarding how issuers have considered the results of previous say-on-pay votes required by Section 14A and Rule 14a-20.<sup>77</sup> After reviewing comments on this proposal, we are adopting amendments to Item 402(b)(1) as proposed, with some modifications in response to concerns raised by commentators.

#### a. Proposed Amendments

We proposed to amend Item 402(b)(1) to add to the mandatory CD&A topics whether, and if so, how an issuer has considered the results of previous shareholder votes on executive compensation required by Section 14A or Rule 14a-20 in determining compensation policies and decisions and, if so, how that consideration has

affected its compensation policies and decisions. We did not propose to add a specific requirement for smaller reporting companies to provide disclosure about how previous votes pursuant to Section 14A or Rule 14a-20 affected compensation policies and decisions because in our view such information would not be as valuable outside the context of a complete CD&A covering the full range of matters required to be addressed by Item 402(b), which smaller reporting companies are not required to provide.

#### b. Comments on the Proposed Amendments

Comments on the proposal were mixed. Several commentators expressed support for an amendment to Item 402(b)(1) to require that issuers discuss the results of the shareholder vote and its effect, if any, on executive compensation decisions and policies.<sup>78</sup> Many of these commentators agreed with the proposal that discussion of say-on-pay vote results in CD&A should be mandatory,<sup>79</sup> in some cases noting that this would provide shareholders a better understanding of how the board of directors considered the results of shareholder advisory votes<sup>80</sup> and encourage a dialogue between issuers and shareholders on the topic of compensation.<sup>81</sup> Commentators also indicated that a mandatory discussion of the consideration of say-on-pay votes will aid transparency of issuers' disclosures on compensation<sup>82</sup> and will help investors better understand compensation decisions made by issuers.<sup>83</sup>

A number of commentators stated that it would be more appropriate instead to include consideration of say-on-pay votes among the non-exclusive examples of the kind of information that should be addressed in CD&A, only if material given the issuer's individual facts and circumstances<sup>84</sup> because this approach would avoid boilerplate disclosure and require discussion only when material,<sup>85</sup> and that discussion on

a mandatory basis may lead to awkward and non-substantive disclosure if the issuer has not made changes to its compensation program in response to the shareholder vote.<sup>86</sup>

Other commentators stated that no amendment to CD&A is required<sup>87</sup> because the Act does not require additional CD&A disclosure and it should not be required by rule,<sup>88</sup> the proposed amendment would add length to CD&A without providing meaningful information to shareholders,<sup>89</sup> and the amendment would deem the consideration of say-on-pay votes material whether such consideration is material or not.<sup>90</sup> Similarly a number of commentators who asserted that amending Item 402(b) is not required also expressed the view that if the Commission does adopt an amendment, such CD&A disclosure should be required only if material under the issuer's individual facts and circumstances.<sup>91</sup>

Commentators also disagreed with respect to which say-on-pay votes should be covered by the CD&A discussion. Some favored only the most recent say-on-pay vote,<sup>92</sup> indicating that mandating discussion of prior votes would result in extraneous discussion<sup>93</sup> and little benefit.<sup>94</sup> Other commentators indicated that prior votes should also be required to be addressed.<sup>95</sup> These commentators noted that such disclosure of prior votes is appropriate given the long-term process of determining compensation<sup>96</sup> and that it would permit investors to evaluate any trends in the results of say-on-pay votes.<sup>97</sup> One commentator stated that if CD&A disclosure with respect to say-on-pay votes is mandatory, it should be limited to the most recent vote, but if not mandatory should not be so limited.<sup>98</sup> Although there was little response to our request for comment regarding whether smaller reporting companies should be required to disclose their consideration of

<sup>74</sup> Item 402 also includes requirements to disclose director compensation (Items 402(k) and 402(r)) and the issuer's compensation policies as they relate to risk management (Item 402(s)).

<sup>75</sup> 17 CFR 229.402(b).

<sup>76</sup> These mandatory principles-based topics require the company to disclose the objectives of the company's compensation programs; what the compensation program is designed to reward; each element of compensation; why the company chooses to pay each element; how the company determines the amount (and, where applicable, the formula) for each element; and how each element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements.

<sup>77</sup> 17 CFR 240.14a-20. Pursuant to the EESA, issuers that have received financial assistance under the Troubled Asset Relief Program, or TARP, are required to conduct a separate annual shareholder vote to approve executive compensation during the period in which any obligation arising from the financial assistance provided under the TARP remains outstanding.

<sup>78</sup> See, e.g., letters from CalPERS, Calvert, CII, Colorado Public Employees' Retirement Association ("COPERA"), ICGN, Meridian Compensation Partners ("Meridian"), PGGM, Pensions Investment Research Consultants ("PIRC"), SBA of Florida, Sullivan, and TIAA-CREF.

<sup>79</sup> See, e.g., letters from CalPERS, Calvert, CII, PGGM, PIRC, SBA of Florida, and TIAA-CREF.

<sup>80</sup> See letter from CalPERS.

<sup>81</sup> See letter from TIAA-CREF.

<sup>82</sup> See letter from PIRC.

<sup>83</sup> See letter from SBA of Florida.

<sup>84</sup> See, e.g., letters from ABA, Boeing, Business Roundtable, Eaton Corporation ("Eaton"), FSR, PM&P, Sullivan, and UnitedHealth Group ("UnitedHealth").

<sup>85</sup> See, e.g., letter from UnitedHealth.

<sup>86</sup> See letter from PM&P.

<sup>87</sup> See, e.g., letters from Center on Exec. Comp., Compensia, Davis Polk, Pfizer, Society of Corp. Sec., and UBC.

<sup>88</sup> See, e.g., letter from Center on Exec. Comp.

<sup>89</sup> See letter from Davis Polk.

<sup>90</sup> See, e.g., letter from Society of Corp. Sec.

<sup>91</sup> See, e.g., letters from Compensia, Davis Polk, and Society of Corp. Sec.

<sup>92</sup> See, e.g., letters from ABA, Boeing, Eaton, FSR, McGuireWoods ("McGuireWoods"), Meridian, NACD, Pfizer, Protective Life, and Sullivan.

<sup>93</sup> See letter from Sullivan.

<sup>94</sup> See letter from McGuireWoods.

<sup>95</sup> See, e.g., letters from Chris Barnard ("Barnard"), Calvert, PGGM, PIRC, PM&P, and SBA of Florida.

<sup>96</sup> See, e.g., letter from PGGM.

<sup>97</sup> See, e.g., letter from SBA of Florida.

<sup>98</sup> See letter from Boeing.

shareholder advisory votes on executive compensation, one commentator stated that our existing disclosure requirements for these companies are sufficient.<sup>99</sup>

#### c. Final Rule

After considering the comments, we are adopting amendments to the disclosure requirements of Item 402(b)(1) substantially as proposed, with a modification to clarify that this mandatory topic relates to the issuer's consideration of the most recent say-on-pay vote. As discussed below, issuers should address their consideration of the results of earlier say-on-pay votes, to the extent material.

The final rule amends Item 402(b)(1) to require issuers to address in CD&A whether and, if so, how their compensation policies and decisions have taken into account the results of the most recent shareholder advisory vote on executive compensation. Although it is not mandated by Section 951 of the Act, we continue to believe that including this mandatory topic in CD&A will facilitate better investor understanding of issuers' compensation decisions. Because the shareholder advisory vote will apply to all issuers, we view information about how issuers have responded to such votes as more in the nature of a mandatory principles-based topic than an example. The manner in which individual issuers may respond to such votes in determining executive compensation policies and decisions will likely vary depending upon facts and circumstances. We expect that this variation will be reflected in the CD&A disclosures.

Following consideration of the comments received, we have decided to limit the mandatory topic to whether, and if so, how the issuer has considered the results of the most recent say-on-pay vote in determining compensation policies and decisions, and if so, how that consideration has affected the issuer's executive compensation policies and decisions.<sup>100</sup> This modification reflects that, in making voting and investment decisions, shareholders will benefit from understanding what consideration the issuer has given to the most recent say-

on-pay vote. Limiting the mandatory topic to the most recent shareholder vote should also focus the disclosure so there should not be lengthy boilerplate discussions of all previous votes. Although we have added issuer consideration of the most recent say-on-pay vote to the mandatory topics, we believe that, consistent with the principles-based nature of CD&A, issuers should address their consideration of the results of earlier say-on-pay votes to the extent such consideration is material to the compensation policies and decisions discussed.

Because companies with outstanding indebtedness under the TARP will continue to have an annual say-on-pay vote until they repay all such indebtedness, these votes should be addressed by issuers in CD&A as well. To reflect our treatment of companies subject to EESA with outstanding obligations under TARP, we have also modified the amendment to Item 402(b)(1) as adopted to address issuer consideration of the results of the most recent shareholder advisory vote on executive compensation required by Section 14A or Rule 14a-20. This reflects that the vote required pursuant to the EESA and 14a-20 is effectively the same vote that would be required under Section 14A(a)(1).<sup>101</sup>

Smaller reporting companies are subject to scaled disclosure requirements in Item 402 of Regulation S-K and are not required to include a CD&A. We are not adding a specific requirement for smaller reporting companies to provide disclosure about how previous votes pursuant to Section 14A affected compensation policies and decisions because we believe such information would not be as valuable outside the context of a complete CD&A covering the full range of matters required to be addressed by Item 402(b). However, we note that pursuant to Item 402(o) of Regulation S-K,<sup>102</sup> smaller reporting companies are required to provide a narrative description of any material factors necessary to an understanding of the information disclosed in the Summary Compensation Table. If consideration of prior say-on-pay votes is such a factor for a particular issuer, disclosure would be required pursuant to Item 402(o).

#### B. Shareholder Approval of the Frequency of Shareholder Votes on Executive Compensation

##### 1. Rule 14a-21(b)

We proposed Rule 14a-21(b) pursuant to which issuers would be required, not less frequently than once every six years, to provide a separate shareholder advisory vote in proxy statements to determine the frequency of the shareholder vote on the compensation of executives required by Section 14A(a)(1). We are adopting this amendment substantially as proposed with slight modifications in response to comments.

##### a. Proposed Rule

Under proposed Rule 14a-21(b), issuers would be required, not less frequently than once every six years, to provide a separate shareholder advisory vote in proxy statements for annual meetings to determine whether the shareholder vote on the compensation of executives required by Section 14A(a)(1) "will occur every 1, 2, or 3 years."<sup>103</sup> As proposed, Rule 14a-21(b) would also clarify that the separate shareholder vote on the frequency of shareholder votes on executive compensation would be required only in a proxy statement for an annual or other meeting of shareholders for which our rules require compensation disclosure. Consistent with Section 14A, issuers would be required to provide the separate shareholder vote on the frequency of the say-on-pay vote for the first annual or other such meeting of shareholders occurring on or after January 21, 2011.

##### b. Comments on the Proposed Rule

Comments on the proposal were generally favorable. Many commentators agreed that the rule did not need to specify the required language to be used for the shareholder vote on the frequency of shareholder votes to approve executive compensation.<sup>104</sup> Some commentators, however, recommended that the Commission should specify language or provide non-exclusive examples of resolutions so issuers would know how the requirement may be satisfied.<sup>105</sup> A number of commentators also requested that the Commission clarify whether the vote should be presented in the form of a resolution given that shareholders will have a choice among three frequencies

<sup>103</sup> Exchange Act Section 14A(a)(2).

<sup>104</sup> See, e.g., letters from AFSCME, Business Roundtable, FSR, Protective Life, and Towers Watson.

<sup>105</sup> See, e.g., letters from Boeing, Pfizer, PGM, Society of Corp. Sec., and Sullivan.

<sup>99</sup> See letter from ICGN.

<sup>100</sup> Reporting companies are currently required to disclose, pursuant to Item 5.07 of Form 8-K [17 CFR 249.208a], the preliminary results of a shareholder vote within four business days after the end of the meeting at which the vote is held and final voting results within four business days after the final voting results are known. We are adopting amendments to require additional disclosure on Form 8-K regarding the company's determination of the frequency of say-on-pay votes. See Section II.B.5 below.

<sup>101</sup> The treatment of companies subject to EESA with outstanding obligations under TARP is discussed in Section II.C.3 below.

<sup>102</sup> 17 CFR 229.402(o).

or abstaining from the frequency vote.<sup>106</sup> Although some commentators suggested that we specify which shares are entitled to vote in the shareholder vote on the frequency of say-on-pay votes,<sup>107</sup> most commentators indicated there was no need for the Commission to address this question.<sup>108</sup>

We also requested comment regarding whether a new issuer should be permitted to disclose the frequency of its say-on-pay votes in the registration statement for its initial public offering and be exempted from conducting say-on-pay votes and frequency votes at its annual meetings until the annual meeting for the year disclosed in its registration statement. Most commentators indicated that newly public companies should not be exempt from the say-on-pay and frequency votes and should be required to conduct say-on-pay and frequency votes at their first annual shareholders meeting after the initial public offering.<sup>109</sup> However, some commentators expressed support for such an exemption as it would provide these issuers additional time to formulate their compensation policies as a public company before conducting the shareholder votes required by Section 14A.<sup>110</sup>

### c. Final Rule

After reviewing and considering the comments, we are adopting Rule 14a-21(b) as proposed with slight modifications to clarify that the frequency vote is required at least once during the six calendar years following the prior frequency vote.<sup>111</sup> Under Rule 14a-21(b), issuers will be required, not less frequently than once every six calendar years, to provide a separate shareholder advisory vote in proxy statements for annual meetings to determine whether the shareholder vote on the compensation of executives required by Section 14A(a)(1) “will occur every 1, 2, or 3 years.”<sup>112</sup> After considering and reviewing comments on the proposed rule, we do not believe it is necessary to provide a form of resolution for the vote required by Rule 14a-21(b). In response to concerns

<sup>106</sup> See, e.g., letters from ABA, Pfizer, Society of Corp. Sec., and Sullivan.

<sup>107</sup> See, e.g., letter from the ABA.

<sup>108</sup> See, e.g., letters from Business Roundtable, FSR, Pfizer, PGGM, and Protective Life.

<sup>109</sup> See, e.g., letters from AFSCME, CII, CalPERS, ICGN, Georg Merkl (“Merkl”), Public Citizen, and RAILPEN Investments and Universities Superannuation Scheme (“RAILPEN & USS”).

<sup>110</sup> See, e.g., letters from ABA, Compensia, Davis Polk, NACD, and Sullivan.

<sup>111</sup> As proposed, Rule 14a-21(b) would have required a frequency vote within the six-year period from the date of the most recent frequency vote.

<sup>112</sup> Exchange Act Section 14A(a)(2).

raised by commentators and discussed below, we are also adopting a temporary exemption under which smaller reporting companies will not be required to conduct a shareholder advisory vote on the frequency of say-on-pay votes until meetings on or after January 21, 2013.<sup>113</sup>

Rule 14a-21(b) will also clarify that the separate shareholder vote on the frequency of shareholder votes on executive compensation will be required only in a proxy statement for an annual or other meeting of shareholders at which directors will be elected and that such vote is required only once every six calendar years. Under Rule 14a-21(b), issuers will be required to provide the separate shareholder vote on the frequency of the say-on-pay vote for the first annual or other such meeting of shareholders occurring on or after January 21, 2011. After reviewing the comment letters, we continue to believe that the say-on-pay vote and the frequency vote should be required of newly public companies in the proxy statement for such company’s first annual meeting after the initial public offering. This will give shareholders the opportunity to express a view on these matters while the company is in the process of establishing policies that will apply as a public company and could benefit from understanding its shareholders’ point of view.

### 2. Item 24 of Schedule 14A

In order to implement the requirements of Section 14A(a), we proposed new Item 24 to Schedule 14A, to briefly explain the general effect of the frequency vote, such as whether the vote is non-binding. We are adopting this amendment to Schedule 14A as proposed with a modification.

#### a. Proposed Amendments

In addition to disclosure regarding the vote on executive compensation, we proposed that issuers would be required to disclose in the proxy statement that they are providing a separate shareholder advisory vote on the frequency of the shareholder advisory vote on executive compensation. Proposed Item 24 of Schedule 14A would also require issuers to briefly explain the general effect of this vote, such as whether the vote is non-binding.

#### b. Comments on the Proposed Amendments

Commentators generally supported proposed Item 24 of Schedule 14A as it relates to the frequency of say-on-pay

votes.<sup>114</sup> One commentator expressed the view that the proposed amendment is not needed as it will lead to boilerplate disclosure.<sup>115</sup> Some commentators also suggested that issuers should be required to disclose the current frequency of say-on-pay votes.<sup>116</sup>

### c. Final Rule

After reviewing and considering the comments, we are adopting Item 24 of Schedule 14A as proposed with a modification. Issuers will be required to disclose in the proxy statement that they are providing a separate shareholder advisory vote on the frequency of say-on-pay votes. Item 24 of Schedule 14A will also require issuers to briefly explain the general effect of this vote, such as whether the vote is non-binding.<sup>117</sup> As noted above, this is similar to the approach taken by the Commission in connection with disclosure requirements about the shareholder advisory vote on executive compensation for companies subject to EESA.<sup>118</sup> Based on our experience with these votes, we believe that such requirements will lead to useful disclosure of information about the nature and effect of the vote for shareholders to consider, such as whether the vote is non-binding.

After reviewing comments, we are also adding a requirement to Item 24 for issuers to provide disclosure of the current frequency of say-on-pay votes and when the next scheduled say-on-pay vote will occur,<sup>119</sup> in their proxy materials. We believe this will provide useful information to shareholders about upcoming say-on-pay and frequency shareholder advisory votes.

### 3. Amendment to Rule 14a-4

In order to implement the requirements of Section 14A(a)(2), we also proposed amendments to Rule 14a-4. After considering comments, we are adopting the amendments to Rule 14a-4 as proposed, with slight modification.

<sup>114</sup> See, e.g., letters from CalPERS, ICGN, PGGM, and Protective Life.

<sup>115</sup> See letter from Society of Corp. Sec.

<sup>116</sup> See, e.g., letters from ICGN and TIAA-CREF.

<sup>117</sup> As discussed in Section II.A.2.a, Section 14A(a) does not require additional disclosure with respect to the non-binding nature of the vote. We are requiring additional disclosure so that information about the advisory nature of the vote is available to shareholders before they vote.

<sup>118</sup> See Section II.A.2.a, above.

<sup>119</sup> Issuers should disclose the current frequency as determined by the board following a shareholder advisory vote. We would not expect disclosure of either the current frequency or when the next scheduled say-on-pay vote will occur in proxy materials for the meeting where an issuer initially conducts the say-on-pay and frequency votes.

<sup>113</sup> See discussion in Section I.E below.

#### a. Proposed Amendments

As noted in the Proposing Release, Section 14A(a)(2) requires a shareholder advisory vote on whether say-on-pay votes will occur every 1, 2, or 3 years. Thus, shareholders must be given four choices: Whether the shareholder vote on executive compensation will occur every 1, 2, or 3 years, or to abstain from voting on the matter. In our view, Section 14A(a)(2) does not allow for alternative formulations of the shareholder vote, such as proposals that would provide shareholders with two substantive choices (*e.g.*, to hold a separate shareholder vote on executive compensation every year or less frequently), or only one choice (*e.g.*, a company proposal to hold shareholder votes every two years). We noted in the Proposing Release that we would expect that the board of directors will include a recommendation as to how shareholders should vote on the frequency of shareholder votes on executive compensation.<sup>120</sup> However, the issuer must make clear in these circumstances that the proxy card provides for four choices (every 1, 2, or 3 years, or abstain) and that shareholders are not voting to approve or disapprove the issuer's recommendation. Accordingly, we proposed amendments to our proxy rules to reflect the statutory requirement that shareholders must be provided the opportunity to cast an advisory vote on whether the shareholder vote on executive compensation required by Section 14A(a)(1) of the Exchange Act will occur every 1, 2, or 3 years, or to abstain from voting on the matter.<sup>121</sup>

Specifically, we proposed amendments to Rule 14a-4 under the Exchange Act, which provides requirements as to the form of proxy that issuers are required to include with their proxy materials, to require that issuers present four choices to their shareholders. Absent amendment, Rule 14a-4 requires the form of proxy to provide means whereby the person solicited is afforded an opportunity to specify by boxes a choice between approval or disapproval of, or abstention with respect to each separate matter to be acted upon, other than elections to office.<sup>122</sup> We proposed amendments to revise this standard to permit proxy cards to reflect the choice

of 1, 2, or 3 years, or abstain, for these votes.

#### b. Comments on the Proposed Amendments

Comments on the proposal were generally favorable. Many commentators expressed support for the proposed approach where shareholders are given four choices on the frequency vote.<sup>123</sup> Some commentators suggested alternative approaches including a vote where shareholders would rank each choice of frequency or vote separately for each of 1, 2, and 3 years,<sup>124</sup> a vote where management would choose 1, 2, or 3 years as the frequency and ask shareholders to approve or disapprove its choice,<sup>125</sup> and a two-step approach whereby shareholders would first vote whether or not they have a preference as to the frequency of say-on-pay votes and, if they do have a preference, subsequently vote on whether such votes should be conducted every 1, 2, or 3 years.<sup>126</sup>

In addition, we requested comment in the Proposing Release as to whether issuers, brokers, transfer agents, and data processing firms would be able to accommodate the four choices for a single line item on the proxy card. Commentators indicated that they would be ready for the vote with four choices on the proxy card by January 21, 2011.<sup>127</sup> One commentator recommended that we clarify that issuers may vote uninstructed shares in accordance with management's recommendations so long as they follow the requirements of Rule 14a-4,<sup>128</sup> while another suggested that the Commission extend the transition guidance permitting the presentation of three choices for the frequency vote for the entire 2011 proxy season and perhaps require the three-choice approach for all issuers for 2011 to allow for uniformity among different issuers.<sup>129</sup>

#### c. Final Rule

After considering the comments, we are adopting the rule substantially as proposed with some modifications. Specifically, we are adopting amendments to Rule 14a-4 under the Exchange Act, which provides

<sup>123</sup> See, *e.g.*, letters from Calvert, COPERA, ICGN, Meridian, Merkl, PGGM, and Protective Life.

<sup>124</sup> See letter from Keith P. Bishop ("Bishop").

<sup>125</sup> See letter from UBC.

<sup>126</sup> See letter from Society of Corp. Sec.

<sup>127</sup> See, *e.g.*, letters from Broadridge Financial Solutions, Inc. ("Broadridge") and Proxytrust ("Proxytrust").

<sup>128</sup> See letter from Sullivan.

<sup>129</sup> See letter from ABA. For a discussion of transition matters, see Section II.F below.

requirements as to the form of proxy that issuers are required to include with their proxy materials, to require that issuers present four choices to their shareholders. Under existing Rule 14a-4, the form of proxy is required to provide means whereby the person solicited is afforded an opportunity to specify by boxes a choice between approval or disapproval of, or abstention with respect to each separate matter to be acted upon, other than elections to office. Absent an amendment, Rule 14a-4 would not permit proxy cards to reflect the choice of 1, 2, or 3 years, or abstain. The amendments revise the rule to permit proxy cards to reflect the choice of 1, 2, or 3 years, or abstain, for the frequency vote.

In response to comment, we note that issuers may vote uninstructed proxy cards in accordance with management's recommendation for the frequency vote only if the issuer follows the existing requirements of Rule 14a-4 to (1) include a recommendation for the frequency of say-on-pay votes in the proxy statement, (2) permit abstention on the proxy card, and (3) include language regarding how uninstructed shares will be voted in bold on the proxy card.

#### 4. Amendment to Rule 14a-8

In connection with implementing the requirements of Section 14A(a)(2), we also proposed a note to Rule 14a-8(i)(10) relating to shareholder proposals. After considering the comments, we are adopting the amendment to Rule 14a-8 with some modifications.

#### a. Proposed Amendments

Our proposed amendment to Rule 14a-8 under the Exchange Act would add a note to Rule 14a-8(i)(10) to clarify the status of shareholder proposals that seek an advisory shareholder vote on executive compensation or that relate to the frequency of shareholder votes approving executive compensation. Rule 14a-8 provides eligible shareholders with an opportunity to include a proposal in an issuer's proxy materials for a vote at an annual or special meeting of shareholders. An issuer generally is required to include the proposal unless the shareholder has not complied with the rule's procedural requirements or the proposal falls within one of the rule's 13 substantive bases for exclusion.<sup>130</sup> One of the substantive bases for exclusion, Rule 14a-8(i)(10), provides that an issuer

<sup>130</sup> These substantive bases for exclusion are set forth in Rule 14a-8(i).

<sup>120</sup> See Section II.B.3 of the Proposing Release.

<sup>121</sup> Because the shareholder vote on the frequency of voting on executive compensation is advisory, we do not believe that it is necessary to prescribe a standard for determining which frequency has been "adopted" by the shareholders.

<sup>122</sup> Rule 14a-4(b)(1).

may exclude a shareholder proposal that has already been substantially implemented.

We proposed adding a note to Rule 14a-8(i)(10) to permit the exclusion of a shareholder proposal that would provide a say-on-pay vote or seeks future say-on-pay votes or that relates to the frequency of say-on-pay votes, provided the issuer has adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent vote in accordance with Rule 14a-21(b). As noted in Section I above, a "say-on-pay" vote is defined as a separate resolution subject to shareholder vote to approve the compensation of executives, as disclosed pursuant to Item 402 of Regulation S-K, or any successor to Item 402.

As proposed, an issuer would be permitted to exclude shareholder proposals that propose a vote on the approval of executive compensation as disclosed pursuant to Item 402 of Regulation S-K or on the frequency of such votes, including those drafted as requests to amend the issuer's governing documents, so long as the issuer has adopted a policy on the frequency of say-on-pay votes that is consistent with the plurality of votes cast in the most recent vote required by Rule 14a-21(b) and provides a vote on frequency at least as often as required by Section 14A(a)(2).

#### b. Comments on the Proposed Amendments

Comments on the proposal were mixed. Many commentators supported the proposed amendment to permit exclusion of shareholder proposals on frequency and say-on-pay,<sup>131</sup> stating that the amendment would eliminate redundancy and reduce administrative burdens and costs.<sup>132</sup> Other commentators disagreed with the general approach,<sup>133</sup> stating that they believe it would be unwise as a matter of public policy and would inappropriately interpret substantial implementation because the note would permit exclusion of proposals requesting a frequency that the issuer has not implemented.<sup>134</sup> Other commentators asserted that an amendment is not required because issuers should be permitted to exclude

<sup>131</sup> See, e.g., letters from ABA, Business Roundtable, Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce ("CCMC"), Eaton, FSR, ICGN, Pfizer, PGGM, and Protective Life.

<sup>132</sup> See, e.g., letter from Business Roundtable.

<sup>133</sup> See, e.g., letters from AFSCME, Calvert, Center on Exec. Comp., CII, Public Citizen, and UBC.

<sup>134</sup> See, e.g., letter from AFSCME.

any shareholder proposals on frequency as long as the issuer complies with Section 14A(a)(2).<sup>135</sup> Some commentators suggested that we should also permit issuers to exclude shareholder proposals on the frequency of say-on-pay votes when they adopt a policy to hold say-on-pay votes more frequently than the frequency that is consistent with the plurality of votes cast in the most recent shareholder vote<sup>136</sup> to prevent issuers being penalized for providing shareholders with more frequent say-on-pay votes.<sup>137</sup> Other commentators felt that issuers should not be required to adopt a particular policy on the frequency of say-on-pay votes in order to be permitted to exclude shareholder proposals on executive compensation,<sup>138</sup> noting that an issuer should be permitted to exclude shareholder proposals on frequency so long as the issuer provides a reasonable basis for the frequency chosen to prevent an annual re-visiting of the frequency vote by shareholders.<sup>139</sup>

In addition, some commentators stated that the proposed note to Rule 14a-8(i)(10) should incorporate a majority standard rather than the proposed plurality standard, so that issuers would need to adopt a policy consistent with the majority of votes cast in order to exclude a shareholder proposal as substantially implemented,<sup>140</sup> noting that the majority standard would be consistent with policies that boards should implement actions recommended by majority shareholder vote.<sup>141</sup> Some commentators also recommended that issuers should be permitted to exclude shareholder proposals for votes on executive compensation that are narrower in scope<sup>142</sup> than the say-on-pay vote required under Rule 14a-21(a).<sup>143</sup> These commentators expressed the concern that shareholders could undermine the non-binding nature of the frequency vote through more specific vote proposals.<sup>144</sup>

<sup>135</sup> See letter from UBC.

<sup>136</sup> See, e.g., letters from ABA, Davis Polk, Meridian, Society of Corp. Sec., and Sullivan.

<sup>137</sup> See letter from Sullivan.

<sup>138</sup> See, e.g., letters from Boeing and Center on Exec. Comp.

<sup>139</sup> See letter from Boeing.

<sup>140</sup> See, e.g., letters from CalPERS, CII, and SBA of Florida.

<sup>141</sup> See letter from CII.

<sup>142</sup> An example would be a shareholder proposal for an advisory vote on the Chief Executive Officer's compensation as disclosed under Item 402 of Regulation S-K.

<sup>143</sup> See, e.g., letters from Business Roundtable, Boeing, CCMC, Davis Polk, Pfizer, and Society of Corp. Sec.

<sup>144</sup> See letter from Boeing.

Finally, some commentators indicated that it would be inappropriate to permit companies to exclude shareholder proposals on frequency if there have been material changes in the company's compensation program since the prior frequency vote<sup>145</sup> because shareholders should be permitted the opportunity to revisit their decision on the frequency vote under such circumstances.<sup>146</sup> Other commentators noted that material changes to an issuer's compensation program should not limit the availability of Rule 14a-8(i)(10) because shareholders will understand that a company's compensation program is dynamic and factor this into their frequency voting decisions.<sup>147</sup> These commentators noted that the difficulty in determining whether changes are material would erode the benefit of the note to Rule 14a-8(i)(10), create uncertainty as to a company's ability to exclude shareholder proposals on frequency,<sup>148</sup> and burden the staff with analyzing materiality on a case-by-case basis.<sup>149</sup>

#### c. Final Rule

After reviewing the comments, we are adopting the amendment to Rule 14a-8(i)(10) with some modifications.

We continue to believe that under certain conditions, an issuer should be permitted to exclude subsequent shareholder proposals that seek a vote on the same matters as the shareholder advisory votes on say-on-pay and frequency required by Section 14A(a). Consequently, consistent with the proposal, we are adding a note to Rule 14a-8(i)(10) to permit the exclusion of a shareholder proposal that would provide a say-on-pay vote, seeks future say-on-pay votes, or relates to the frequency of say-on-pay votes in certain circumstances; however, in response to comments,<sup>150</sup> we are changing the threshold for exclusion from a plurality to a majority. Specifically, as adopted, the note to Rule 14a-8(i)(10) will permit exclusion of such a shareholder proposal if, in the most recent shareholder vote on frequency of say-on-pay votes, a single frequency (*i.e.*, one, two or three years) received the support of a majority of the votes cast and the issuer has adopted a policy on

<sup>145</sup> See, e.g., letters from Boston Common, Calvert, First Affirmative, ICGN, PIRC, PGGM, RAILPEN & USS, Social Investment, and Walden.

<sup>146</sup> See letter from RAILPEN & USS.

<sup>147</sup> See, e.g., letters from ABA, Boeing, Frederic W. Cook & Co., Inc. ("Frederic Cook"), McGuireWoods, Pfizer, PM&P, and Protective Life.

<sup>148</sup> See letter from McGuireWoods.

<sup>149</sup> See letter from Frederic Cook.

<sup>150</sup> See, e.g., letters from CalPERS, CII, and SBA of Florida.

the frequency of say-on-pay votes that is consistent with that choice.<sup>151</sup>

In light of the nature of the vote—with three substantive choices—it is possible that no single choice will receive a majority of votes and that, as a result, there may be issuers that may not be able to exclude subsequent shareholder proposals regarding say-on-pay matters even if they adopt a policy on frequency that is consistent with plurality of votes cast. We also recognize, however, that if no single frequency choice receives the support of a majority of votes cast, the choice preferred by the plurality may not represent the choice preferred by most of the company's shareholders. For example, if 30% of votes support annual voting, 30% support biennial voting, and 40% favor triennial voting, no frequency would have received a majority of votes cast; therefore, it is not clear that implementing the plurality choice would be favored by most of the company's shareholders. In that situation, if the company implemented triennial voting and the note to Rule 14a-8(i)(10) allowed exclusion of shareholder proposals seeking a different frequency, this could prevent shareholders from putting forth proposals that seek to request that the company implement a frequency that would be preferred by a majority of shareholders. After considering commentators' views, we are concerned that this approach would inappropriately restrict shareholder proposals on this topic, particularly in light of Section 14A(c)(4)'s directive that the shareholder advisory votes required by Sections 14A(a) and (b) may not be construed "to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation."

On the other hand, if a majority of votes cast favors a given frequency and the issuer adopts a policy on frequency that is consistent with the choice of the majority of votes, then in our view, as a matter of policy it is appropriate for Rule 14a-8 to provide for exclusion of subsequent shareholder proposals that would provide a say-on-pay vote, seek future say-on-pay votes, or relate to the frequency of say-on-pay votes. We believe that, in these circumstances, additional shareholder proposals on frequency generally would

<sup>151</sup> For purposes of this analysis, an abstention would not count as a vote cast. We are prescribing this voting standard solely for purposes of determining the scope of the exclusion under the note to Rule 14a-8(i)(10), and not for the purpose of determining whether a particular voting frequency should be considered to have been adopted or approved by shareholder vote as a matter of state law.

unnecessarily burden the company and its shareholders given the company's adherence to the view favored by a majority of shareholder votes regarding the frequency of say-on-pay votes.<sup>152</sup> As described above, an issuer would not be permitted to exclude such shareholder proposals under the note if no frequency choice received a majority of the votes cast.

As a result of this amendment, an issuer will be permitted to exclude shareholder proposals that propose a vote on the frequency of such votes,<sup>153</sup> including those drafted as requests to amend the issuer's governing documents. For example, if in the first vote under Rule 14a-21(b) a majority of votes were cast for a two-year frequency for future shareholder votes on executive compensation, and the issuer adopts a policy to hold the vote every two years, a shareholder proposal seeking a different frequency could be excluded so long as the issuer seeks votes on executive compensation every two years.<sup>154</sup>

We also believe that a shareholder proposal that would provide an advisory vote or seek future advisory votes on executive compensation with substantially the same scope as the say-on-pay vote required by Rule 14a-21(a)—the approval of executive compensation as disclosed pursuant to Item 402 of Regulation S-K—should also be subject to exclusion under Rule 14a-8(i)(10) if the issuer adopts a policy on frequency that is consistent with the majority of votes cast. This is consistent with the proposal, although like additional frequency votes, the note to Rule 14a-8(i)(10) would condition exclusion on the company implementing the frequency favored by a majority of shareholders. In this circumstance, shareholders would be provided the opportunity to provide

<sup>152</sup> We recognize that this approach is different from the traditional "substantially implemented" standard in Rule 14a-8(i)(10) since the frequency sought by a shareholder would be different from the frequency the issuer has implemented. We have revised the note to avoid confusion in that regard. A shareholder proposal seeking a frequency that is the same as that provided by the company would be excludable under the traditional "substantially implemented" standards in Rule 14a-8(i)(10) without regard to the new note, assuming there are no other differences that would lead to a different result.

<sup>153</sup> No-action requests to exclude shareholder proposals that seek shareholder advisory votes on different aspects of executive compensation will be evaluated on a case-by-case basis by the staff.

<sup>154</sup> Issuers seeking to exclude a shareholder proposal under the note to Rule 14a-8(i)(10) are required to follow the same shareholder proposal process with the staff of the Commission as would be required if the issuer intended to rely on any other substantive basis for exclusion under Rule 14a-8.

say-on-pay votes on the frequency preferred by a majority of shareholders when last polled, and we believe additional proposals on the same matter would impose unnecessary burdens on companies and shareholders.

We are also modifying the note slightly. To avoid confusion, we are removing the requirement that an issuer must provide "a vote on frequency at least as often as required by Section 14A(a)(2)." We believe this language is not necessary as issuers are already required to comply with Section 14A(a)(2) in any event. In addition, we are removing the language "as substantially implemented" from the note to avoid confusion.

#### 5. Amendment to Form 8-K

We also proposed amendments to Form 10-Q and Form 10-K to require additional disclosure regarding the issuer's decision to adopt a policy on the frequency of say-on-pay votes following a shareholder advisory vote on frequency. After considering the comments, we are not adopting amendments to Form 10-Q and Form 10-K. Instead, we are adopting a new Form 8-K Item to require disclosure of the issuer's decision on the frequency of say-on-pay votes.

##### a. Proposed Amendments

Issuers are currently required to disclose the preliminary results of shareholder votes pursuant to Item 5.07 of Form 8-K within four business days following the day the shareholder meeting ends and final voting results within four business days of when they are known. This item will require issuers to report how shareholders voted in the say-on-pay vote and the frequency of shareholder votes on executive compensation.

We proposed amendments to Form 10-K and Form 10-Q to require additional disclosure regarding the issuer's decision in light of such vote as to how frequently the company will include those say-on-pay votes for the six subsequent years. Our proposed amendments to Item 9B of Form 10-K and new Item 5(c) of Part II of Form 10-Q would have required an issuer to disclose this decision in the Form 10-Q covering the quarterly period during which the shareholder advisory vote occurs, or in the Form 10-K if the shareholder advisory vote occurs during the issuer's fourth quarter. In light of the relevance of this decision to potential shareholder proposals on the topic, we proposed this disclosure to notify shareholders on a timely basis about the issuer's decision on how frequently it

will provide the say-on-pay vote to shareholders.

b. Comments on the Proposed Amendments

Comments on the proposal were mixed. A number of commentators supported the amendments as proposed that would require disclosure of an issuer's decision as to the frequency of say-on-pay votes in the Form 10-Q or Form 10-K for the period during which the advisory vote occurs<sup>155</sup> as the requirement would allow shareholders to readily obtain an issuer's decision on the frequency of say-on-pay votes.<sup>156</sup> Some commentators questioned whether the Commission should require such disclosure of an issuer's determination regarding frequency following the results of a shareholder advisory vote at all,<sup>157</sup> given that the shareholder vote on the frequency of say-on-pay votes is only advisory.<sup>158</sup> Other commentators suggested that we should allow issuers additional time to consider the results of the shareholder vote<sup>159</sup> and to contact shareholders for additional feedback,<sup>160</sup> particularly if the shareholders do not express a clear preference on frequency. These commentators recommended that we instead require that disclosure about the issuer's decision be included in a later Form 10-Q or Form 10-K filing,<sup>161</sup> Form 8-K filing,<sup>162</sup> or on the issuer's Web site.<sup>163</sup> These commentators indicated that a requirement for a later filing would still permit shareholders adequate time to submit a shareholder proposal on the frequency of say-on-pay votes.<sup>164</sup>

Commentators also noted that Item 5.07 of Form 8-K currently requires disclosure of the number of votes cast "for, against or withheld" on matters submitted to a vote of shareholders, but that the item would not permit disclosure of the results of the frequency vote for "1 year, 2 years, 3 years, or abstain."<sup>165</sup> These commentators suggested that we amend Item 5.07 of

Form 8-K to facilitate reporting the results of the frequency vote.<sup>166</sup>

c. Final Rule

After reviewing the comments on this issue, we have concluded that disclosure of the issuer's determination regarding frequency of say-on-pay votes should be required, but we are adopting the disclosure requirement through an amendment to Item 5.07 of Form 8-K in lieu of amendments to Form 10-Q and Form 10-K. We have considered the position of commentators who were concerned that the required timing of disclosure under our proposal would not permit sufficient time for issuers to fully consider the results of the vote, including through board deliberations and consultation with shareholders as described above, before the disclosure of the decision is required.<sup>167</sup> In light of this concern, we are adopting this disclosure requirement as a Form 8-K requirement due at a later date, in lieu of amending Form 10-Q and Form 10-K, to give issuers additional time to make their decisions.

Under our final rule, Item 5.07 of Form 8-K requires an issuer to disclose its decision regarding how frequently it will conduct shareholder advisory votes on executive compensation following each shareholder vote on the frequency of say-on-pay votes. To comply, an issuer will file an amendment to its prior Form 8-K filings under Item 5.07 that disclose the preliminary and final results of the shareholder vote on frequency. This amended Form 8-K will be due no later than 150 calendar days after the date of the end of the annual or other meeting in which the vote required by Rule 14a-21(b) took place, but in no event later than 60 calendar days prior to the deadline for the submission of shareholder proposals under Rule 14a-8 for the subsequent annual meeting, as disclosed in the issuer's proxy materials for the meeting at which the frequency vote occurred.<sup>168</sup>

<sup>166</sup> See letter from PIRC.

<sup>167</sup> See, e.g., letters from ABA, Boeing, Compensia, Davis Polk, Eaton, Frederic Cook, PM&P, Protective Life, TIAA-CREF, and Time Warner.

<sup>168</sup> Item 5.07 is not among the list of items subject to the safe harbor from liability in Rules 13a-11 [17 CFR 240.13a-11] and 15d-11 [17 CFR 240.15d-11] under the Exchange Act. In addition, companies that fail to file a timely report required by Item 5.07 will lose their eligibility to file Form S-3 registration statements. We are not making a change to this as a result of our amendments to Item 5.07. We continue to believe that Item 5.07 does not require management to make rapid materiality and similar judgments within the compressed Form 8-K timeframe. See *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, Release No. 33-8400 (Mar. 16, 2004) [69 FR 15594] at Section II.E and *Proxy Disclosure Enhancements*,

In the amended Item 5.07 Form 8-K, the issuer must disclose its determination regarding the frequency of say-on-pay votes.<sup>169</sup>

We believe the time period specified for filing the amended Item 5.07 Form 8-K should address commentators' requests that we revise the proposal to allow companies additional time to carefully consider the results of the frequency vote, including through board and committee deliberations and discussions with shareholders, before disclosure of the decision is required.<sup>170</sup> It also should provide enough time for shareholders to consider whether to submit a shareholder proposal on say-on-pay votes or on the frequency of say-on-pay votes once the disclosure is provided.

In addition, in response to comment,<sup>171</sup> we are adopting a technical amendment to Item 5.07(b) of Form 8-K to facilitate reporting of shareholder votes on frequency. Item 5.07 of Form 8-K generally requires an issuer to "state the number of votes cast for, against, or withheld, as well as the number of abstentions and broker non-votes as to each such matter \* \* \*." The amendments we adopt today will clarify that, with respect to the vote on the frequency of say-on-pay votes, the issuer will be required to disclose the number of votes cast for each of 1 year, 2 years, and 3 years, as well as the number of abstentions.<sup>172</sup>

6. Effect of Shareholder Vote

Although the language in Section 951 of the Act indicates that the separate resolution subject to shareholder vote is "to determine" the frequency of the shareholder vote on executive compensation, in light of new Section 14A(c) of the Exchange Act, we continue to believe this shareholder vote, and all shareholder votes required by Section 951 of the Act, are intended to be non-binding on the issuer or the issuer's board of directors. New Section 14A(c) states that the shareholder votes referred to in Section 14A(a) and Section 14A(b) (which includes all votes

Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334] at Section II.E.

<sup>169</sup> Item 5.07(d) of Form 8-K.

<sup>170</sup> In this regard, we note the recent guidance provided by the Division of Corporation Finance that Regulation FD [17 CFR 243.100 *et seq.*] does not prohibit directors from speaking privately with a shareholder or group of shareholders as described in that guidance. See Regulation FD CDIs, Question 101.11.

<sup>171</sup> See, e.g., letters from Davis Polk and PIRC.

<sup>172</sup> We are adopting a conforming technical change to Instruction 1 to Item 5.07 to carve out Item 5.07(d) from the four-business day period for reporting the event. See Instruction 1 to Item 5.07 of Form 8-K.

<sup>155</sup> See, e.g., letters from CalPERS, ICGN, Meridian, PGGM, and SBA of Florida.

<sup>156</sup> See letter from SBA of Florida.

<sup>157</sup> See, e.g., letters from Business Roundtable, Boeing, Center on Exec. Comp., CCMC, FSR, and Society of Corp. Sec.

<sup>158</sup> See, e.g., letter from Society of Corp. Sec.

<sup>159</sup> See, e.g., letters from Compensia, Davis Polk, Eaton, Frederic Cook, PM&P, and Protective Life.

<sup>160</sup> See, e.g., letters from ABA, Boeing, TIAA-CREF, and Time Warner Inc. ("Time Warner").

<sup>161</sup> See, e.g., letters from Eaton, Frederic Cook, Compensia, and PM&P.

<sup>162</sup> See, e.g., letters from ABA and Davis Polk.

<sup>163</sup> See letter from Business Roundtable.

<sup>164</sup> See letter from ABA.

<sup>165</sup> See, e.g., letter from Davis Polk.

under Section 951 of the Act) “shall not be binding on the issuer or the board of directors of an issuer.”<sup>173</sup> Though we received a comment letter asserting that the shareholder vote on frequency is binding,<sup>174</sup> in our view the plain language of Exchange Act Section 14A(c) indicates that this vote is advisory. Accordingly, we are adopting new Item 24 of Schedule 14A to include language to require disclosure regarding the general effect of the shareholder advisory votes, such as whether the vote is non-binding.<sup>175</sup>

### C. Issues Relating to Both Shareholder Votes Required by Section 14A(a)

#### 1. Amendments to Rule 14a–6

We proposed amendments to Rule 14a–6 to add the say-on-pay and frequency of say-on-pay votes to the list of items that do not require the filing of proxy materials in preliminary form. After considering comments, we are adopting the proposed amendments to Rule 14a–6, with some modification.

##### a. Proposed Amendments

Rule 14a–6(a) generally requires issuers to file proxy statements in preliminary form at least ten calendar days before definitive proxy materials are first sent to shareholders, unless the items included for a shareholder vote in the proxy statement are limited to specified matters. During the time before final proxy materials are filed, our staff has the opportunity to comment on the disclosures and issuers are able to incorporate the staff’s comments in their final proxy materials. Absent an amendment to Rule 14a–6(a), a proxy statement that includes a solicitation for either the shareholder vote on the approval of executive compensation or the approval of the frequency of the votes approving executive compensation required by Sections 14A(a)(1) and 14A(a)(2) would need to be filed in preliminary form. Because the shareholder vote on executive compensation and the shareholder vote on the frequency of such shareholder votes are required for all issuers, we view them as similar to the other items specified in Rule 14a–6(a) that do not require a preliminary filing. In the Proposing Release, we noted our view that a preliminary filing requirement for the shareholder votes on executive

compensation and the frequency of such votes would impose unnecessary administrative burdens and preparation and processing costs associated with the filing and processing of proxy material that would unlikely be selected for review in preliminary form.<sup>176</sup>

We proposed amendments to Rule 14a–6(a) to add the shareholder votes on executive compensation and the frequency of shareholder votes on executive compensation required by Section 14A(a) to the list of items that do not trigger a preliminary filing.<sup>177</sup> As proposed, a proxy statement that includes a solicitation with respect to either of these shareholder votes would not trigger a requirement that the issuer file the proxy statement in preliminary form, so long as a preliminary filing would not otherwise be required under Rule 14a–6(a).

##### b. Comments on the Proposed Amendments

Comments on the proposal were favorable. While one commentator stated that say-on-pay votes and votes on the frequency of say-on-pay votes should trigger the requirement to file in preliminary form to provide the market and investors additional time to consider the executive compensation disclosures,<sup>178</sup> the preponderance of commentators agreed that no preliminary proxy should be required.<sup>179</sup> These commentators noted the similarity in proposals for all issuers and the likelihood that the administrative burdens would outweigh any benefits from a preliminary filing.<sup>180</sup> In addition, one commentator asserted that we should not require a preliminary proxy statement for shareholder advisory votes on the

frequency of say-on-pay votes that are not required by Section 14A so that issuers would not be required to file in preliminary form as a result of including a frequency vote in their proxy materials voluntarily.<sup>181</sup> Other commentators suggested that no preliminary proxy statement should be required for any separate shareholder vote on executive compensation,<sup>182</sup> noting that it would be inappropriate to require a preliminary filing for proposals on more narrow aspects of compensation if a preliminary filing is not required for broader proposals.<sup>183</sup>

##### c. Final Rule

After considering the comments, we are adopting the amendments to Rule 14a–6(a) as proposed, with slight modifications. We are adopting amendments to Rule 14a–6(a) to add any shareholder advisory vote on executive compensation, including shareholder votes to approve executive compensation and the frequency of shareholder votes on executive compensation required by Section 14A(a), to the list of items that do not trigger a preliminary filing. As adopted, a proxy statement that includes a solicitation with respect to any advisory vote on executive compensation, including a say-on-pay vote or a vote on the frequency of say-on-pay votes, would not trigger a requirement that the issuer file the proxy statement in preliminary form, so long as any other matters to which the solicitation relates include only the other matters specified by Rule 14a–6(a). Finally, in a revision from the proposal, this amendment will also encompass an advisory vote on executive compensation, including a vote on the frequency of say-on-pay votes, that is not required by Section 14A. Upon review of the comments, we are persuaded by commentators’ arguments that our preliminary proxy filing requirements should not differentiate between say-on-pay votes simply because, in one case, the issuer is required to include the proposal, and, in the other, the issuer chooses to do so.

#### 2. Broker Discretionary Voting

As noted in the Proposing Release,<sup>184</sup> Section 957 of the Act amends Section 6(b) of the Exchange Act<sup>185</sup> to direct the national securities exchanges to change their rules to prohibit broker discretionary voting of uninstructed shares in certain matters, including

<sup>173</sup> Exchange Act Section 14A(c).

<sup>174</sup> See letter from Merkl.

<sup>175</sup> Even though each of the shareholder advisory votes required by Section 14A is non-binding pursuant to the rule of construction in Section 14A(c), as we noted in Note 69 of the Proposing Release, we believe these votes could play a role in an issuer’s executive compensation decisions.

<sup>176</sup> See Section II.C.1 of the Proposing Release. See also, *Proxy Rules—Amendments to Eliminate Filing Requirements for Certain Preliminary Proxy Material; Amendments With Regard to Rule 14a–8, Shareholder Proposals*, Release No. 34–25217 (Dec. 21, 1987) [52 FR 48982].

<sup>177</sup> In the recent release relating to the similar shareholder votes for companies subject to EESA with outstanding indebtedness under the TARP program, we received comments regarding whether a preliminary proxy statement should be required for shareholder votes on executive compensation for TARP companies. While some commentators argued that a preliminary proxy statement should be required, other commentators argued persuasively that the burdens of such an approach outweighed the costs. As a result, we decided to eliminate the requirement for a preliminary proxy statement for shareholder votes on executive compensation for TARP companies. See TARP Adopting Release, *supra* note 18, at 75 FR 2791.

<sup>178</sup> See letter from Brian Foley (“Foley”).

<sup>179</sup> See, e.g., letters from Ameriprise Financial (“Ameriprise”), ABA, Business Roundtable, CalPERS, Center on Exec. Comp., Compensia, Davis Polk, FSR, ICGN, Pfizer, PGGM, PM&P, Protective Life, and Society of Corp. Sec.

<sup>180</sup> See, e.g., letter from Compensia.

<sup>181</sup> See letter from Business Roundtable.

<sup>182</sup> See letters from ABA and ICGN.

<sup>183</sup> See letter from ABA.

<sup>184</sup> See Section II.C.2 of the Proposing Release.

<sup>185</sup> 15 U.S.C. 78f(b).

shareholder votes on executive compensation. The national securities exchanges have made substantial progress in amending their rules regarding broker discretionary voting on executive compensation matters to implement this requirement.<sup>186</sup> Under these amended exchange rules, for issuers with a class of securities listed on a national securities exchange, broker discretionary voting of uninstructed shares is not permitted for a shareholder vote on executive compensation or a shareholder vote on the frequency of the shareholder vote on executive compensation.<sup>187</sup>

### 3. Relationship to Shareholder Votes on Executive Compensation for TARP Companies

Issuers that have received financial assistance under the Troubled Asset Relief Program, or TARP, are required to conduct a separate annual shareholder vote to approve executive compensation during the period in which any obligation arising from the financial assistance provided under the TARP remains outstanding.<sup>188</sup>

Because the vote required to approve executive compensation pursuant to the Emergency Economic Stabilization Act of 2008, or EESA, is effectively the same vote that would be required under Section 14A(a)(1), as we indicated in the Proposing Release,<sup>189</sup> we believe that a shareholder vote to approve executive compensation under Rule 14a-20 for issuers with outstanding indebtedness under the TARP would satisfy Rule 14a-21(a). Consequently, we noted in the Proposing Release that we would not require an issuer that conducts an annual shareholder advisory vote to approve executive compensation pursuant to EESA to conduct a separate shareholder advisory vote on executive compensation under Section 14A(a)(1) until that issuer has repaid all indebtedness under the TARP. Such an issuer would be required to include a separate shareholder advisory vote on

executive compensation pursuant to Section 14A(a)(1) and Rule 14a-21(a) for the first annual meeting of shareholders after the issuer has repaid all outstanding indebtedness under the TARP. Commentators on this issue generally expressed support for our proposed approach to companies with outstanding indebtedness under TARP,<sup>190</sup> and we have determined to implement this approach under the rules as adopted.

Even though issuers with outstanding indebtedness under the TARP have a separate statutory requirement to provide an annual shareholder vote on executive compensation so long as they are indebted under the TARP, absent exemptive relief these issuers would be required, pursuant to Section 14A(a)(2) of the Exchange Act, to provide a separate shareholder advisory vote on the frequency of shareholder votes on executive compensation for the first annual or other such meeting of shareholders on or after January 21, 2011. In our view, however, because such issuers have a requirement to conduct an annual shareholder advisory vote on executive compensation so long as they are indebted under the TARP, a shareholder advisory vote on the frequency of such votes while the issuer remains subject to a requirement to conduct such votes on an annual basis would not serve a useful purpose. We expressed these views in the Proposing Release<sup>191</sup> and, as noted above, commentators supported our views on this point.

We have considered, therefore, whether issuers with outstanding indebtedness under the TARP should be subject to the requirements of Section 14A(a)(2) of the Exchange Act. We do not believe it is necessary or appropriate in the public interest or consistent with the protection of investors to require an issuer to conduct a shareholder advisory vote on the frequency of the shareholder advisory vote on executive compensation when the issuer already is required to conduct advisory votes on executive compensation annually regardless of the outcome of such frequency vote. Because Section 14A(a)(2) would burden TARP issuers and their shareholders with an additional vote while providing little benefit to either the issuer or its shareholders, we continue to believe an exemption by rule is appropriate, pursuant to both the exemptive authority granted by Section 14A(e) of

the Exchange Act<sup>192</sup> and the Commission's general exemptive authority pursuant to Section 36(a)(1) of the Exchange Act.<sup>193</sup> As a result, Rule 14a-21(b), as we are adopting it, exempts an issuer with outstanding indebtedness under the TARP from the requirements of Rule 14a-21(b) and Section 14A(a)(2) until the issuer has repaid all outstanding indebtedness under the TARP. Similar to the approach for shareholder advisory votes under Rule 14a-21(a), such an issuer would be required to include a separate shareholder advisory vote on the frequency of shareholder advisory votes on executive compensation pursuant to Section 14A(a)(2) and Rule 14a-21(b) for the first annual meeting of shareholders after the issuer has repaid all outstanding indebtedness under the TARP.

### D. Disclosure of Golden Parachute Arrangements and Shareholder Approval of Golden Parachute Arrangements

#### 1. General

Section 14A(b)(1) of the Exchange Act requires all persons making a proxy or consent solicitation seeking shareholder approval of an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of an issuer's assets to provide disclosure, in accordance with rules we promulgate, of any agreements or understandings that the soliciting person has with its named executive officers (or that it has with the named executive officers of the acquiring issuer) concerning compensation that is based on or otherwise relates to the

<sup>192</sup> Exchange Act Section 14A(e) provides that "the Commission may, by rule or order, exempt an issuer or class of issuers from the requirement" under Sections 14A(a) or 14A(b). Section 14A(e) further provides that "in determining whether to make an exemption under this subsection, the Commission shall take into account, among other considerations, whether the requirements under [Section 14A(a) and 14A(b)] disproportionately burdens small issuers." In adopting this exemption, the Commission considered whether the requirements of Section 14A(a) and (b) as applied to TARP recipients to conduct a shareholder advisory vote on the frequency of say-on-pay votes could disproportionately burden small issuers. As described further in Section I.I.E below, we have also considered whether the provision as a whole disproportionately burdens small issuers. We note, in addition, that to the extent a TARP recipient is a small issuer, it will be subject to the exemption.

<sup>193</sup> 15 U.S.C. 78mm(a)(1). Exchange Act Section 36(a)(1) provides that "the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."

<sup>186</sup> See, e.g., *Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change to Amend NYSE Rule 452 and Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting on Executive Compensation Matters*, Release No. 34-62874, SR-NYSE-2010-59 (Sept. 9, 2010); *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Prohibit Members from Voting Uninstructed Shares on Certain Matters*, Release No. 34-62992, SR-NASDAQ-2010-114 (Sept. 24, 2010).

<sup>187</sup> Broker discretionary voting in connection with merger or acquisition transactions also is not permitted under rules of the national securities exchanges. See, e.g., NYSE Rule 452.

<sup>188</sup> Section 111(e) of the Emergency Economic Stabilization Act of 2008, 12 U.S.C. 5221. See also Rule 14a-20.

<sup>189</sup> See Section I.I.C.3 of the Proposing Release.

<sup>190</sup> See, e.g., letters from ABA, CalPERS, COPERA, Davis Polk, FSR, PGGM, and RAILPEN & USS.

<sup>191</sup> See Section I.I.C.3 of the Proposing Release.

merger transaction. In addition, Section 14A(b)(1) requires disclosure of any agreements or understandings that an acquiring issuer has with its named executive officers and that it has with the named executive officers of the target company in transactions in which the acquiring issuer is making a proxy or consent solicitation seeking shareholder approval of an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of an issuer's assets. Section 14A(b)(1) of the Exchange Act requires the disclosure to be in a "clear and simple form in accordance with regulations to be promulgated by the Commission" and to include "the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of such executive officer."<sup>194</sup>

Under existing Commission rules, a target issuer soliciting shareholder approval of a merger is required to describe briefly any substantial interest, direct or indirect, by security holdings or otherwise, of any person who has been an executive officer or director since the beginning of the last fiscal year in any matter to be acted upon.<sup>195</sup> In response to this requirement, target issuers often include disclosure in their proxy statements about compensation arrangements that may be payable to a target issuer's executive officers and directors in connection with the transaction. In addition, under our existing rules, issuers are required to include in annual reports and annual meeting proxy statements detailed information in accordance with Item 402(j) of Regulation S-K about payments that may be made to named executive officers upon termination of employment or in connection with a change in control.<sup>196</sup> The Item 402(j) disclosure is provided based on year-end information and various assumptions, and generally does not reflect any actual termination or termination event.<sup>197</sup>

<sup>194</sup> Exchange Act Section 14A(b)(1).

<sup>195</sup> Item 5 of Schedule 14A.

<sup>196</sup> See Item 402(j) of Regulation S-K [17 CFR 229.402(j)], Item 8 of Schedule 14A, and Item 11 of Form 10-K. Item 402(j) disclosure is required in both Annual Reports on Form 10-K and in annual meeting proxy statements, though such disclosure is typically provided in annual meeting proxy statements and incorporated into the Form 10-K by reference pursuant to General Instruction G(3) of Form 10-K. References to "annual meeting proxy statements" in this context are meant to encompass both locations for the disclosure.

<sup>197</sup> See Instruction 1 to Item 402(j), which requires quantitative disclosure applying the assumptions that the triggering event took place on the last business day of the issuer's last completed fiscal year, and the price per share of the issuer's securities is the closing market price as of that date.

## 2. Item 402(t) of Regulation S-K

We proposed Item 402(t) of Regulation S-K to require disclosure of named executive officers' golden parachute arrangements in both tabular and narrative formats. This disclosure will be required in merger proxies and other disclosure documents for similar transactions as described in Section II.D.3 below. After considering the comments on this proposal, we are adopting Item 402(t) as proposed, with some modifications.

### a. Proposed Amendments

We proposed Item 402(t) of Regulation S-K to require disclosure of named executive officers' golden parachute arrangements in both tabular and narrative formats. We based our proposals on Section 14A(b)(1)'s requirement that disclosure of the golden parachute compensation in any proxy or consent solicitation to approve an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all assets be "in a clear and simple form in accordance with regulations to be promulgated by the Commission" and include "the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of such executive officer."<sup>198</sup>

Consistent with Section 14A(b)(1) of the Exchange Act, agreements or understandings between a target issuer conducting a solicitation and its named executive officers would be subject to disclosure under proposed Item 402(t). In addition, because golden parachute compensation arrangements also may involve agreements or understandings between the acquiring issuer and the named executive officers of the target issuer, we proposed that Item 402(t) require disclosure of this compensation in addition to the disclosure mandated by Section 14A(b)(1). Specifically, to cover the full scope of potential golden parachute compensation applicable to the transaction, we proposed that Item 402(t) require disclosure of all golden parachute compensation relating to the merger among the target and acquiring issuers and the named executive officers of each.<sup>199</sup>

Where a triggering event has actually occurred for a named executive officer who was no longer serving as a named executive officer of the issuer at the end of the last completed fiscal year, Instruction 4 to Item 402(j) requires Item 402(j) disclosure for that named executive officer only for that triggering event.

<sup>198</sup> Exchange Act Section 14A(b)(1).

<sup>199</sup> However, because any agreements between a soliciting target company's named executive officers and the acquiring company are beyond the scope of the disclosure required by Section

We did not propose to amend the requirements for golden parachute disclosure in annual meeting proxy statements, although, under our proposal companies would be permitted to provide disclosure in annual meeting proxies in accordance with the new requirement.<sup>200</sup>

### b. Comments on the Proposed Amendments

Comments on the proposal were generally favorable. We requested comment on a number of aspects of proposed Item 402(t), which we describe in more detail below.

#### i. General Comments on the Proposed Item 402(t) Table

We proposed that the Item 402(t) table would present quantitative disclosure of the individual elements of compensation that a named executive officer would receive that are based on or otherwise relate to the merger, acquisition, or similar transaction, and the total for each named executive officer.

Many commentators agreed that Item 402(t) as proposed would elicit disclosure of all elements of golden parachute compensation "in a clear and simple form" as required by Section 14A(b)(1).<sup>201</sup> In addition, some commentators suggested that Item 402(t) should be clarified to require disclosure of only compensation triggered by the subject transaction so that issuers are not required to disclose any golden parachute compensation that would not be triggered by the subject transaction.<sup>202</sup>

#### ii. Comments on the Elements of Compensation and Presentation of the Proposed Item 402(t) Table

As proposed, Item 402(t) would not have any *de minimis* exceptions for compensation below a certain dollar threshold and would not require disclosure of previously vested equity and pension benefits. Some commentators urged that Item 402(t) should have *de minimis* exceptions, like Item 402(j),<sup>203</sup> because, in their view, the exclusion of such immaterial amounts would not be inconsistent with Section 14A(b)(1)'s requirement to

14A(b)(1), we did not propose to subject such agreements to the Rule 14a-21(c) shareholder advisory vote required by Section 14A(b)(2) and Rule 14a-21(c). See discussion of Rule 14a-21(c) in Section II.D.4 below.

<sup>200</sup> See Sections II.D.2 and II.D.4 below.

<sup>201</sup> See, e.g., letters from Davis Polk, PGGM, and WorldatWork.

<sup>202</sup> See, e.g., letters from Davis Polk, Society of Corp. Sec., and Wachtell.

<sup>203</sup> See, e.g., letters from Compensia, Davis Polk, McGuireWoods, PM&P, and Sullivan.

disclose the total amount of golden parachute compensation.<sup>204</sup> In addition, some commentators asserted that we should amend Item 402(j) rather than propose a new Item 402(t).<sup>205</sup>

Most commentators agreed with the proposed approach to omit previously vested equity and pension benefits from the table,<sup>206</sup> as including such amounts in the table could lead to confusion by overstating the total compensation.<sup>207</sup> Other commentators, however, recommended that such compensation be disclosed in the table<sup>208</sup> to make the compensation disclosure more comprehensive.<sup>209</sup>

A number of commentators also requested various other changes to the proposed table. Some commentators argued that issuers should have more flexibility in drafting the table to fit their individual circumstances,<sup>210</sup> or that issuers should be permitted to differentiate between cash severance compensation and cash amounts for outstanding awards that have been accelerated.<sup>211</sup> With respect to employment agreements, most commentators supported our proposed approach to exclude disclosure of employment agreements from the Item 402(t) table,<sup>212</sup> though some commentators argued that such employment agreements should be quantified and included in the tabular disclosure to provide more comprehensive disclosure.<sup>213</sup> A number of commentators supported the footnote identification of amounts of “single-trigger” and “double-trigger”<sup>214</sup> compensation elements,<sup>215</sup> with some

commentators recommending that the disclosure be included in the main text rather than in footnotes if an issuer believes it would be useful to the presentation.<sup>216</sup> One commentator, however, indicated that identification of single-trigger and double-trigger elements should not be required as it believed this disclosure would not be useful to investors.<sup>217</sup>

We also requested comment with respect to the appropriate measurement for issuer stock price for tabular disclosure in proxy statements for mergers or similar transactions. A number of commentators agreed with our proposed approach to calculate such amounts based on the issuer’s share price as of the latest practicable date,<sup>218</sup> though many other commentators suggested that the share price contemplated by the deal should be used, if available,<sup>219</sup> with an alternative to use the average closing price over the first five business days following public announcement of the transaction.<sup>220</sup> One commentator expressed a concern that the share price as of the latest practicable date could lead to potential gaming of the price by issuers.<sup>221</sup>

#### iii. Comments on Individuals Subject to Item 402(t) Disclosure

Some commentators indicated that requiring disclosure under Item 402(t) of a broader group of individuals than is required by Exchange Act Section 14A(b)(1) would be potentially confusing to investors<sup>222</sup> as such disclosure goes beyond the requirements of Section 14A and could lead to as many as three separate tables.<sup>223</sup> Different commentators supported disclosure of the broader group of individuals<sup>224</sup> in order to provide the full picture of compensation being received in connection with the transaction.<sup>225</sup>

Most commentators supported the proposal that issuers would not be

<sup>216</sup> See, e.g., letters from ABA and NACD.

<sup>217</sup> See letter from Protective Life.

<sup>218</sup> See, e.g., letters from ABA, Center on Exec. Comp., and ICGN.

<sup>219</sup> See, e.g., letters from Davis Polk, PM&P, and Sullivan.

<sup>220</sup> See letter from PGGM.

<sup>221</sup> See letter from PGGM.

<sup>222</sup> See, e.g., letters from Center on Exec. Comp., Davis Polk, FSR, NACD, Pfizer, PGGM, Protective Life, Towers Watson, Wachtell, Lipton, Rosen & Katz (“Wachtell”), and WorldatWork.

<sup>223</sup> See letter from Davis Polk.

<sup>224</sup> See, e.g., letters from CalPERS, ICGN, PIRC, and Senator Carl Levin (“Senator Levin”).

<sup>225</sup> See letter from PIRC.

required to include Item 402(t) information with respect to individuals who would have been among the most highly compensated executive officers but for the fact that they were not serving as an executive officer at the end of the last completed fiscal year.<sup>226</sup> One commentator, however, argued that issuers should be permitted to include disclosure of the compensation of such individuals to conform to the presentation of compensation in prior filings and that we should clarify that the named executive officers subject to Item 402(t) is determined in the same manner as under Item 5.02(e) of Form 8-K.<sup>227</sup>

#### iv. Comments on Item 402(t) Disclosure in Annual Meeting Proxy Statements

In the Proposing Release, we did not propose requiring Item 402(t) disclosure in annual meeting proxy statements. Most commentators agreed that the proposed Item 402(t) narrative and tabular disclosure should not be required in annual meeting proxy statements<sup>228</sup> given the costs and burdens this would impose on issuers.<sup>229</sup> However, other commentators recommended that such disclosure should be required in annual meeting proxy statements,<sup>230</sup> noting that such information plays a key part in shareholder evaluation of an issuer’s compensation program.<sup>231</sup>

#### c. Final Rule

After considering comments, we are adopting Item 402(t) of Regulation S-K as proposed, with some modifications, to require disclosure of named executive officers’ golden parachute arrangements in both tabular and narrative formats.

#### i. Item 402(t) Table and Narrative Requirements

We are adopting the following new table, as proposed:

<sup>226</sup> See, e.g., letters from Davis Polk, ICGN, PGGM, and PM&P.

<sup>227</sup> See letter from ABA.

<sup>228</sup> See, e.g., letters from ABA, Center for Exec. Comp., Compensia, Davis Polk, Frederic Cook, FSR, Hermes Equity Ownership Services (“Hermes”), ICGN, McGuireWoods, PGGM, PM&P, and WorldatWork.

<sup>229</sup> See, e.g., letter from Frederic Cook.

<sup>230</sup> See, e.g., letters from AFSCME, Protective Life, and Public Citizen.

<sup>231</sup> See letter from AFSCME.

<sup>204</sup> See letter from Compensia.

<sup>205</sup> See, e.g., letters from Business Roundtable and Meridian.

<sup>206</sup> See, e.g., letters from ABA, Center on Exec. Comp., Davis Polk, FSR, ICGN, NACD, Pfizer, PM&P, Protective Life, and WorldatWork.

<sup>207</sup> See letter from ABA.

<sup>208</sup> See, e.g., letters from Barnard, Glass Lewis, PGGM, and Senator Levin.

<sup>209</sup> See, e.g., letter from Glass Lewis.

<sup>210</sup> See letter from ABA.

<sup>211</sup> See letter from Towers Watson.

<sup>212</sup> See, e.g., letters from ABA, Center on Exec. Comp., Compensia, Davis Polk, Frederic Cook, FSR, Hermes, and PGGM.

<sup>213</sup> See, e.g., letters from Glass Lewis, NACD, and PIRC.

<sup>214</sup> A “double-trigger” arrangement requires that the executive’s employment be terminated without cause or that the executive resign for good reason within a limited period of time after the change-in-control to trigger payment. A “single-trigger” arrangement does not require such a termination or resignation after the change-in-control to trigger payment.

<sup>215</sup> See, e.g., letters from CalPERS, CII, FSR, Hermes, ICGN, and PGGM.

GOLDEN PARACHUTE COMPENSATION

Name	Cash (\$)	Equity (\$)	Pension/ NQDC (\$)	Perquisites/ benefits (\$)	Tax reimbursement (\$)	Other (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
PEO .....	.....	.....	.....	.....	.....	.....	.....
PFO .....	.....	.....	.....	.....	.....	.....	.....
A .....	.....	.....	.....	.....	.....	.....	.....
B .....	.....	.....	.....	.....	.....	.....	.....
C .....	.....	.....	.....	.....	.....	.....	.....

The table presents quantitative disclosure of the individual elements of compensation that an executive would receive that are based on or otherwise relate to the merger, acquisition, or similar transaction, and the total for each named executive officer.<sup>232</sup> As proposed and adopted, elements that will be separately quantified and included in the total will be any cash severance payment (e.g., base salary, bonus, and pro-rata non-equity incentive plan<sup>233</sup> compensation payments) (column (b)); the dollar value of accelerated stock awards, in-the-money option awards for which vesting would be accelerated, and payments in cancellation of stock and option awards (column (c)); pension and nonqualified deferred compensation benefit enhancements (column (d)); perquisites and other personal benefits and health and welfare benefits (column (e)); and tax reimbursements (e.g., Internal Revenue Code Section 280G tax gross-ups) (column (f)). Consistent with the proposal, we are adopting an “Other” column of the table for any additional elements of compensation not specifically includable in the other columns of the table (column (g)). This column, like the columns for the other elements, will require footnote identification of each separate form of compensation reported. The final column in the table requires disclosure, for each named executive officer, of the aggregate total of all such compensation (column (h)).<sup>234</sup> We are adopting the table as proposed, with a requirement for separate footnote identification of amounts attributable to “single-trigger” arrangements and amounts attributable to “double-trigger” arrangements, so that shareholders can readily discern these amounts.

<sup>232</sup> Item 402(t)(2) of Regulation S–K.  
<sup>233</sup> As defined in Item 402(a)(6)(iii) of Regulation S–K.  
<sup>234</sup> Exchange Act Section 14A(b)(1) requires disclosure of “the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to or on behalf of such executive officer.”

As proposed and adopted, the tabular disclosure required by Item 402(t) requires quantification with respect to any agreements or understandings, whether written or unwritten, between each named executive officer and the acquiring company or the target company, concerning any type of compensation, whether present, deferred or contingent, that is based on or otherwise relates to an acquisition, merger, consolidation, sale or other disposition of all or substantially all assets. The table will quantify cash severance, equity awards that are accelerated or cashed out, pension and nonqualified deferred compensation enhancements, perquisites, and tax reimbursements. In addition, the table requires disclosure and quantification of the value of any other compensation related to the transaction.<sup>235</sup>

However, as adopted, Item 402(t) will require tabular and narrative disclosure in a proxy statement soliciting shareholder approval of a merger or similar transaction or a filing made with respect to a similar transaction only of compensation that is based on or otherwise relates to the subject transaction.<sup>236</sup> We agree with commentators that it would not be useful to shareholders to require disclosure of amounts that would not be paid or payable in connection with the transaction subject to shareholder approval.

To implement the statutory mandate to disclose the conditions upon which the compensation may be paid or become payable, as proposed and adopted, Item 402(t)<sup>237</sup> requires issuers to describe any material conditions or

<sup>235</sup> Consistent with our proposals, we have adopted Instruction 3 to Item 402(t)(2) to provide, like Instruction 1 to Item 402(j), that in the event uncertainties exist as to the provision of payments and benefits, or the amounts involved, the issuer is required to make a reasonable estimate applicable to the payment or benefit and disclose material assumptions underlying such estimate in its disclosure. Unlike Item 402(j), Item 402(t) does not permit the disclosure of an estimated range of payments.  
<sup>236</sup> Instruction 1 to Item 402(t)(2).  
<sup>237</sup> Item 402(t)(3) of Regulation S–K.

obligations applicable to the receipt of payment, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, their duration, and provisions regarding waiver or breach.<sup>238</sup> We are also adopting a requirement, as proposed, to provide a description of the specific circumstances that would trigger payment,<sup>239</sup> whether the payments would or could be lump sum, or annual, and their duration, and by whom the payments would be provided,<sup>240</sup> and any material factors regarding each agreement.<sup>241</sup> These narrative items are modeled on the narrative disclosure required with respect to termination and change-in-control agreements.<sup>242</sup>

ii. Elements of Compensation and Presentation of Item 402(t) Table

In response to commentators’ requests for greater flexibility to facilitate clear presentation, we note that under our final rule issuers are permitted to add additional named executive officers, and additional columns or rows to the tabular disclosure, such as to disclose cash severance separately from other cash compensation or to distinguish “single-trigger” and “double-trigger” arrangements, so long as such disclosure is not misleading.

As noted in the Proposing Release,<sup>243</sup> we considered whether making the disclosure requirements in Item 402(j) applicable to transactions enumerated in Section 14A(b)(1), rather than adopting a new disclosure item for purposes of Section 14A(b)(1), would be an appropriate approach to satisfy the requirements of the Act. However, certain elements required by Section

<sup>238</sup> Item 402(t)(3)(iii) of Regulation S–K.  
<sup>239</sup> Item 402(t)(3)(i) of Regulation S–K.  
<sup>240</sup> Item 402(t)(3)(ii) of Regulation S–K.  
<sup>241</sup> Item 402(t)(3) of Regulation S–K. Such material factors would include, for example, provisions regarding modifications of outstanding options to extend the vesting period or the post-termination exercise period, or to lower the exercise price.  
<sup>242</sup> Item 402(j) of Regulation S–K.  
<sup>243</sup> See Section I.LD.2 of the Proposing Release.

14A(b)(1) are not included in Item 402(j). Specifically, Item 402(j) does not require disclosure about arrangements that do not discriminate in scope, terms or operation in favor of executive officers and that are available generally to all salaried employees,<sup>244</sup> permits exclusion of *de minimis* perquisites and other personal benefits,<sup>245</sup> and does not require presentation of an aggregate total of all compensation that is based on or otherwise relates to a transaction.<sup>246</sup>

Despite the views of some commentators, we continue to believe that Item 402(t) should not permit exclusion of *de minimis* perquisites and other personal benefits because exclusion of these amounts would be inconsistent with Section 14A(b)(1), which requires disclosure of “the aggregate total of all such compensation that may [\* \* \*] be paid or become payable [\* \* \*].” Moreover, we continue to believe that the Section 14A(b)(1) requirement to disclose the information “in a clear and simple form” is best satisfied through the use of tabular disclosure, which Item 402(j) does not require.

Item 402(t), like Item 402(j),<sup>247</sup> does not require separate disclosure or quantification with respect to compensation disclosed in the Pension Benefits Table and Nonqualified Deferred Compensation Table. Item 402(t), as proposed and adopted, also does not require disclosure or quantification of previously vested equity awards because these award amounts are vested without regard to the transaction. We agree with the views expressed by some commentators that previously vested equity awards are not compensation “that is based on or otherwise relates to” the transaction. Similarly, after reviewing the comments, we continue to believe that we should not require tabular disclosure and quantification of compensation from *bona fide* post-transaction employment agreements to be entered into in connection with the merger or acquisition transaction. We agree with the views expressed by many

<sup>244</sup> Instruction 5 to Item 402(j).

<sup>245</sup> See Instruction 2 to Item 402(j), which permits exclusion of perquisites and other personal benefits or property if the aggregate amount of such compensation will be less than \$10,000.

<sup>246</sup> As proposed, we are adopting conforming changes to Item 402(a)(6)(ii) [17 CFR 229.402(a)(6)(ii)] and Item 402(m)(5)(ii) [17 CFR 229.402(m)(5)(ii)] of Regulation S-K to clarify that information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the company and that are generally available to all salaried employees must be included in disclosure pursuant to proposed Item 402(t).

<sup>247</sup> See Instruction 3 to Item 402(j).

commentators that future employment arrangements are not compensation “that is based on or otherwise relates to” the transaction.<sup>248</sup>

Under the final rule, where Item 402(t) disclosure is included in an annual meeting proxy statement,<sup>249</sup> the price per share amount will be calculated based on the closing market price per share of the issuer’s securities on the last business day of the issuer’s last completed fiscal year, as proposed,<sup>250</sup> consistent with quantification standards used in Item 402(j). However, in response to comments, we have modified how the issuer stock price will be measured for calculating dollar amounts for the tabular disclosure required by Item 402(t) in connection with a transactional filing. In a proxy statement soliciting shareholder approval of a merger or similar transaction or a filing made with respect to a similar transaction, Item 402(t)’s tabular quantification of dollar amounts based on issuer stock price will be based on the consideration per share, if such value is a fixed dollar amount, or otherwise on the average closing price per share over the first five business days following the first public announcement of the transaction.<sup>251</sup>

#### iii. Individuals Subject to Item 402(t) Disclosure

We continue to believe that Item 402(t) disclosure should cover a broader group of individuals than is required by Section 14A(b). Because compensation arrangements may involve agreements or understandings between the acquiring issuer and the named executive officers of the target issuer, Item 402(t), as proposed and adopted, requires disclosure of the full scope of golden parachute compensation applicable to the transaction. We agree with commentators and continue to believe that shareholders may find disclosure about these arrangements that are not otherwise required to be disclosed by Section 14A(b) informative to their voting decisions.

As both proposed and adopted, we have included an instruction providing that Item 402(t) disclosure need not be provided for persons who are named

<sup>248</sup> Information regarding such future employment agreements is subject to disclosure pursuant to Item 5(a) and Item 5(b)(xii) of Schedule 14A to the extent that such agreements constitute a “substantial interest” in the matter to be acted upon.

<sup>249</sup> A company may choose to include the disclosure in the annual meeting proxy statement in order for the Section 14A(a)(1) shareholder vote to satisfy the exception from the merger proxy separate vote. See Section I.D.4 below.

<sup>250</sup> Instruction 2 to Item 402(t)(2).

<sup>251</sup> Instruction 1 to Item 402(t)(2).

executive officers because they would have been among the most highly compensated executive officers but for the fact that they were not serving as an executive officer at the end of the last completed fiscal year.<sup>252</sup> However, in response to comments, we are clarifying that where Item 402(t) disclosure is provided in a proxy statement soliciting shareholder approval of a merger or similar transaction or a filing made with respect to a similar transaction, this instruction will be applied with respect to the named executive officers for whom disclosure was required in the issuer’s most recent filing requiring Summary Compensation Table disclosure.<sup>253</sup>

#### iv. Item 402(t) Disclosure in Annual Meeting Proxy Statements

We are not requiring Item 402(t) disclosure in annual meeting proxy statements. We agree with the views expressed by most commentators that the proposed Item 402(t) narrative and tabular disclosure should not be required in annual meeting proxy statements given the costs and burdens this would impose on issuers. We believe that the requirements of Item 402(j) provide sufficient information to shareholders in that context, and note that issuers may also include disclosure pursuant to Item 402(t) voluntarily if they believe it would permit shareholders to gain a better understanding of their compensation programs.

An issuer seeking to satisfy the exception from the separate merger proxy shareholder vote under Section 14A(b)(2) and Rule 14a-21(c) by including Item 402(t) disclosure in an annual meeting proxy statement soliciting the shareholder vote required by Section 14A(a)(1) and Rule 14a-21(a)<sup>254</sup> will be able to satisfy Item 402(j) disclosure requirements with respect to a change-in-control of the issuer by providing the disclosure required by Item 402(t).<sup>255</sup> The issuer

<sup>252</sup> Instruction 1 to Item 402(t), which requires Item 402(t) disclosure for individuals covered by Items 402(a)(3)(i), (ii) and (iii), and for smaller reporting companies, the individuals covered by Items 402(m)(2)(i) and (ii). Item 402(t) disclosure will not be required for individuals for whom Item 402(t) disclosure otherwise is required by Item 402(a)(3)(iv), and for smaller reporting companies, by Item 402(m)(2)(iii).

<sup>253</sup> Instruction 1 to Item 402(t)(2) and Instruction 2 to Item 1011(b). This is similar to the approach used in Instruction 4 to Item 5.02 of Form 8-K.

<sup>254</sup> This exception and the comments we received on the exception are discussed in Section I.D.4 below.

<sup>255</sup> We note also that one example of material information to be addressed in CD&A is the basis for selecting particular termination or change-in-

must still include in an annual meeting proxy statement disclosure in accordance with Item 402(j) about payments that may be made to named executive officers upon termination of employment.

3. Amendments to Schedule 14A, Schedule 14C, Schedule 14D–9, Schedule 13E–3, Schedule TO, and Item 1011 of Regulation M–A

We proposed amendments to require that the disclosure set forth in Item 402(t) of Regulation S–K be included in merger proxies as well as filings for other transactions not referenced in the Act. After considering the comments received, we are adopting the amendments to Schedule 14A, Schedule 14C, Schedule 14D–9, Schedule 13E–3, and Item 1011 of Regulation M–A as proposed with slight modifications to Item 1011 of Regulation M–A. We are also adopting an amendment to Schedule TO to clarify that the Item 402(t) disclosure is not required in third-party bidders' tender offer statements, so long as the transactions are not also Rule 13e–3 going-private transactions.

#### a. Proposed Amendments

We proposed amendments to Items 5(a) and (b) of Schedule 14A under the Exchange Act, as well as conforming changes to Item 3 of Schedule 14C, Item 1011(b) of Regulation M–A, Item 15 of Schedule 13E–3 and Item 8 of Schedule 14D–9. These proposals were intended to implement the disclosure requirements in Section 14A(b)(1) as well as to extend the new disclosure requirements to similar transactions by requiring that the disclosure set forth in Item 402(t) of Regulation S–K be included in any proxy or consent solicitation material seeking shareholder approval of an acquisition, merger, consolidation, or proposed sale or other distribution of all or substantially all the assets of the issuer. Our proposals would require such disclosure not only in a proxy or consent solicitation relating to such a transaction, as required by the Act, but also in the following:

- Information statements filed pursuant to Regulation 14C;
- Proxy or consent solicitations that do not contain merger proposals but require disclosure of information under Item 14 of Schedule 14A pursuant to Note A of Schedule 14A;
- Registration statements on Forms S–4 and F–4 containing disclosure

control events as triggering payment (*e.g.*, the rationale for providing a single trigger for payment in the event of a change-in-control). *See* Item 402(b)(2)(xi) of Regulation S–K.

relating to mergers and similar transactions;

- Going private transactions on Schedule 13E–3; and
- Third-party tender offers on Schedule TO and Schedule 14D–9 solicitation/recommendation statements.

We also proposed amendments to Item 1011(b) of Regulation M–A that would require the bidder<sup>256</sup> in a third-party tender offer to provide information in its Schedule TO about a target's golden parachute arrangements only to the extent the bidder has made a reasonable inquiry about the golden parachute arrangements and has knowledge of such arrangements. In addition, we proposed exceptions to both the disclosure requirement under Item 1011(b) for both bidders and targets in third-party tender offers and filing persons in Rule 13e–3 going-private transactions where the target or subject company is a foreign private issuer, and to the disclosure obligation under Item 402(t) with respect to agreements and understandings with senior management of foreign private issuers where the target or acquirer is a foreign private issuer.

#### b. Comments on the Proposed Amendments

Comments on the proposal were generally favorable. A number of commentators expressed support for our proposed approach to require disclosure of golden parachute arrangements in connection with other transaction not specifically referenced in the Act.<sup>257</sup> One commentator objected that the proposal goes beyond the scope of the statute by requiring disclosure of golden parachute compensation in connection with tender and exchange offers.<sup>258</sup> One commentator also questioned whether such disclosure should be required in third-party tender offers, given the difficulty bidders may face in obtaining accurate information regarding a target company's golden parachute arrangements.<sup>259</sup> Commentators also supported excluding foreign private issuers from Item 402(t) disclosure requirements for bidders and target companies in third-party tender offers and filing persons in Rule 13e–3 going-private transactions.<sup>260</sup>

#### c. Final Rule

After considering the comments, we are adopting the amendments to

<sup>256</sup> "Bidder" is defined in Rule 14d–1(g)(2) [17 CFR 240.14d–1(g)(2)].

<sup>257</sup> *See, e.g.*, letters from ICGN and PGGM.

<sup>258</sup> *See* letter from Wachtell.

<sup>259</sup> *See* letter from ABA.

<sup>260</sup> *See, e.g.*, letters from ABA, ICGN, and PGGM.

Schedule 14A, Schedule 14C, Schedule 14D–9, Schedule 13E–3, and Item 1011 of Regulation M–A as proposed, with slight modifications to Item 1011 of Regulation M–A. We are also adopting an amendment to Schedule TO to provide that bidders in third-party tender offers are not required to provide the disclosure required by Item 1011(b) of Regulation M–A.

Issuers could structure transactions in a manner that avoids implicating Section 14(a) of the Exchange Act (*e.g.*, tender offers and certain Rule 13e–3 going-private transactions), while still effectively seeking the consent of shareholders with respect to their investment decision (*e.g.*, whether or not to tender their shares or approve a going-private transaction, in instances where such going-private transactions are not subject to Regulation 14A). For these reasons, we continue to believe that requiring Item 402(t) disclosure in all such transactions furthers the purposes of Section 14A(b) of the Exchange Act and would minimize the regulatory disparity that might otherwise result from treating such transactions differently. Thus, we are adopting amendments that would require the Item 402(t) disclosure in various transactions, whether a merger, acquisition, a Rule 13e–3 going-private transaction or a tender offer.<sup>261</sup>

In addition, we note that acquiring companies may solicit proxies to approve the issuance of shares or a reverse stock split in order to conduct a merger transaction, and that such proxy statements are required to include disclosure of information required under Item 14 of Schedule 14A pursuant to Note A of Schedule 14A. Thus, we are also adopting amendments that would require the Item 402(t) disclosure in those proxy statements that are required to include disclosure of information required under Item 14 of Schedule 14A pursuant to Note A of Schedule 14A.<sup>262</sup> The shareholder advisory vote required by Section 14A(b)(2), however, will not be extended to transactions beyond those specified in that section.

We have revised the final rule in response to comments to provide that

<sup>261</sup> As adopted, companies filing solicitation/recommendation statements on Schedule 14D–9 in connection with third-party tender offers will be obligated to provide this additional disclosure. *See* Item 8 of Schedule 14D–9. However, as explained below, bidders filing offer statements on Schedule TO will not have a similar obligation. *See* Item 11 of Schedule TO.

<sup>262</sup> *See* Item 5(a)(5) and Item 5(b)(3) of Schedule 14A, which will require acquiring companies to include the Item 402(t) disclosure with respect to each named executive officer of both the acquiring issuer and the target issuer.

bidders in third-party tender offers will not be required to comply with Item 1011(b), which calls for Item 402(t) disclosure. We are persuaded that bidders may face difficulties in obtaining the information necessary to provide such disclosure<sup>263</sup> and that it is not necessary to require a bidder to provide this information since the target companies will be required to provide the Item 402(t) golden parachute compensation disclosure in Schedule 14D-9 filed by the tenth business day from the date the tender offers are first published, sent or given to security holders.<sup>264</sup> We believe this revision to the proposal will alleviate a potential burden that bidders in third-party tender offers may encounter while still accomplishing our goal of minimizing the regulatory disparity that might otherwise result from treating third-party tender offers differently than other transactions described in this section by retaining the disclosure requirement in Schedule 14D-9. However, we did not adopt a similar revision to the proposed changes to Schedule 13E-3; therefore, the disclosure of golden parachute arrangements will be required in third-party tender offers that are also Rule 13e-3 going-private transactions.<sup>265</sup> In light of the revision to the proposal, we are not adopting the instruction to Item 1011(b) of Regulation M-A that would have allowed bidders to provide the disclosure only to the extent the information was known after making a reasonable inquiry. Therefore, Item 1011(b), as adopted, does not include the proposed instruction.

In addition, we are adopting as proposed an exception to the disclosure requirement under Item 1011(b) for targets in third-party tender offers and filing persons in Rule 13e-3 going-private transactions where the target or subject company is a foreign private issuer. Consistent with the proposal, we are also adopting an exception to the disclosure obligation under Item 402(t) with respect to agreements and understandings with senior management of foreign private issuers where the target or acquirer is a foreign private issuer.<sup>266</sup> We agree with commentators and believe such accommodations are appropriate in light of our long-standing accommodation to

foreign private issuers regarding compensation disclosure.<sup>267</sup>

#### 4. Rule 14a-21(c)

Section 14A(b)(2) generally requires a separate shareholder advisory vote on golden parachute compensation arrangements required to be disclosed under Section 14A(b)(1) in connection with mergers and similar transactions. A separate shareholder advisory vote would not be required on golden parachute compensation if disclosure of that compensation had been included in the executive compensation disclosure that was subject to a prior advisory vote of shareholders under Section 14A(a)(1) of the Exchange Act.

We proposed Rule 14a-21(c) to implement these requirements. We are adopting this rule substantially as proposed with some minor changes in response to comments.

##### a. Proposed Rule

Proposed Rule 14a-21(c) would require issuers to conduct a separate shareholder advisory vote in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets, consistent with Section 14A(b)(2). This shareholder advisory vote would be required only with respect to the golden parachute agreements or understandings required to be disclosed by Section 14A(b)(1), as disclosed pursuant to proposed Item 402(t) of Regulation S-K. We proposed Rule 14a-21(c) to require a shareholder advisory vote only on the golden parachute compensation agreements or understandings for which Section 14A(b)(1) requires disclosure and Section 14A(b)(2) requires a shareholder vote. Consistent with Section 14A(b)(2), as proposed, issuers would not be required to include in the merger proxy a separate shareholder vote on golden parachute compensation disclosed in accordance with Item 402(t) of Regulation S-K if Item 402(t) disclosure of that compensation had been included in the executive compensation disclosure that was subject to a prior vote of shareholders under Section 14A(a)(1) of the Exchange Act and Rule 14a-21(a).

##### b. Comments on the Proposed Amendments

Comments on the proposal were generally positive. As noted above, some commentators indicated that

requiring disclosure under Item 402(t) of a broader group of individuals than would be covered by the Rule 14a-21(c) shareholder advisory vote would be potentially confusing to investors<sup>268</sup> as such disclosure goes beyond the requirements of Section 14A and could lead to as many as three separate tables.<sup>269</sup>

Most commentators agreed with our proposed approach that if golden parachute arrangements were modified or amended subsequent to being subject to the annual shareholder vote under Rule 14a-21(a), a separate shareholder vote in the merger proxy should be required to cover only the changes to such arrangements,<sup>270</sup> given that full disclosure of the full set of arrangements will also be provided.<sup>271</sup> Some commentators, however, believed that in this circumstance the subsequent vote should cover the entire set of golden parachute arrangements, not just the changes, so that shareholders have the opportunity to vote on the full complement of compensation that would be payable.<sup>272</sup>

In addition, some commentators recommended that certain changes to golden parachute arrangements that were altered or amended subsequent to being subject to the shareholder advisory vote under Rule 14a-21(a) should be exempt from a separate shareholder advisory vote in a merger proxy. In their view, there should be an exemption for certain routine, non-substantive changes, such as where the same compensation arrangements apply to new named executive officers who were not included in the prior disclosure that was subject to the shareholder vote,<sup>273</sup> subsequent grants in the ordinary course of additional awards subject to the same acceleration terms that applied to awards covered by a previous vote,<sup>274</sup> routine changes in salary subsequent to the prior vote,<sup>275</sup> and changes that result in a reduction in compensation value.<sup>276</sup> Other

<sup>268</sup> See, e.g., letters from Center on Exec. Comp., Davis Polk, FSR, NACD, Pfizer, PGM, Protective Life, Towers Watson, Wachtell, Lipton, Rosen & Katz ("Wachtell"), and WorldatWork.

<sup>269</sup> See letter from Davis Polk.

<sup>270</sup> See, e.g., letters from ABA, Frederic Cook, McGuireWoods, NACD, PGM, Protective Life, and WorldatWork.

<sup>271</sup> See, e.g., letter from ABA.

<sup>272</sup> See, e.g., letter from CII.

<sup>273</sup> See, e.g., letters from McGuireWoods, PM&P, Protective Life, Steve Quinlivan ("Quinlivan"), and Sullivan.

<sup>274</sup> See, e.g., letters from Business Roundtable, Compensia, FSR, McGuireWoods, PM&P, Protective Life, Sullivan, and Wachtell.

<sup>275</sup> See letter from McGuireWoods.

<sup>276</sup> See, e.g., letters from Frederic Cook, Meridian, and Protective Life.

<sup>263</sup> See letter from ABA.

<sup>264</sup> We are adopting an amendment to Schedule TO to avoid imposing on bidders the obligation to provide such disclosure. See Item 11 of Schedule TO.

<sup>265</sup> See Item 15 of Schedule 13E-3.

<sup>266</sup> Instruction 2 to Item 402(t).

<sup>267</sup> See, e.g., Item 402(a)(1) of Regulation S-K, and Items 6.B and 6.E.2 of Form 20-F [17 CFR 249.220f].

commentators stated that there should be no exceptions and that a new golden parachute vote should be required if there have been any changes since the arrangements were subject to the Rule 14a–21(a) shareholder advisory vote.<sup>277</sup>

#### c. Final Rule

After considering the comments, we are adopting Rule 14a–21(c) as proposed, with some modifications. Consistent with the proposal, our rule does not require issuers to use any specific language or form of resolution to be voted on by shareholders. In addition, we note that, as provided in Section 14A(c), this shareholder vote will not be binding on the issuer or its board of directors.

#### i. Scope of Rule 14a–21(c) Shareholder Advisory Vote

Under Rule 14a–21(c), issuers will be required to provide a separate shareholder advisory vote in proxy statements for meetings at which shareholders are asked to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all assets, consistent with Section 14A(b)(2). However, issuers are not required to provide a separate shareholder advisory vote in proxy statements for meetings at which shareholders are asked to approve other proposals, such as an increase in authorized shares or a reverse stock split, which may be necessary for the issuer to effectuate a transaction. A vote under Rule 14a–21(c) is required only if the shareholders are voting to approve the transaction and the transaction and golden parachute arrangements come within those covered by Section 14A(b). Consistent with the proposal, this advisory vote will be required only with respect to the golden parachute agreements or understandings required to be disclosed by Section 14A(b)(1), as disclosed pursuant to proposed Item 402(t) of Regulation S–K.

Section 14A(b)(1) requires disclosure of any agreements or understandings between the soliciting person and any named executive officer of the issuer or any named executive officers of the acquiring issuer, if the soliciting person is not the acquiring issuer. When a target issuer conducts a proxy or consent solicitation to approve a merger or similar transaction, golden parachute compensation agreements or understandings between the acquiring issuer and the named executive officers of the target issuer are not within the scope of disclosure required by Section 14A(b)(1), and thus a shareholder vote

to approve arrangements between the soliciting target issuer's named executive officers and the acquiring issuer is not required by Exchange Act Section 14A(b)(2). Consequently, consistent with the proposal, Rule 14a–21(c) as adopted requires a shareholder advisory vote only on the golden parachute compensation agreements or understandings for which Section 14A(b)(1) requires disclosure and Section 14A(b)(2) requires a shareholder vote. As described in Section II.D.2.c.iii above, however, disclosure of all golden parachute arrangements will be required, even though a vote on the arrangements will not be required.

#### ii. Exceptions to Rule 14a–21(c) Shareholder Advisory Vote

Consistent with Section 14A(b)(2) and our proposal, issuers will not be required to include in the merger proxy a separate shareholder vote on the golden parachute compensation disclosed under Item 402(t) of Regulation S–K if Item 402(t) disclosure of that compensation had been included in the executive compensation disclosure that was subject to a prior vote of shareholders under Section 14A(a)(1) of the Exchange Act and Rule 14a–21(a). In this regard, we note that Section 14A(b)(2) requires only that the golden parachute arrangements have been subject to a prior shareholder vote under Section 14A(a)(1); such arrangements need not have been approved by shareholders.

For issuers to take advantage of this exception, however, the executive compensation disclosure subject to the prior shareholder vote must have included Item 402(t) disclosure of the same golden parachute arrangements. Even if the annual meeting proxy statement provided some disclosure with respect to golden parachute arrangements,<sup>278</sup> the annual meeting proxy statement must include the disclosure required by Item 402(t) in order for the annual meeting shareholder vote under Section 14A(a)(1) and Rule 14a–21(a) to satisfy the exception from the merger proxy separate shareholder vote under Section 14A(b)(2) and Rule 14a–21(c). Consequently, we would expect that some issuers may voluntarily include Item 402(t) disclosure with their other executive compensation disclosure in annual meeting proxy statements soliciting the shareholder vote required by Section 14A(a)(1) and Rule 14a–21(a)

<sup>278</sup> See CD&A and Item 402(j) of Regulation S–K, and for smaller reporting companies see Item 402(q)(2) of Regulation S–K for the disclosure requirements applicable to annual meeting proxy statements.

so that this exception would be available to the issuer for a potential subsequent merger or acquisition transaction. We also expect that some issuers may choose to include the new disclosure for other reasons, such as investor interest in the information.

The exception will be available only to the extent the same golden parachute arrangements previously subject to an annual meeting shareholder vote remain in effect, and the terms of those arrangements have not been modified subsequent to the Section 14A(a)(1) shareholder vote. As proposed and adopted, if the disclosure pursuant to Item 402(t) has been updated to change only the value of the items in the Golden Parachute Compensation Table to reflect price movements in the issuer's securities, no new shareholder advisory vote under Section 14A(b)(1) will be required. New golden parachute arrangements, and any revisions to golden parachute arrangements that were subject to a prior Section 14A(a)(1) shareholder vote will be subject to the separate merger proxy shareholder vote requirement of Section 14A(b)(2) and Rule 14a–21(c).<sup>279</sup>

Additionally, we agree with certain commentators<sup>280</sup> that changes that result only in a reduction in value of the total compensation payable should not require a new shareholder vote. If the shareholders have had an opportunity to vote on a more highly valued compensation package, then we do not believe issuers should be required to provide a separate vote on a change that results only in a compensation package that has been reduced in value.

We believe that the other examples of changes cited by commentators, including changes in compensation because of a new named executive officer, additional grants of equity compensation in the ordinary course, and increases in salary, are significant changes to the golden parachute compensation disclosure and, consistent with Section 14A(b)(2), should be subject to a shareholder vote. Because a shareholder vote would already have been obtained on portions of the arrangements, however, only the new arrangements and revised terms of the arrangements previously subject to a Section 14A(a)(1) shareholder vote will be subject to the merger proxy separate

<sup>279</sup> For example, we would view any change that would result in an IRC Section 280G tax gross-up becoming payable as a change in terms triggering such a separate vote, even if such tax gross-up becomes payable only because of an increase in the issuer's share price.

<sup>280</sup> See, e.g., letters from Frederic Cook, Meridian, and Protective Life.

<sup>277</sup> See, e.g., letters from Glass Lewis and PGGM.

shareholder vote under Section 14A(b)(2) and Rule 14a-21(c).

Consistent with the proposal, issuers providing for a shareholder vote on new arrangements or revised terms will need to provide two separate tables under Item 402(t) of Regulation S-K in merger proxy statements.<sup>281</sup> One table will disclose all golden parachute compensation, including both arrangements and amounts previously disclosed and subject to a say-on-pay vote under Section 14A(a)(1) and Rule 14a-21(a) and the new arrangements or revised terms. The second table will disclose only the new arrangements or revised terms subject to the vote, so that shareholders can clearly see what is subject to the shareholder vote under Section 14A(b)(2) and Rule 14a-21(c). Similarly, in cases where Item 402(t) requires disclosure of arrangements between an acquiring company and the named executive officers of the soliciting target company, issuers will need to clarify whether these agreements are included in the shareholder advisory vote by providing a separate table of all agreements and understandings subject to the shareholder advisory vote required by Section 14A(b)(2) and Rule 14a-21(c), if different from the full scope of golden parachute compensation subject to Item 402(t) disclosure.<sup>282</sup>

#### *E. Treatment of Smaller Reporting Companies*

Section 951 of the Act establishes a new Section 14A(e) of the Exchange Act, which provides that we may, by rule or order, exempt an issuer or class of issuers from the requirements of Section 14A(a) and (b). In determining whether to make an exemption under this subsection, we are directed to take into account, among other considerations, whether the requirements of Sections 14A(a) and 14A(b) disproportionately burden small issuers.

In the Proposing Release, we did not propose to exempt small issuers or smaller reporting companies<sup>283</sup> from the requirements of Sections 14A(a) and 14A(b). Comments on this issue were mixed. Many commentators agreed that the requirements of Section 14A should be applied to all issuers and that there should be no exemptions for smaller

<sup>281</sup> See Instruction 6 to Item 402(t)(2) of Regulation S-K.

<sup>282</sup> Instruction 7 to Item 402(t)(2). As discussed above, such agreements are not required to be subject to the Rule 14a-21(c) shareholder advisory vote, but issuers may voluntarily subject them to such a vote.

<sup>283</sup> "Smaller reporting company" is defined in Rule 12b-2 under the Exchange Act.

reporting companies,<sup>284</sup> while a number of other commentators asserted that smaller reporting companies should be exempt from the requirements of Exchange Act Section 14A and our proposed rules.<sup>285</sup> Among those opposed to applying the requirements to smaller reporting companies, in addition to stating that these requirements would be a burden to smaller reporting companies,<sup>286</sup> some commentators asserted that smaller reporting companies may feel compelled to include additional disclosure beyond the scaled requirements otherwise applicable to smaller reporting companies, including a CD&A, because of such votes,<sup>287</sup> which would impose significant burdens on these issuers. One commentator urged that, if we do not exempt smaller reporting companies, we should at least delay implementation of the proposed rules for smaller reporting companies so that smaller companies would have the opportunity to observe how larger companies conduct the vote and respond to the disclosure requirements.<sup>288</sup>

After reviewing and considering these comments, we are adopting a temporary exemption for smaller reporting companies so that these issuers will not be required to conduct either a shareholder advisory vote on executive compensation or a shareholder advisory vote on the frequency of say-on-pay votes until the first annual or other meeting of shareholders occurring on or after January 21, 2013.<sup>289</sup> We do not believe that smaller reporting companies should be permanently exempt from the say-on-pay vote, frequency of say-on-pay votes and golden parachute disclosure and vote because we believe investors have the same interest in voting on the compensation of smaller reporting companies and in clear and simple disclosure of golden parachute compensation in connection with mergers and similar transactions as they have for other issuers. However, after reviewing comments on the potential

<sup>284</sup> See, e.g., letters from AFSCME, Boston Common, CalPERS, Calvert, CII, First Affirmative, Glass Lewis, ICGN, Merkl, PGGM, Public Citizen, RAILPEN & USS, SBA of Florida, Senator Levin, Social Investment, and Walden.

<sup>285</sup> See, e.g., letters from American Bankers Association ("Am. Bankers"), Independent Community Bankers of America ("ICBA"), NACD, Society of Corp. Sec., and Virginia Bankers Association ("VBA").

<sup>286</sup> See, e.g., letters from ABA, Am. Bankers, and VBA.

<sup>287</sup> See, e.g., letters from ABA and Society of Corp. Sec.

<sup>288</sup> See letter from ABA.

<sup>289</sup> Rules 14a-21(a) and (b).

burdens on smaller reporting companies, we believe it is appropriate to provide additional time before smaller reporting companies are required to conduct the shareholder advisory votes on executive compensation and the frequency of say-on-pay votes.

We believe that a delayed effective date for the say-on-pay and frequency votes for smaller reporting companies should allow those companies to observe how the rules operate for other companies and should allow them to better prepare for implementation of the rules. We also believe that delayed implementation for these companies will allow us to evaluate the implementation of the adopted rules by larger companies and provide us with the additional opportunity to consider whether adjustments to the rule would be appropriate for smaller reporting companies before the rule becomes applicable to them. We believe a temporary exemption by rule is appropriate, under the exemptive authority granted by Section 14A(e) of the Exchange Act<sup>290</sup> and also under the Commission's general exemptive authority pursuant to Section 36(a)(1) of the Exchange Act, in the public interest and consistent with the protection of investors.<sup>291</sup>

This temporary exemption for smaller reporting companies does not apply to the requirements of Section 14A(b)(2) and Rule 14a-21(c) to provide a shareholder advisory vote on golden parachute compensation in connection with mergers or other extraordinary transactions. We view the temporary exemption as a transition matter that will facilitate eventual compliance with the regular, periodic say-on-pay vote requirement by smaller reporting

<sup>290</sup> Exchange Act Section 14A(e) provides that "the Commission may, by rule or order, exempt an issuer or class of issuers from the requirement" under Sections 14A(a) or 14A(b). Section 14A(e) further provides that "in determining whether to make an exemption under this subsection, the Commission shall take into account, among other considerations, whether the requirements under [Section 14A(a) and 14A(b)] disproportionately burden small issuers." In considering whether to provide an exemption, the Commission considered whether the requirements of Section 14A(a) and (b) as applied to smaller reporting companies to conduct a shareholder advisory vote on executive compensation and a shareholder advisory vote on the frequency of say-on-pay votes could disproportionately burden small issuers.

<sup>291</sup> 15 U.S.C. 78 mm(a)(1). Exchange Act Section 36(a)(1) provides that "the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."

companies. We do not believe similar considerations support an exemption for the shareholder advisory vote on golden parachute arrangements in light of the extraordinary nature of the transactions involved.

We have also crafted our amendments to minimize the costs for smaller reporting companies, while providing shareholders the opportunity to express their views on the companies' compensation arrangements. For example, once they fully apply to smaller reporting companies, our amendments will provide shareholders of those companies the same voting rights with respect to executive compensation as apply to shareholders of other companies subject to the proxy rules. We do not believe that Section 14A and our final rules, especially given the temporary exemption, would unduly burden smaller reporting companies. For example, our final rule does not alter the existing scaled disclosure requirements set forth in Item 402 of Regulation S-K for smaller reporting companies, which recognize that the compensation arrangements of smaller reporting companies typically are less complex than those of other public companies.<sup>292</sup> Under the rules we adopt today, we do not alter the provision in our rules that smaller reporting companies are not required to provide a CD&A. Therefore, the amendment to Item 402(b) of Regulation S-K will not apply to smaller reporting companies, as such companies are not required to provide a CD&A.

Our amendments will, however, require quantification of golden parachute arrangements in merger proxies. Smaller reporting companies are not required to provide this quantification under current Item 402(q) in annual meeting proxy statements, and are not required to do so under our new rules unless they seek to qualify for the exception for a shareholder advisory vote on golden parachute compensation in a later merger transaction. Even though our rules impose additional disclosure requirements relating to the shareholder advisory votes required by Section 14A, we do not believe our rules will impose a significant additional cost or disproportionate burden upon smaller reporting companies. As noted above, smaller reporting companies tend to have less complex compensation

arrangements<sup>293</sup> so the additional disclosures should not add significantly to their disclosure burden. As a result, we do not believe the rules we adopt today place a disproportionate burden on smaller reporting companies.

#### F. Transition Matters

As noted above in Section I, Section 14A(a)(3) requires that both the initial shareholder vote on executive compensation and the initial vote on the frequency of votes on executive compensation be included in proxy statements relating to an issuer's first annual or other meeting of the shareholders occurring on or after January 21, 2011. Because Section 14A(a) applies to shareholder meetings taking place on or after January 21, 2011, any proxy statements, whether in preliminary or definitive form, even if filed prior to this date, for meetings taking place on or after January 21, 2011, must include the separate resolutions for shareholders to approve executive compensation and the frequency of say-on-pay votes required by Section 14A(a) without regard to whether our rules to implement Section 14A(a) have become effective by that time. To facilitate compliance with the new statute, we addressed certain first year transition issues in the Proposing Release. We are now extending those transition positions as described below.

Before effectiveness of the amendment to Rule 14a-6(a) adopted in this release, Rule 14a-6 will continue to require the filing of a preliminary proxy statement at least ten days before the proxy is sent or mailed to shareholders unless the meeting relates only to the matters specified by Rule 14a-6(a). Until the rules we are adopting to implement Exchange Act Section 14A become effective, we will not object if issuers do not file proxy material in preliminary form if the only matters that would require a filing in preliminary form are the say-on-pay vote and frequency of say-on-pay vote required by Section 14A(a).

Before the amendment to Rule 14a-4 adopted in this release becomes effective, Rule 14a-4 provides that persons solicited are to be afforded the choice between approval or disapproval of, or abstention with respect to, each matter to be voted on, other than elections of directors. Until effectiveness of the amendment to Rule 14a-4 adopted in this release, we will not object if the form of proxy for a shareholder vote on the frequency of say-on-pay votes provides means

whereby the person solicited is afforded an opportunity to specify by boxes a choice among 1, 2 or 3 years, or abstain. In addition, we understand that, although some commentators indicated they are prepared for the four-choice frequency vote, the systems of other proxy service providers are currently set up to register at most three votes—for, against, or abstain—and these providers may have short-term difficulty in programming their systems to enable shareholders to vote among four choices. As a result, because the preparedness of these providers may vary significantly on a firm-by-firm basis, for any proxy materials filed for meetings to be held on or before December 31, 2011, we will not object if the form of proxy for a shareholder vote on the frequency of say-on-pay votes provides means whereby the person solicited is afforded an opportunity to specify by boxes a choice among 1, 2 or 3 years, and there is no discretionary authority to vote proxies on the frequency of say-on-pay votes matter in the event the person solicited does not select a choice among 1, 2 or 3 years.<sup>294</sup>

Issuers with outstanding indebtedness under the TARP are already required to conduct an annual shareholder advisory vote on executive compensation until the issuer has repaid all outstanding indebtedness under the TARP. Because such issuers are subject to an annual requirement to provide a say-on-pay vote, a requirement to provide a vote on the frequency of such votes would impose unnecessary burdens on issuers and shareholders, and our final rules provide an exemption from such requirement. Until the rules we are adopting to implement Exchange Act Section 14A become effective, we will not object if an issuer with outstanding indebtedness under the TARP does not include a resolution for a shareholder advisory vote on the frequency of say-on-pay votes in its proxy statement for its annual meeting, provided it fully complies with its say-on-pay voting obligations under EESA Section 111(e).

Finally, as we discussed above, we are adopting a temporary exemption for smaller reporting companies to defer application of the requirements of Section 14A(a)(1) and (a)(2) and Rule 14a-21(a) and (b) to conduct shareholder advisory votes on executive compensation and the frequency of such votes. Until the rules we are adopting to implement Exchange Act Section 14A

<sup>292</sup> See *Executive Compensation and Related Person Disclosure*, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] (hereinafter, the "2006 Executive Compensation Release") at Section II.D.1. The scaled compensation disclosure requirements for smaller reporting companies are set forth in Item 402(1) [17 CFR 229.402(l)] through (r) [17 CFR 229.402(r)] of Regulation S-K.

<sup>293</sup> See 2006 Executive Compensation Release, *supra* note 292, at Section II.D.1.

<sup>294</sup> See *Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally*, Release No. 34-16356 (Nov. 21, 1979) [44 FR 68770].

become effective, we will not object if a smaller reporting company does not include a resolution for a shareholder advisory vote on say-on-pay or the frequency of say-on-pay votes in its proxy statement for its annual meeting. As with other issuers, smaller reporting companies are required to conduct the shareholder advisory vote on golden parachute compensation upon effectiveness of Rule 14a-21(c).

### III. Paperwork Reduction Act

#### A. Background

Certain provisions of the final amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>295</sup> We published a notice requesting comment on the collection of information requirements in the proposing release for the rule amendments, and we submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with the PRA.<sup>296</sup> The title for the collection of information is:

- (1) "Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059);
- (2) "Regulation 14C and Schedule 14C" (OMB Control No. 3235-0057);
- (3) "Form 8-K" (OMB Control No. 3235-0060);
- (4) "Form 10" (OMB Control No. 3235-0064);
- (5) "Regulation S-K" (OMB Control No. 3235-0071);<sup>297</sup>
- (6) "Schedule 14D-9" (OMB Control No. 3235-0102);
- (7) "Schedule 13E-3" (OMB Control No. 3235-0007);
- (8) "Schedule TO" (OMB Control No. 3235-0515);
- (9) "Form S-1" (OMB Control No. 3235-0065);
- (10) "Form S-4" (OMB Control No. 3235-0324);
- (11) "Form S-11" (OMB Control No. 3235-0067);
- (12) "Form F-4" (OMB Control No. 3235-0325); and
- (13) "Form N-2" (OMB Control No. 3235-0026).

The regulations, schedules, and forms were adopted under the Securities Act and the Exchange Act, except for Form N-2, which we adopted pursuant to the Securities Act and the Investment

Company Act. The regulations, forms, and schedules set forth the disclosure requirements for periodic reports, current reports, registration statements and proxy and information statements filed by companies to help shareholders make informed voting decisions. The hours and costs associated with preparing, filing and sending the form or schedule constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

#### B. Summary of the Final Rules

As discussed in more detail above, we are adopting new Rule 14a-21 under the Exchange Act and new Item 24 of Schedule 14A. Rule 14a-21 will implement the requirements of Section 14A of the Exchange Act to provide separate shareholder advisory votes on executive compensation, the frequency of shareholder votes on executive compensation, and, in connection with merger and similar transactions, golden parachute compensation arrangements. New Item 24 of Schedule 14A will require disclosure in proxy statements with respect to each of these shareholder votes. New Rule 14a-21 and new Item 24 of Schedule 14A will increase existing disclosure burdens for proxy statements by requiring:

- New disclosure about the requirement to provide separate shareholder votes on executive compensation, the frequency of shareholder votes on executive compensation and golden parachute compensation arrangements in connection with merger transactions; and
- New disclosure of the general effect of the shareholder advisory votes, such as whether such votes are non-binding.

As discussed in more detail above, we are also adopting amendments to Item 402(b) of Regulation S-K. The amendments to Item 402(b) of Regulation S-K may increase existing disclosure burdens for proxy statements by requiring:

- New disclosure of whether, and if so, how the issuer has considered the results of the most recent shareholder vote on executive compensation required by Section 14A of the Exchange Act in determining compensation policies and decisions, and, if so, how that consideration has affected the issuer's compensation decisions and policies.

As discussed in more detail above, we are also adopting new Item 402(t) of Regulation S-K and amendments to

Item 1011(b) of Regulation M-A, Item 5 of Schedule 14A, Item 3 of Schedule 14C, Item 15 of Schedule 13E-3, Item 11 of Schedule TO, and Item 8 of Schedule 14D-9. These amendments, other than the amendment to Schedule TO, will increase existing disclosure burdens for proxy statements, registration statements on Form S-4 and F-4, solicitation/recommendation statements on Schedule 14D-9, and going-private schedules by requiring:

- New tabular and narrative disclosure of understandings and agreements of named executive officers with acquiring and target companies in connection with merger, acquisition, Rule 13e-3 going-private transactions, and tender offers,<sup>298</sup> and disclosure of the aggregate total of all compensation that may be paid or become payable to each named executive officer.

As discussed in more detail above, we are adopting amendments to Form 8-K. The amendments to Form 8-K will increase existing disclosure burdens for current reports on Form 8-K by requiring:

- New disclosure of the issuer's decision of how frequently to provide a separate shareholder vote on executive compensation in light of a shareholder advisory vote on the frequency of shareholder votes on executive compensation conducted pursuant to Section 14A(a)(2) of the Exchange Act.

Together, new Rule 14a-21 and new Item 24 of Schedule 14A and the amendments to Item 5 of Schedule 14A, Item 3 of Schedule 14C, Item 402 of Regulation S-K, Item 1011 of Regulation M-A, Item 15 of Schedule 13E-3, Item 11 of Schedule TO, and Item 8 of Schedule 14D-9 will implement and supplement the requirements under Section 14A of the Exchange Act and also will provide additional meaningful disclosure regarding golden parachute arrangements and issuers' consideration of the shareholder votes and the effect of such votes on issuers' compensation policies and decisions. We believe these changes will result in more meaningful disclosure for investors making voting or investment decisions.

We are adopting an amendment to Rule 14a-4, which relates to the form of proxy that issuers are required to include with their proxy materials, to require that issuers present four choices to their shareholders in connection with the advisory vote on frequency. We are also adopting an amendment to Rule

<sup>298</sup> Companies filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers will be obligated to provide this additional disclosure. However, bidders filing tender offer statements on Schedule TO will not have a similar obligation.

<sup>295</sup> 44 U.S.C. 3501 *et seq.*

<sup>296</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>297</sup> The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosures in Regulation S-K and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience we estimate the burdens imposed by Regulation S-K to be a total of one hour.

14a-6 to add the shareholder votes on executive compensation and the frequency of shareholder votes on executive compensation required by Section 14A(a), as well as any shareholder advisory vote on executive compensation, to the list of items that do not trigger the filing of a preliminary proxy statement. In addition, we are adopting an amendment to Rule 14a-8, adding a note to Rule 14a-8(i)(10) to clarify the status of shareholder proposals relating to the approval of executive compensation or the frequency of shareholder votes approving executive compensation. Finally, we are adopting conforming amendments to Item 402(a) and Item 402(m) of Regulation S-K, clarifying that the disclosure required by proposed Item 402(t) includes information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees. Pursuant to these conforming amendments, issuers may continue to omit such information in connection with disclosure required by other portions of Item 402 of Regulation S-K. The amendments to Rule 14a-4, Rule 14a-6, Rule 14a-8 under the Exchange Act and Item 402(a) and Item 402(m) of Regulation S-K will not increase any existing disclosure burden. We believe these amendments will merely clarify existing and new statutory requirements or reduce burdens otherwise arising from our proposals. As a result, these amendments will not affect any existing disclosure burden.

Compliance with the proposed amendments by affected U.S. issuers will be mandatory. Responses to the information collections will not be kept confidential and there would be no mandatory retention period for the information disclosed.

### *C. Summary of Comment Letters and Revisions to Proposals*

In the Proposing Release, we requested comment on the PRA analysis. We did not receive any comments that addressed our overall burden estimates for the proposed amendments, though our analysis was cited by one commentator who discussed our cost-benefit analysis.<sup>299</sup>

We have made few substantive modifications to the proposed amendments. We have adopted an amendment to Form 8-K to require the

disclosure we had proposed to require in Form 10-Q or Form 10-K. Therefore, we have adjusted our estimates to reflect no changes to Forms 10-Q and 10-K and to estimate the increased burdens for Form 8-K.

We have also revised our amendments with respect to Schedule TO to eliminate the proposed requirement for bidders in third-party tender offers to provide Item 402(t) disclosure. We have adjusted our estimates to reflect no changes to Schedule TO, as any increased burden will be reflected in Schedule 13E-3 because Item 402(t) disclosure will be required in any tender offer that is also a Rule 13e-3 going-private transaction.

### *D. Revisions to PRA Reporting and Cost Burden Estimates*

We anticipate that the disclosure amendments will increase the burdens and costs for companies that would be subject to the proposed amendments. New Section 14A of the Exchange Act, as created by Section 951 of the Act, has already increased the burdens and costs for issuers by requiring separate shareholder votes on executive compensation and the frequency of shareholder votes on executive compensation. Section 14A also requires additional disclosure of golden parachute arrangements in proxy solicitations to approve merger transactions and a separate shareholder vote to approve such arrangements in certain circumstances. Our amendments address the Act's requirements in the context of disclosure under the Federal proxy rules, Regulation S-K and related forms and schedules, thereby creating only an incremental increase in the burdens and costs for such issuers. The amendments specify how issuers are to comply with Section 14A of the Exchange Act and require new disclosure with respect to comparable transactions.

For purposes of the PRA, in the Proposing Release we estimated the annual incremental paperwork burden for all companies to prepare the disclosure that would be required under our proposals to be approximately 25,192 hours of company personnel time and a cost of approximately \$8,141,200 for the services of outside professionals. These estimates included the time and the cost of data gathering systems and disclosure controls and procedures, the time and cost of preparing and reviewing disclosure by in-house and outside counsel and executive officers, and the time and cost of filing documents and retaining records. In deriving our estimates, we recognize that the burdens will likely

vary among individual companies based on a number of factors, including the size and complexity of their organizations, the nature and complexity of their golden parachute compensation arrangements, and the nature of their operations. We believe that some companies will experience costs in excess of this average in the first year of compliance with proposals and some companies may experience less than the average costs. As discussed above, as a result of changes to our proposed rules, we are slightly reducing the total PRA burden and cost estimates that we originally submitted to the OMB in connection with the proposed amendments. We estimate the annual incremental paperwork burden for all companies to prepare the disclosure that would be required under our rule amendments to be approximately 24,942 hours of company personnel time and a cost of approximately \$7,841,200 for the services of outside professionals.

We derived our new burden hour and cost estimates by estimating the average number of hours it would take an issuer to prepare and review the proposed disclosure requirements. These estimates represent the average burden for all companies, both large and small. Our estimates have been adjusted to reflect the fact that some of the amendments will be required in some but not all of the above listed documents depending upon the circumstances, and would not apply to all companies.

With respect to reporting companies, the disclosure required by new Item 402(t) of Regulation S-K will be required in merger proxy and information statements, Forms S-4 and F-4, Schedule 13E-3 and certain solicitation/recommendation statements. The disclosure required by new Item 402(t) may also be included in annual meeting proxy statements on a voluntary basis.

The disclosure required by our amendments to Item 402(b) of Regulation S-K will be required in proxy and information statements as well as Forms 10, 10-K, S-1, S-4, S-11, and N-2. The proposed amendments to CD&A will not be applicable to smaller reporting companies because under current CD&A reporting requirements these companies are not required to provide CD&A in their Commission filings. Based on the number of proxy filings that were received in the 2009 fiscal year, we estimate that approximately 1,200 domestic companies are smaller reporting companies that have a public float of less than \$75 million.

<sup>299</sup> See letter from CCMC.

In the Proposing Release, we based our annual burden estimates on other assumptions. We have made some small adjustments to these estimates to reflect the revisions we made to the amendments. First, we continue to assume that the burden hours of the amendments will be comparable to the burden hours related to similar disclosure requirements under current reporting requirements, such as the disclosure required by Item 402(j). Second, we continue to assume that substantially all of the burdens associated with the amendments to Rule 14a-21 and Item 24 will be associated with Schedule 14A as this will be the primary disclosure document in which these items will be prepared and presented. In the case of our proposed amendments to Item 402(b) and Item 402(t) of Regulation S-K, we continue to assume that the burdens associated with the amendments will be associated with various disclosure documents as these items will be included in a number of forms and statements. We have noted an additional 1 hour for the amendments to Form 8-K, and we are no longer proposing any amendments that would alter the disclosure burden of Form 10-Q and Form 10-K.

For each reporting company, we estimate that the amendments will impose on average the following incremental burden hours:

- 2 hours for the amendments to CD&A.
- 1 hour for the amendments to Item 24 of Schedule 14A.
- 1 hour for the amendments to Form 8-K.
- 20 hours for new Item 402(t) of Regulation S-K.

#### 1. Annual Meeting Proxy Statements

For purposes of the PRA, in the case of reporting companies, we estimate the annual incremental paperwork burden for annual meeting proxy statements under the amendments will be approximately 1 hour per form for companies that are smaller reporting companies, and 3 hours per form for companies that are non-accelerated filers (and not smaller reporting companies), accelerated filers, or large

accelerated filers.<sup>300</sup> The estimated burden is smaller for smaller reporting companies as such issuers are not required to include a CD&A.

#### 2. Exchange Act Current Reports

For purposes of the PRA, we estimate the annual incremental paperwork burden for Form 8-K under the amendments will be approximately 1 hour per form. Our estimates below also account for the fact that each issuer will only be required to include additional disclosure in one amended Form 8-K each year the issuer conducts a shareholder advisory vote on frequency.

#### 3. Securities Act Registration Statements and Exchange Act Registration Statements

For purposes of the PRA, in the case of reporting companies, we estimate the annual incremental paperwork burden for Securities Act and Exchange Act registration statements under the amendments is approximately 2 hours per form, which represents the additional burden associated with our amendments to CD&A.<sup>301</sup> In making our estimates, we note that the additional burdens in CD&A only apply to issuers who have conducted a prior shareholder advisory vote and would not apply, for example, to issuers making an initial filing on Form S-1 or Form S-11.

#### 4. Merger Proxies, Tender Offer Documents and Schedule 13E-3

For purposes of the PRA, in the case of reporting companies, we estimate the annual incremental paperwork burden for merger proxy statements, and registration statements on Form S-4 and F-4 to be 21 hours per form, as these forms will be required to include

additional disclosures under Item 24 of Schedule 14A and Item 402(t) of Regulation S-K. We estimate the annual incremental paperwork burden for merger information statements, and tender offer solicitation/recommendation statements and Schedules 13E-3 to be 20 hours per form, as these forms will be required to include Item 402(t) disclosure but will not be required to include additional disclosure under Item 24 of Schedule 14A.

The tables below illustrate the total annual compliance burden of the collection of information in hours and in cost under the proposed amendments for current reports; proxy and information statements; Form 10; registration statements on Forms S-1, S-4, F-4, S-11, and N-2; and Regulation S-K.<sup>302</sup> The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take an issuer to prepare and review the proposed disclosure requirements. For the Exchange Act report on Form 8-K, and the proxy statements we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour.

For registration statements on Forms S-1, S-4, F-4, S-11, and N-2, and the Exchange Act registration statement on Form 10, we estimate that 25% of the burden of preparation is carried by the issuer internally and that 75% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of \$400 per hour. There is no change to the estimated burden of the collections of information under Regulation S-K because the burdens that this regulation imposes are reflected in our revised estimated for the forms. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours.

<sup>300</sup> Our estimate for annual proxy statements is based upon an estimated burden over a six-year period during which the shareholder advisory votes required by Section 14A(a) would not occur annually. We used a six-year period because issuers will conduct at least two shareholder advisory votes on executive compensation and at least one shareholder advisory vote on the frequency of such votes in this time period. We then estimated an average annual burden based on the average burden over the six-year period.

<sup>301</sup> We have assumed that the annual incremental paperwork burden under the proposed amendments to Item 402(b) of Regulation S-K would be included in the annual meeting proxy statement.

<sup>302</sup> Figures in both tables have been rounded to the nearest whole number.

TABLE 1—INCREMENTAL PAPERWORK BURDEN UNDER THE AMENDMENTS FOR CURRENT REPORTS; PROXY AND INFORMATION STATEMENTS

	Number of responses <sup>303</sup>	Incremental burden hours/form	Total incremental burden hours	75% Company	25% Professional	Professional costs
	(A)	(B)	(C)=(A)*(B)	(D)=(C)*0.75	(E)=(C)*0.25	(F)=(E)*\$400
8-K <sup>304</sup> .....	7,212	1	7,212	5,409	1,803	\$721,200
Form 10 <sup>305</sup> .....	9	2	18	4	14	5,600
DEF 14A <sup>306</sup> .....	7,212					
Accel. Filers .....	6,112	3	18,336	13,752	4,584	1,833,600
SRC Filers .....	1,100	1	1,100	825	275	110,000
DEF 14C .....	582					
Accel. Filers .....	482	2	964	723	241	96,400
SRC Filers .....	100	0	0	0	0	0
Reg. S-K .....	N/A	N/A	N/A	N/A	N/A	N/A
Total .....			27,630	20,713		2,766,800

TABLE 2—INCREMENTAL PAPERWORK BURDEN UNDER THE AMENDMENTS FOR REGISTRATION STATEMENTS, MERGER PROXY AND INFORMATION STATEMENTS, TENDER OFFER DOCUMENTS AND SCHEDULES 13E-3

	Number of responses <sup>307</sup>	Incremental burden hours/form	Total incremental burden hours	25% Company	75% Professional	Professional costs
	(A)	(B)	(C)=(A)*(B)	(D)=(C)*0.25	(E)=(C)*0.75	(F)=(E)*\$400
Form S-1 <sup>308</sup> .....	485	2	970	243	727	\$290,800
Form S-11 .....	22	2	44	11	33	13,200
Form S-4 <sup>309</sup> .....	499	21	10,479	2,620	7,859	3,143,600
Form F-4 .....	27	21	567	142	425	170,000
DEFM 14A .....	137	21	2,877	719	2,158	863,200
DEFM 14C <sup>310</sup> .....	14	20	280	70	210	84,000
Schedule 14D-9 .....	77	20	1,540	385	1,155	462,000
Schedule 13E-3 .....	5	20	100	25	75	30,000
Form N-2 <sup>311</sup> .....	29	2	58	14	44	17,600
Reg. S-K .....	N/A	N/A	N/A	N/A	N/A	N/A
Total .....			16,915	4,229		5,074,400

IV. Cost-Benefit Analysis

A. Introduction

We are adopting amendments to implement and supplement the

<sup>303</sup> The number of responses reflected in the table equals the actual number of forms and schedules filed with the Commission during the 2009 calendar year, adjusted to reflect the estimated number of forms and schedules that would be required to include additional disclosure under our rules as proposed. As explained below in notes 304 through 306, we have reduced the number of estimated filings to reflect that the additional disclosure requirements will only apply to a smaller number of the forms filed.

<sup>304</sup> We calculated the burden hours for Form 8-K based on the number of proxy statements filed with the Commission during the 2009 calendar year. We assumed that there would be an aggregate equal number of Forms 8-K to disclose the issuer's plans with respect to the frequency vote as the number of proxy statements.

<sup>305</sup> The burden allocation for Form 10 uses a 25% internal to 75% outside professional allocation. We have reduced the number of estimated Form 10 filings to reflect that approximately 95% of these forms would not require additional disclosure, as new disclosure required under Item 402 will only

relate to issuers in spin-off transactions that are disclosing compensation of public parent companies that have conducted a prior shareholder vote on executive compensation.

<sup>306</sup> The estimates for Schedule 14A and Schedule 14C are separated to reflect our estimate of the burden hours and costs related to the proposed amendments to CD&A which will be applicable to companies that are large accelerated filers, accelerated filers, and non-accelerated filers (that are not smaller reporting companies), but will not be applicable to smaller reporting companies.

<sup>307</sup> The number of responses reflected in the table equals the actual number of forms and schedules filed with the Commission during the 2009 calendar year, adjusted to reflect the estimated number of forms and schedules that would be required to include additional disclosure under our rules as proposed. As explained below in notes 308 through 311, we have reduced the number of estimated filings to reflect that the additional disclosure requirements will only apply to a smaller number of the forms filed.

<sup>308</sup> We have reduced the number of estimated Form S-1 and Form S-11 filings to reflect that approximately 60% of these forms will not require additional disclosure, as new disclosure required under Item 402 will only relate to issuers who are already public companies and have conducted a prior shareholder vote on executive compensation.

<sup>309</sup> We have reduced the number of estimated Form S-4 and Form F-4 filings to reflect an approximate 75% of these forms which will not relate to mergers or similar transactions but will be other transactions (e.g., holding company formations and financings) to which the amended rules will not apply.

<sup>310</sup> We have reduced the number of estimated DEFM 14C filings to reflect an approximate 15% of these forms, which will not relate to merger transactions but will involve dissolutions and similar transactions.

<sup>311</sup> We have reduced the number of estimated Form N-2 filings to reflect that 29 filings were made by business development companies during calendar year 2009, because only business

provisions of the Dodd-Frank Act relating to shareholder approval of executive compensation and disclosure and shareholder approval of golden parachute compensation arrangements. Section 951 of the Dodd-Frank Act amends the Exchange Act by adding new Section 14A. New Section 14A(a)(1) requires companies to conduct a separate shareholder advisory vote to approve the compensation of executives. Section 14A(a)(2) requires companies to conduct a separate shareholder advisory vote to determine how often an issuer will conduct a shareholder advisory vote on executive compensation. In addition, Section 14A(b) requires companies soliciting votes to approve merger or acquisition transactions to provide disclosure of certain "golden parachute" compensation arrangements and, when such arrangements have not been included in the shareholder advisory vote on executive compensation, to conduct a separate shareholder advisory vote to approve the golden parachute compensation arrangements.<sup>312</sup>

We are adopting new Rule 14a-21 to implement Section 14A(a)(1) by providing separate shareholder advisory votes to approve executive compensation, to approve the frequency of such votes on executive compensation, and to approve golden parachute compensation arrangements at shareholder meetings at which shareholders are asked to approve merger transactions. In addition to the votes required by Section 14A, we are also adopting a new Item 24 of Schedule 14A to elicit disclosure, similar to our approach with respect to TARP companies providing shareholder advisory votes on executive compensation, regarding the effect of the shareholder votes required by Rule 14a-21, including whether the votes are non-binding.

New Item 402(t) of Regulation S-K implements and supplements the statutory requirement in Section 14A(b)(1) to promulgate rules for the clear and simple disclosure of golden parachute compensation arrangements that the soliciting person has with its named executive officers (if the acquiring issuer is not the soliciting person) or that it has with the named executive officers of the acquiring issuer that relate to the merger transaction. In

development companies will be subject to the amended disclosure required under Item 402 on Form N-2.

<sup>312</sup> According to the Dodd-Frank Wall Street Reform and Consumer Protection Act Conference Report at page 872, Section 951 is "designed to address shareholder rights and executive compensation practices."

addition, Item 402(t), will supplement the requirements of Section 14A(b)(1) by requiring disclosure of golden parachute compensation arrangements between the acquiring company and the named executive officers of the target company if the target company is the soliciting person.

Our amendments to Item 5 of Schedule 14A and Item 3 of Schedule 14C will require disclosure regarding golden parachute compensation arrangements in accordance with Section 14A(b)(1) of the Exchange Act. We are also adopting amendments to require that additional disclosure regarding golden parachute compensation arrangements be included in connection with other transactions. We are adopting amendments to Regulation M-A, Schedule 14D-9, and Schedule 13E-3 that will require additional disclosure regarding golden parachute compensation arrangements in connection with Rule 13e-3 going-private transactions and tender offers.<sup>313</sup>

We are also adopting amendments to Item 402 of Regulation S-K to require additional Compensation Discussion and Analysis disclosure about the issuer's response to the shareholder vote on executive compensation and to provide additional disclosure about golden parachute compensation arrangements. We are also adopting amendments to Form 8-K to require disclosure regarding the issuer's action as a result of the shareholder advisory vote on the frequency of shareholder votes on executive compensation.

We are adopting an amendment to Rule 14a-4, which relates to the form of proxy that issuers are required to include with their proxy materials, to require that issuers present four choices to their shareholders in connection with the advisory vote on frequency. We are also adopting an amendment to Rule 14a-6 to add the shareholder votes on executive compensation and the frequency of shareholder votes on executive compensation required by Section 14A(a), as well as any shareholder advisory vote on executive compensation, to the list of items that do not trigger the filing of a preliminary proxy statement. In addition, we are adopting an amendment to Rule 14a-8, adding a note to Rule 14a-8(i)(10) to clarify the status of shareholder proposals relating to the approval of executive compensation or the

frequency of shareholder votes approving executive compensation.

The rules we are adopting, which implement the relevant provisions of the Dodd-Frank Act, will directly affect most public companies as well as potential private acquirers. Our amended rules implement the shareholder advisory vote requirements of Section 14A, promulgate rules for additional disclosure in accordance with Section 14A(b)(1), and provide for additional disclosure, not required by Section 14A, relating to the shareholder advisory votes. In addition, our amended rules expand the required disclosure of Section 14A(b)(1) to require disclosure of arrangements between additional parties, namely agreements between the acquiring company and named executive officers of the target company, and require disclosure with respect to additional transactions, including certain tender offers and Rule 13e-3 going-private transactions. As discussed below, the enhanced disclosure required by our amended rules regarding the shareholder approval of executive compensation and companies' responses to shareholder votes will provide shareholders and investors with timely information about such votes that is consistent with the information required to be provided under the Act and that enhance the operation of our rules pursuant to the Act. The enhanced disclosure regarding golden parachute compensation will provide a more complete picture of the compensation to shareholders as they consider voting and investment decisions relating to mergers and similar transactions.

We are sensitive to the costs and benefits imposed by the rule and form amendments we are adopting. The discussion below focuses on the costs and benefits of the amendments made by the Commission to implement the Act within its permitted discretion, rather than the costs and benefits of the Act itself.

#### *B. Comments on the Cost-Benefit Analysis*

In the Proposing Release, we requested qualitative and quantitative feedback on the nature of the benefits and costs described and any benefits and costs we may have overlooked. We received one comment letter relating to the cost-benefit analysis in the Proposing Release.<sup>314</sup> The commentator asserted that we had underestimated the costs and burdens involved because we did not take into account the following additional categories of costs: Costs

<sup>313</sup> Companies filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers will be obligated to provide this additional disclosure. However, bidders filing tender offer statements on Schedule TO will not have a similar obligation.

<sup>314</sup> See letter from CCMC.

associated with proxy advisory firms and the potential for companies to retain additional consulting services relating to their compensation decisions and say-on-pay votes, additional costs associated with submitting no-action letter requests under Rule 14a-8, and increased costs due to increased demand for proxy solicitation and other shareholder communications services.<sup>315</sup>

### C. Benefits

The amended rules we are adopting today are intended to implement and supplement the requirements of Section 14A of the Exchange Act as set forth in Section 951 of the Dodd-Frank Act. Our amended rules not only implement the shareholder advisory votes required by Section 14A, but also require additional disclosure addressing whether, and if so, how issuers have considered these required shareholder advisory votes, and if so, how such votes have affected the companies' compensation policies and decisions.

We believe the enhanced disclosures about the results of the shareholder advisory vote on the frequency of the approval of executive compensation will provide timely information to shareholders about the issuer's plans for future shareholder advisory votes. The enhanced disclosure and amendments to the CD&A requirements in Item 402(b) of Regulation S-K about whether, and if so, how an issuer has considered the results of a shareholder vote to approve executive compensation and, if so, how that consideration has affected its compensation policies and decisions will benefit shareholders and other market participants by providing potentially useful information for voting and investment decisions.

Our amended rules will also specify how the shareholder advisory votes required by Section 14A(a) relate to existing shareholder advisory votes required for issuers with outstanding indebtedness under TARP. In our view, because of the similarity of the separate annual say-on-pay vote requirements, a company with indebtedness under TARP need only provide one annual shareholder advisory vote. As we have discussed above, we have indicated that the annual shareholder advisory vote under EESA would fulfill the requirements for the shareholder vote pursuant to Section 14A(a)(1) and Rule 14a-21(a). We believe this benefits such companies by reducing confusion and burdens of the two requirements by specifying that two separate annual

shareholder votes are not required. In addition, because issuers with indebtedness under TARP must conduct an annual shareholder advisory vote on executive compensation, we have adopted an exemption from the frequency vote required by Section 14A(a)(2) and Rule 14a-21(b) until the issuer repays all indebtedness under TARP. We believe this benefits such issuers and their shareholders by avoiding the cost and confusion of conducting a vote on the frequency of a shareholder advisory vote when the frequency of such a vote is mandated by another requirement.

After reviewing the comments we have received, we are also adopting a temporary exemption for smaller reporting companies that will delay the implementation of the shareholder advisory votes on say-on-pay and frequency required by Section 14A(a) and Rule 14a-21(a) and (b) for a two-year period. We believe that a delayed effective date for the say-on-pay and frequency votes will benefit smaller reporting companies by allowing these companies to observe how the rules operate for other companies by preparing them for implementation of the rules. We believe that delayed implementation for these companies will also allow us to evaluate the implementation of the adopted rules by larger companies and provide us with the additional opportunity to consider whether adjustments to the rule would be appropriate for smaller reporting companies before the rule becomes applicable to them.

In these amended rules, we also provide guidance for issuers and shareholders regarding the interaction of the shareholder advisory votes required by Section 14A and shareholder proposals under Rule 14a-8 by adding a note to Rule 14a-8(i)(10). The note we are adopting will reduce potential confusion among shareholders and issuers with respect to what may be excluded under our rules in light of the new requirements under Section 14A, while preserving the ability of shareholders to make proposals relating to executive compensation.

New Item 402(t) of Regulation S-K will require narrative and tabular disclosure of golden parachute compensation arrangements in the clear and simple form required by Section 14A(b)(1) of the Exchange Act. Because Section 14A(b)(1) requires that disclosure not only be in a clear and simple form, but also that it include an aggregate total of all golden parachute compensation for each named executive officer, we have adopted Item 402(t) to require that such disclosure appear in a

table. The tabular format is designed to provide investors with clear disclosure about golden parachute compensation that is comparable across different issuers and transactions and make the information more accessible. In addition to the tabular disclosure, we are also adopting amendments to require narrative disclosure to provide additional context and disclosure not suitable to the tabular format. Our approach is similar to the existing approach to executive compensation disclosure in Item 402 of Regulation S-K and provides a focused manner in which to present and quantify golden parachute compensation. Narrative disclosure supplements the tables by providing additional context and discussion of the numbers presented in the table. We believe that the combination of narrative and tabular disclosure will provide the clearest picture of the full scope of golden parachute compensation in the clear and simple format required by Section 14A(b)(1).

Because Section 14A(b)(1)'s disclosure requirements are limited to agreements or understandings between the person conducting the solicitation and any named executive officers of the issuer or any named executive officers of the acquiring issuer if the person conducting the solicitation is not the acquiring issuer, we have formulated Item 402(t) to require disclosure, in addition to the disclosure mandated by Section 14A(b)(1), of agreements or understandings between the acquiring company and the named executive officers of the target company. Item 402(t) requires disclosure of all golden parachute compensation relating to the merger among the target and acquiring companies and the named executive officers of each in order to cover the full scope of golden parachute compensation applicable to the transaction. By providing disclosure of the full scope of golden parachute compensation, we believe issuers will provide more detailed, comprehensive, and useful information to shareholders to consider when making their voting or investment decisions.

Likewise, additional disclosure on golden parachute compensation, without regard to whether the transaction is structured as a merger, a tender offer,<sup>316</sup> or a Rule 13e-3 going-private transaction that is not subject to Regulation 14A, will benefit

<sup>316</sup> Companies filing solicitation/recommendation statements on Schedule 14D-9 in connection with third-party tender offers will be obligated to provide this additional disclosure. However, bidders filing tender offer statements on Schedule TO will not have a similar obligation.

<sup>315</sup> See letter from CCMC. See also Section IV.D below for additional discussion.

shareholders and other market participants by allowing them to timely and more accurately assess the transaction and evaluate with greater acuity the golden parachute compensation that named executive officers could expect to receive and the related potential interests such officers might have in pursuing and/or supporting a change in control transaction. While our existing disclosure requirements include much of this disclosure, the specificity and narrative and tabular format of Item 402(t) will allow for a clear presentation of the full scope of the information. Furthermore, by standardizing disclosure of golden parachute compensation arrangements across different transaction structures, our amended rules will enable shareholders to compare more easily such compensation among various types of change in control transactions and structures. In addition, our amended rules will also enable the shareholders of the acquirer to timely and more accurately assess the cost of the acquisition transaction in proxy statements for which additional disclosure is required pursuant to Note A of Schedule 14A where acquirer shareholders do not vote on the merger transaction but vote to approve another proposal such as the issuance of shares or a stock split.

We have adopted such disclosure requirements in both tabular and narrative formats, with disclosure of aggregate total compensation, in accordance with the requirement of Section 14A(b)(1) that such disclosure be in a clear and simple form. To the extent investors expect to see information about all of the economic benefits that may accrue to an executive in one location of the proxy statement (including golden parachute arrangements and other compensation, such as future employment contracts), the benefit of this disclosure may be limited since the information about other executive compensation that may be disclosed in proxy materials does not need to be included in tabular format pursuant to Item 402(t) of Regulation S-K.

Our amended rules will also benefit issuers by specifying how they must comply with the requirements of Exchange Act Section 14A in the context of the Federal proxy rules. The amended rules will eliminate uncertainty that may exist among issuers and other market participants, if we did not propose any rules, regarding what is necessary under the Commission's proxy rules when conducting a shareholder vote required

under Exchange Act Section 14A. The amended rules specify how the statutory requirements operate in connection with the Federal proxy rules and accordingly, we believe the amended rules promote better compliance with the requirements of Exchange Act Section 14A and reduce the amount of management time and financial resources necessary to ensure that issuers comply with their obligations under both Exchange Act Section 14A and the Federal proxy rules. This will benefit issuers, their shareholders and other market participants.

#### *D. Costs*

We recognize that the amendments we are adopting will impose new disclosure requirements on companies and are likely to result in costs related to information collection.<sup>317</sup> The amendments we are adopting that require the disclosure of executive compensation in a tabular format are likely to result in certain costs. We expect these costs, however, to be limited since much of the compensation required to be disclosed under our amended rules is currently required to be disclosed in narrative format in the existing disclosure regime.

Our analysis of the costs of the amendments we are adopting today relates to the incremental direct and indirect costs arising from the requirements in our rule amendments. The analysis below does not reflect any additional direct or indirect costs arising from new Exchange Act Section 14A, including the shareholder advisory votes on say-on-pay, frequency, and golden parachute compensation, and any likely additional costs which would be incurred because of these votes. As noted above, one commentator asserted that we had underestimated the costs and burdens involved because we did not take into account the following additional categories of costs: Costs associated with proxy advisory firms

<sup>317</sup> We estimate the annual incremental paperwork burden for all companies to prepare the disclosure that would be required under both Exchange Act Section 14A and our rule amendments to be approximately 24,942 hours of company personnel time and a cost of approximately \$7,841,200 for the services of outside professionals. As noted above in the Comments on the Cost-Benefit Analysis section, we received one comment letter relating to the cost-benefit analysis that asserted that the PRA numbers cited in the Proposing Release underestimated the costs and burdens involved. See letter from CCMC. We acknowledge that the PRA estimates do not reflect the full magnitude of the economic costs involved, but are estimates of the collection of information burden and cost for the limited purpose of the PRA. In addition to costs arising from our rule amendments, the PRA estimates include collection of information-related costs arising from new Exchange Act Section 14A.

and the potential for companies to retain additional consulting services relating to their compensation decisions and say-on-pay votes, additional costs associated with submitting no-action letter requests under Rule 14a-8, and increased costs due to increased demand for proxy solicitation and other shareholder communications services.<sup>318</sup> We do not believe the additional costs described by the commentator will arise as a result of our amendments today as these items relate to increased costs resulting from the requirements of Section 14A, including the say-on-pay vote, the frequency vote, and the shareholder advisory vote on golden parachute compensation. With respect to costs associated with submitting no-action letter requests and Rule 14a-8, we note that Section 14A(c)(4) specifically provides that the Section 14A shareholder advisory votes may not be construed "to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation."<sup>319</sup> Although our new rules include a note advising of one circumstance when a shareholder proposal may be excluded, the rules do not impose any new obligations with respect to Rule 14a-8.

We are adopting new Item 402(t) to implement the requirement of Section 14A(b)(1) of the Exchange Act that we promulgate rules for disclosure of golden parachute compensation arrangements in a clear and simple form, which we believe is best provided in both narrative and tabular format. In addition to the required disclosure under Section 14A(b)(1), we are also expanding the disclosure to cover agreements between the acquiring company and the named executive officers of a target company in a merger or similar transaction. Though this additional disclosure will result in certain additional costs for issuers preparing a merger proxy, we believe that the additional disclosure is appropriate in order to provide shareholders information about the full scope of golden parachute compensation applicable to the transaction. If the disclosure provided by the issuer is not presented in a clear manner, the disclosure of golden parachute compensation for both target and acquirer executives in target and acquirer proxy statements may be confusing to investors. In addition, because parties often have to rely on each other for the other side's information, this reliance may add to

<sup>318</sup> See letter from CCMC.

<sup>319</sup> Exchange Act Section 14A(c)(4).

the costs of mergers that are ultimately born by shareholders. There may also be certain indirect costs to issuers and shareholders as a result of our rule amendments, as the additional disclosure of golden parachute compensation may result in increased transactional expenses in the form of additional advisers and consultants, increased time to prepare disclosure documents, and increased time and expense to negotiate compensation arrangements.

Furthermore, companies engaging in or subject to a Rule 13e-3 going-private transaction and companies preparing solicitation/recommendation statements given their status as targets in third-party tender offers may face increased costs because of the required disclosure of golden parachute compensation arrangements, including the required table and aggregate totals. In addition, companies soliciting proxies or consents for transactions for which additional disclosure is required pursuant to Note A of Schedule 14A may face increased costs as well due to the additional disclosure requirements of Item 5 of Schedule 14A. We have adopted these disclosure requirements that go beyond the requirements of Section 14A(b)(1) because we believe the rules will reduce the regulatory disparity that might otherwise result from treating such transactions differently from mergers. In response to commentators, however, we have eliminated the proposed requirement for bidders in third-party tender offers to provide Item 402(t) disclosure. We believe this change is appropriate given that target companies that are the subject of third-party tender offers will provide the 402(t) disclosure in their Schedules 14D-9 within ten days after the commencement of the offers. We also believe this change addresses the concern expressed by one of the commentators that third-party bidders, particularly in non-negotiated transactions, may not have access to reliable information about the golden parachute arrangements between target companies and their named executive officers. By retaining the disclosure requirement in Schedule 14D-9, we are still able to minimize the regulatory disparity that might otherwise result from treating third-party tender offers differently than other transactions.

As noted above, there may also be additional indirect costs relating to such increased disclosure, as well as costs associated with obtaining compensation information from the other parties involved in a transaction in order to fulfill the issuer's disclosure obligations.

The expanded Compensation Discussion and Analysis disclosure may

also result in costs associated with drafting disclosure that addresses whether, and if so, how the results of a shareholder vote on executive compensation were considered in determining the issuer's compensation policies and decisions and any resultant effect on those compensation policies and decisions. Similarly, the revisions to the current reporting requirements on Form 8-K may result in costs associated with assessing the results of a shareholder vote on the frequency of shareholder votes to approve executive compensation and drafting the additional disclosure regarding the company's plans to conduct votes in the future. Some of these costs could include the cost of hiring additional advisors, such as attorneys, to assist in the analysis and drafting.

We believe that these costs will not be unduly burdensome given that much of the disclosure is covered by our pre-existing disclosure requirements, even though we are adopting rules that require that such disclosure be included in both narrative and tabular format. The amendments we adopt exceed the pre-existing narrative requirements, as we are adopting tabular disclosure with an aggregate total and no *de minimis* threshold for perquisites. We expect that there will be incremental costs associated with drafting the additional disclosure, but that much of the information would be readily obtainable by the parties given existing disclosure requirements and as part of the due diligence process prior to drafting the transaction documents.

In addition to the direct costs associated with the required disclosure, the amended rules might create additional indirect costs for private companies that may be engaged in takeovers of public companies. We do not expect, however, the specific and detailed disclosure and the shareholder advisory vote regarding golden parachutes to diminish the number of takeover transactions.

The note to Rule 14a-8(i)(10) we are adopting may also impose certain costs on shareholders as it would permit issuers to exclude certain shareholder proposals that would otherwise not be excludable under our rules. In addition, our rule amendments may impose certain indirect costs on shareholders who might pursue alternative means to communicate their positions regarding the frequency of say-on-pay votes. We do not believe that the rules we are adopting today would impose any additional direct or indirect costs on issuers because of shareholder proposals. Any such costs would result

from the shareholder advisory votes required by Section 14A.

#### V. Consideration of Impact on the Economy, Burden on Competition, and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act<sup>320</sup> also requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 2(b)<sup>321</sup> of the Securities Act and Section 3(f)<sup>322</sup> of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

The amendments we are adopting will implement the Section 14A requirement for shareholder advisory votes to approve executive compensation, the frequency of such votes, and golden parachute compensation arrangements in connection with merger and similar transactions. We also adopting certain additional disclosure requirements to provide investors with additional information about these required votes and to apply the required disclosure from Section 14A(b)(1) to certain other agreements and transaction structures. We do not believe that the additional disclosure we are adopting will impose a burden on competition.

The amendments we are adopting will not only implement the requirements of Section 14A of the Exchange Act, but will also help ensure that shareholders receive disclosure regarding the required votes, the nature of an issuer's responsibilities to hold the votes under Section 14A, and the issuer's consideration of the results of the votes and the effect of such consideration on the issuer's compensation policies and decisions. The amendments will also enhance the transparency of a company's compensation policies. As discussed in greater detail above, we believe these benefits will be achieved without imposing any significant additional burdens on issuers. As a result, the amendments we are adopting should improve the ability of investors to make informed voting and investment decisions, and, therefore lead to

<sup>320</sup> 15 U.S.C. 78w(a)(2).

<sup>321</sup> 15 U.S.C. 77b(b).

<sup>322</sup> 15 U.S.C. 78c(f).

increased efficiency and competitiveness of the U.S. capital markets.

We believe the amendments we are adopting will also benefit issuers and their shareholders by specifying in a clear and concise fashion how issuers must comply with the Dodd-Frank Act requirements, in the context of the Federal proxy rules and our disclosure rules. By specifying how issuers must comply with the shareholder advisory votes and enhanced disclosure requirements from Section 14A, our rules will allow for more consistent disclosure from all entities and clearer disclosure for shareholders. By reducing uncertainty and promoting efficient presentation of information, our rules will permit issuers to more efficiently plan and draft disclosure documents, including annual meeting proxy statements, merger proxies, and tender offer and going-private documents.

Our rules will also provide additional time before smaller reporting companies are required to conduct the shareholder advisory votes on executive compensation and the frequency of say-on-pay votes. We believe that a delayed effective date for smaller reporting companies should allow those companies to observe how the rules operate for other companies and will increase efficiency by allowing them to better prepare for implementation of the rules. We also believe that delayed implementation for these companies will allow us to evaluate the implementation of the adopted rules by larger companies and provide us with the additional opportunity to consider whether adjustments to the rule would be appropriate for smaller reporting companies before the rules become applicable to them.

Our rules will require enhanced disclosure of golden parachute compensation arrangements in merger and similar transactions, regardless of how such transactions are structured. We believe the uniformity of our disclosure requirements across different types of transactions will help competition as issuers will be able to structure such transactions as they see fit, without the additional disclosure required by Section 14A(b) weighing in favor of a particular transaction structure. Though our amended rules will create additional, incremental disclosure burdens, we believe that the rules we are amending will enhance capital formation by allowing for clearer disclosure, more informed voting decisions by investors, and consistency across different types of transactions.

## VI. Final Regulatory Flexibility Act Analysis

This Final Regulatory Flexibility Analysis (FRFA) has been prepared in accordance with the Regulatory Flexibility Act.<sup>323</sup> This FRFA relates to revisions to the rules under the Exchange Act regarding the proxy solicitation process and related executive compensation disclosures.

### A. Reasons for, and Objectives of, the Proposed Action

The rule amendments are designed to implement the requirements of Section 951 of the Dodd-Frank Act, enhance the disclosure relating to the shareholder advisory votes required by Exchange Act Section 14A, and specify how our proxy rules will apply to such votes. Specifically, we are adopting amendments to the proxy rules to require shareholder advisory votes to approve executive compensation, to approve the frequency of shareholder votes to approve executive compensation, and to approve golden parachute compensation arrangements in connection with merger transactions. The amendments also require enhanced disclosure regarding an issuer's consideration of these votes and the impact of such consideration on an issuer's compensation policies and decisions.

### B. Legal Basis

We are adopting the amendments pursuant to Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 3(b), 6, 7, 10, and 19(a) of the Securities Act of 1933, as amended, and Sections 13, 14(a), 14A, 23(a), and 36 of the Securities Exchange Act of 1934, as amended.

### C. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on any aspect of the IRFA, including the number of small entities that would be affected by the proposed amendments, the nature of the impact, how to quantify the number of small entities that would be affected, and how to quantify the impact of the proposed amendments. We did not receive comments specifically addressing the IRFA. However, several commentators addressed aspects of the proposed rule amendments that could potentially affect small entities. In particular, some commentators believed that smaller companies should be exempted from all or part of the

amendments.<sup>324</sup> Although we are not adopting a complete exemption from the amendments, we have made revisions to the amendments to phase-in the requirements for a shareholder advisory vote on executive compensation and a shareholder advisory vote on the frequency of say-on-pay votes for two full years to give smaller reporting companies more time to prepare for implementation of the rules and so that they can observe how larger companies conduct the votes. Smaller reporting companies will be required to conduct shareholder advisory votes on golden parachute compensation as required by Rule 14a-21(c) without a two-year delay.

### D. Small Entities Subject to the Final Amendments

The amendments will affect some companies that are small entities. The Regulatory Flexibility Act defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."<sup>325</sup> The Commission's rules define "small business" and "small organization" for purposes of the Regulatory Flexibility Act for each of the types of entities regulated by the Commission. Securities Act Rule 157<sup>326</sup> and Exchange Act Rule 0-10(a)<sup>327</sup> define a company, other than an investment company, to be a "small business" or "small organization" if it has total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,210 companies, other than investment companies, that may be considered small entities. The proposed amendments would affect small entities that have a class of securities that are registered under Section 12 of the Exchange Act. An investment company, including a business development company,<sup>328</sup> is considered to be a "small business" if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>329</sup> We believe that certain of the amendments would affect small entities that are business development companies that have a class of securities registered under Section 12 of the Exchange Act. We estimate that there

<sup>324</sup> See, e.g., letters from Am. Bankers, ICBA, NACD, Society of Corp. Sec., and VBA.

<sup>325</sup> 5 U.S.C. 601(6).

<sup>326</sup> 17 CFR 230.157.

<sup>327</sup> 17 CFR 240.0-10(a).

<sup>328</sup> Business development companies are a category of closed-end investment companies that are not required to register under the Investment Company Act [15 U.S.C. 80a-2(a)(48)].

<sup>329</sup> 17 CFR 270.0-10(a).

<sup>323</sup> 5 U.S.C. 601.

are approximately 31 business development companies that may be considered small entities.

#### *E. Reporting, Recordkeeping, and Other Compliance Requirements*

The disclosure amendments are designed to enhance the disclosure regarding the shareholder advisory votes required by Section 14A of the Exchange Act and provide additional disclosure about golden parachute compensation arrangements. These amendments would require small entities to provide:

- Disclosure of the shareholder advisory votes required by Section 14A and the effects of such votes, including whether they are non-binding;
- Disclosure of golden parachute arrangements described by Section 14A(b)(1) of the Exchange Act in merger proxies, and additional disclosure not required by Section 14A(b)(1) in connection with tender offers and going private transactions; and
- Disclosure of the issuer's decision in light of the shareholder vote on the frequency of shareholder votes to approve executive compensation required by Section 14A(a)(2) of the Exchange Act as to how frequently the issuer will include a shareholder vote on the compensation of executives.

#### *F. Duplicative, Overlapping, or Conflicting Federal Rules*

We believe the amendments would not duplicate, overlap, or conflict with other Federal rules.

#### *G. Significant Alternatives*

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the disclosure amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities;
- Use of performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

Currently, small entities that are smaller reporting companies under Exchange Act Rule 12b-12 are subject to some different compliance or reporting requirements under Regulation S-K and the amendments will not affect these

requirements.<sup>330</sup> Under Regulation S-K, smaller reporting companies are permitted to provide abbreviated compensation disclosure with respect to the principal executive officer and two most highly compensated executive officers for the last two completed fiscal years. Specifically, smaller reporting companies may provide the executive compensation disclosure specified in Items 402(l) through (r) of Regulation S-K, rather than the corresponding disclosure specified in Items 402(a) through (k) of Regulation S-K. Items 402(l) through (r) do not require smaller reporting companies to provide CD&A. Other than the amendments to CD&A, the remaining disclosure requirements apply to smaller reporting companies to the same extent as larger issuers, following the two-year phase-in period for say-on-pay votes and votes on the frequency of say-on-pay votes.

As noted above, the amendments to CD&A do not apply to smaller reporting companies. We are not expanding the existing scaled disclosure requirements under Item 402 of Regulation S-K, or establishing additional different compliance requirements or an exemption from coverage of the proposed amendments for smaller reporting companies. The amendments will provide investors with enhanced disclosure regarding the shareholder votes required by Section 14A of the Exchange Act and the issuers' consideration of the votes.

We are adopting amendments to Item 5 of Schedule 14A, as well as other forms and schedules, to implement and supplement the requirement of Section 14A(b)(1) to provide disclosure of golden parachute compensation arrangements in a clear and simple form. Under the amendments, all companies will be subject to the same golden parachute disclosure requirements. As amended, Schedule 14A will require the disclosure pursuant to Item 402(t) of Regulation S-K with respect to golden parachute compensation arrangements for merger proxies. Though much of the disclosure required by our amendment to Item 5 of Schedule 14A is currently required for all issuers, regardless of size, under our amended rules such disclosure will be required to be included in a tabular format pursuant to Item 402(t) of Regulation S-K, which will include an aggregate total and specific quantification of various compensation elements. All companies, regardless of size, will also be subject to these

<sup>330</sup> Rule 12b-2 excludes business development companies from the definition of "smaller reporting companies."

additional disclosure requirements in connection with other transactions not required by Section 14A(b)(1), including certain tender offers and Rule 13e-3 going-private transactions.

In addition, our amendments will require clear and straightforward disclosure of issuer's responses to shareholder advisory votes, and of golden parachute compensation arrangements in connection with mergers and similar transactions. We have used design rather than performance standards in connection with the amendments because, based on our past experience, we believe the amendments will be more useful to investors if there are specific disclosure requirements. The amendments are intended to result in more comprehensive and clear disclosure. In addition, the specific disclosure requirements in the amendments will promote consistent and comparable disclosure among all companies.

#### **VII. Statutory Authority and Text of the Amendments**

The amendments described in this release are being adopted under the authority set forth in Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 3(b), 6, 7, 10, and 19(a) of the Securities Act of 1933, as amended, and Sections 13, 14(a), 14A, 23(a), and 36 of the Securities Exchange Act of 1934, as amended.

#### **List of Subjects in 17 CFR Parts 229, 240 and 249**

Reporting and recordkeeping requirements, Securities.

#### **Text of the Amendments**

For the reasons set out in the preamble, the Commission amends title 17, chapter II, of the Code of Federal Regulations as follows:

#### **PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K**

- 1. The general authority citation for part 229 is revised to read as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

- 2. Amend § 229.402 by:
  - a. Revising the last sentence of paragraph (a)(6)(ii);
  - b. Removing “and” at the end of paragraph (b)(1)(v);
  - c. Removing the period and adding in its place “; and” at the end of paragraph (b)(1)(vi);
  - d. Adding paragraph (b)(1)(vii);
  - e. Revising the last sentence of paragraph (m)(5)(ii); and
  - f. Adding paragraph (t).

The revisions read as follows:

**§ 229.402 (Item 402) Executive compensation.**

(a) \* \* \*  
 (6) \* \* \*  
 (ii) \* \* \* Except with respect to the disclosure required by paragraph (t) of this Item, registrants may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees.

(b) \* \* \*  
 (1) \* \* \*  
 (vii) Whether and, if so, how the registrant has considered the results of the most recent shareholder advisory vote on executive compensation required by section 14A of the Exchange Act (15 U.S.C. 78n-1) or § 240.14a-20 of this chapter in determining compensation policies and decisions and, if so, how that consideration has affected the registrant’s executive compensation decisions and policies.

(m) \* \* \*  
 (5) \* \* \*  
 (ii) \* \* \* Except with respect to disclosure required by paragraph (t) of this Item, smaller reporting companies may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the smaller reporting company and that are available generally to all salaried employees.

(t) *Golden Parachute Compensation.*  
 (1) In connection with any proxy or consent solicitation material providing the disclosure required by section 14A(b)(1) of the Exchange Act (15 U.S.C. 78n-1(b)(1)) or any proxy or consent solicitation that includes disclosure under Item 14 of Schedule 14A (§ 240.14a-101) pursuant to Note A of Schedule 14A, with respect to each named executive officer of the acquiring company and the target company, provide the information specified in paragraphs (t)(2) and (3) of this section regarding any agreement or understanding, whether written or unwritten, between such named executive officer and the acquiring company or target company, concerning any type of compensation, whether present, deferred or contingent, that is based on or otherwise relates to an acquisition, merger, consolidation, sale or other disposition of all or substantially all assets of the issuer, as follows:

**GOLDEN PARACHUTE COMPENSATION**

Name	Cash (\$)	Equity (\$)	Pension/ NQDC (\$)	Perquisites/ benefits (\$)	Tax reimbursement (\$)	Other (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
PEO .....	.....	.....	.....	.....	.....	.....	.....
PFO .....	.....	.....	.....	.....	.....	.....	.....
A .....	.....	.....	.....	.....	.....	.....	.....
B .....	.....	.....	.....	.....	.....	.....	.....
C .....	.....	.....	.....	.....	.....	.....	.....

- (2) The table shall include, for each named executive officer:
- (i) The name of the named executive officer (column (a));
  - (ii) The aggregate dollar value of any cash severance payments, including but not limited to payments of base salary, bonus, and pro-rated non-equity incentive compensation plan payments (column (b));
  - (iii) The aggregate dollar value of:
    - (A) Stock awards for which vesting would be accelerated;
    - (B) In-the-money option awards for which vesting would be accelerated; and
    - (C) Payments in cancellation of stock and option awards (column (c));
  - (iv) The aggregate dollar value of pension and nonqualified deferred compensation benefit enhancements (column (d));
  - (v) The aggregate dollar value of perquisites and other personal benefits

- or property, and health care and welfare benefits (column (e));
  - (vi) The aggregate dollar value of any tax reimbursements (column (f));
  - (vii) The aggregate dollar value of any other compensation that is based on or otherwise relates to the transaction not properly reported in columns (b) through (f) (column (g)); and
  - (viii) The aggregate dollar value of the sum of all amounts reported in columns (b) through (g) (column (h)).
- Instructions to Item 402(t)(2).*
1. If this disclosure is included in a proxy or consent solicitation seeking approval of an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of the registrant, or in a proxy or consent solicitation that includes disclosure under Item 14 of Schedule 14A (§ 240.14a-101) pursuant to Note A of Schedule 14A, the disclosure provided by this table shall be

quantified assuming that the triggering event took place on the latest practicable date, and that the price per share of the registrant’s securities shall be determined as follows: If the shareholders are to receive a fixed dollar amount, the price per share shall be that fixed dollar amount, and if such value is not a fixed dollar amount, the price per share shall be the average closing market price of the registrant’s securities over the first five business days following the first public announcement of the transaction. Compute the dollar value of in-the-money option awards for which vesting would be accelerated by determining the difference between this price and the exercise or base price of the options. Include only compensation that is based on or otherwise relates to the subject transaction. Apply Instruction 1 to Item 402(t) with respect to those executive officers for whom disclosure was required in the issuer’s most recent filing with the Commission

under the Securities Act (15 U.S.C. 77a *et seq.*) or Exchange Act (15 U.S.C. 78a *et seq.*) that required disclosure pursuant to Item 402(c).

2. If this disclosure is included in a proxy solicitation for the annual meeting at which directors are elected for purposes of subjecting the disclosed agreements or understandings to a shareholder vote under section 14A(a)(1) of the Exchange Act (15 U.S.C. 78n-1(a)(1)), the disclosure provided by this table shall be quantified assuming that the triggering event took place on the last business day of the registrant's last completed fiscal year, and the price per share of the registrant's securities is the closing market price as of that date. Compute the dollar value of in-the-money option awards for which vesting would be accelerated by determining the difference between this price and the exercise or base price of the options.

3. In the event that uncertainties exist as to the provision of payments and benefits or the amounts involved, the registrant is required to make a reasonable estimate applicable to the payment or benefit and disclose material assumptions underlying such estimates in its disclosure. In such event, the disclosure would require forward-looking information as appropriate.

4. For each of columns (b) through (g), include a footnote quantifying each separate form of compensation included in the aggregate total reported. Include the value of all perquisites and other personal benefits or property. Individual perquisites and personal benefits shall be identified and quantified as required by Instruction 4 to Item 402(c)(2)(ix) of this section. For purposes of quantifying health care benefits, the registrant must use the assumptions used for financial reporting purposes under generally accepted accounting principles.

5. For each of columns (b) through (h), include a footnote quantifying the amount payable attributable to a double-trigger arrangement (*i.e.*, amounts triggered by a change-in-control for which payment is conditioned upon the executive officer's termination without cause or resignation for good reason within a limited time period following the change-in-control), specifying the time-frame in which such termination or resignation must occur in order for the amount to become payable, and the amount payable attributable to a single-trigger arrangement (*i.e.*, amounts triggered by a change-in-control for which payment is not conditioned upon such a termination or resignation of the executive officer).

6. A registrant conducting a shareholder advisory vote pursuant to

§ 240.14a-21(c) of this chapter to cover new arrangements and understandings, and/or revised terms of agreements and understandings that were previously subject to a shareholder advisory vote pursuant to § 240.14a-21(a) of this chapter, shall provide two separate tables. One table shall disclose all golden parachute compensation, including both the arrangements and amounts previously disclosed and subject to a shareholder advisory vote under section 14A(a)(1) of the Exchange Act (15 U.S.C. 78n-1(a)(1)) and § 240.14a-21(a) of this chapter and the new arrangements and understandings and/or revised terms of agreements and understandings that were previously subject to a shareholder advisory vote. The second table shall disclose only the new arrangements and/or revised terms subject to the separate shareholder vote under section 14A(b)(2) of the Exchange Act and § 240.14a-21(c) of this chapter.

7. In cases where this Item 402(t)(2) requires disclosure of arrangements between an acquiring company and the named executive officers of the soliciting target company, the registrant shall clarify whether these agreements are included in the separate shareholder advisory vote pursuant to § 240.14a-21(c) of this chapter by providing a separate table of all agreements and understandings subject to the shareholder advisory vote required by section 14A(b)(2) of the Exchange Act (15 U.S.C. 78n-1(b)(2)) and § 240.14a-21(c) of this chapter, if different from the full scope of golden parachute compensation subject to Item 402(t) disclosure.

(3) Provide a succinct narrative description of any material factors necessary to an understanding of each such contract, agreement, plan or arrangement and the payments quantified in the tabular disclosure required by this paragraph. Such factors shall include, but not be limited to a description of:

(i) The specific circumstances that would trigger payment(s);

(ii) Whether the payments would or could be lump sum, or annual, disclosing the duration, and by whom they would be provided; and

(iii) Any material conditions or obligations applicable to the receipt of payment or benefits, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality agreements, including the duration of such agreements and provisions regarding waiver or breach of such agreements.

*Instructions to Item 402(t).*

1. A registrant that does not qualify as a "smaller reporting company," as defined by § 229.10(f)(1) of this chapter, must provide the information required by this Item 402(t) with respect to the individuals covered by Items 402(a)(3)(i), (ii) and (iii) of this section. A registrant that qualifies as a "smaller reporting company," as defined by § 229.10(f)(1) of this chapter, must provide the information required by this Item 402(t) with respect to the individuals covered by Items 402(m)(2)(i) and (ii) of this section.

2. The obligation to provide the information in this Item 402(t) shall not apply to agreements and understandings described in paragraph (t)(1) of this section with senior management of foreign private issuers, as defined in § 240.3b-4 of this chapter.

■ 3. Amend § 229.1011 by redesignating paragraph (b) as paragraph (c) and adding new paragraph (b) to read as follows:

**§ 229.1011 (Item 1011) Additional information.**

\* \* \* \* \*

(b) Furnish the information required by Item 402(t)(2) and (3) of this part (§ 229.402(t)(2) and (3)) and in the tabular format set forth in Item 402(t)(1) of this part (§ 229.402(t)(1)) with respect to each named executive officer

(1) Of the subject company in a Rule 13e-3 transaction; or

(2) Of the issuer whose securities are the subject of a third-party tender offer, regarding any agreement or understanding, whether written or unwritten, between such named executive officer and the subject company, issuer, bidder, or the acquiring company, as applicable, concerning any type of compensation, whether present, deferred or contingent, that is based upon or otherwise relates to the Rule 13e-3 transaction or third-party tender offer.

*Instructions to Item 1011(b).*

1. The obligation to provide the information in paragraph (b) of this section shall not apply where the issuer whose securities are the subject of the Rule 13e-3 transaction or tender offer is a foreign private issuer, as defined in § 240.3b-4 of this chapter.

2. For purposes of Instruction 1 to Item 402(t)(2) of this part: If the disclosure is included in a Schedule 13E-3 (§ 240.13e-100 of this chapter) or Schedule 14D-9 (§ 240.14d-101 of this chapter), the disclosure provided by this table shall be quantified assuming that the triggering event took place on the latest practicable date and that the price per share of the securities of the subject

company in a Rule 13e-3 transaction, or of the issuer whose securities are the subject of the third-party tender offer, shall be determined as follows: If the shareholders are to receive a fixed dollar amount, the price per share shall be that fixed dollar amount, and if such value is not a fixed dollar amount, the price per share shall be the average closing market price of such securities over the first five business days following the first public announcement of the transaction. Compute the dollar value of in-the-money option awards for which vesting would be accelerated by determining the difference between this price and the exercise or base price of the options. Include only compensation that is based on or otherwise relates to the subject transaction. Apply Instruction 1 to Item 402(t) with respect to those executive officers for whom disclosure was required in the most recent filing by the subject company in a Rule 13e-3 transaction or by the issuer whose securities are the subject of a third-party tender offer, with the Commission under the Securities Act (15 U.S.C. 77a *et seq.*) or Exchange Act (15 U.S.C. 78a *et seq.*) that required disclosure pursuant to Item 402(c).

\* \* \* \* \*

**PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

■ 4. The general authority citation for part 240 is revised to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*, 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

\* \* \* \* \*

■ 5. Amend § 240.13e-100 by revising Item 15 to read as follows:

\* \* \* \* \*

**§ 240.13e-100 Schedule 13E-3, Transaction statement under section 13(e) of the Securities Exchange Act of 1934 and Rule 13e-3 (§ 240.13e-3) thereunder.**

\* \* \* \* \*

**Item 15. Additional Information**

Furnish the information required by Item 1011(b) and (c) of Regulation M-A (§ 229.1011(b) and (c) of this chapter).

\* \* \* \* \*

■ 6. Amend § 240.14a-4 by:

■ a. Adding the phrase “and votes to determine the frequency of shareholder votes on executive compensation

pursuant to § 240.14a-21(b) of this chapter” at the end of the first sentence of paragraph (b)(1);

■ b. Adding paragraph (b)(3).

The addition reads as follows:

**§ 240.14a-4 Requirements as to proxy.**

\* \* \* \* \*

(b) \* \* \*

(3) A form of proxy which provides for a shareholder vote on the frequency of shareholder votes to approve the compensation of executives required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1(a)(2)) shall provide means whereby the person solicited is afforded an opportunity to specify by boxes a choice among 1, 2 or 3 years, or abstain.

\* \* \* \* \*

■ 7. Amend § 240.14a-6 by:

■ a. Revising paragraph (a)(7); and  
 ■ b. Adding the phrase “to paragraph (a)” following the words “Note 1”, “Note 2”, “Note 3” and “Note 4”.

The revision reads as follows:

**§ 240.14a-6 Filing requirements.**

(a) \* \* \*

(7) A vote to approve the compensation of executives as required pursuant to section 14A(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1(a)(1)) and § 240.14a-21(a) of this chapter, or pursuant to section 111(e)(1) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5221(e)(1)) and § 240.14a-20 of this chapter, a vote to determine the frequency of shareholder votes to approve the compensation of executives as required pursuant to Section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1(a)(2)) and § 240.14a-21(b) of this chapter, or any other shareholder advisory vote on executive compensation.

\* \* \* \* \*

■ 8. Amend § 240.14a-8 by adding *Note to paragraph (i)(10)* to read as follows:

**§ 240.14a-8 Shareholder proposals.**

\* \* \* \* \*

(i) \* \* \*

(10) \* \* \*

**Note to paragraph (i)(10):** A company may exclude a shareholder proposal that would provide an advisory vote or seek future advisory votes to approve the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K (§ 229.402 of this chapter) or any successor to Item 402 (a “say-on-pay vote”) or that relates to the frequency of say-on-pay votes, provided that in the most recent shareholder vote required by § 240.14a-21(b) of this chapter a single year (*i.e.*, one, two, or three years) received approval of a majority of votes cast on the matter and the company has adopted a policy

on the frequency of say-on-pay votes that is consistent with the choice of the majority of votes cast in the most recent shareholder vote required by § 240.14a-21(b) of this chapter.

\* \* \* \* \*

■ 9. Add § 240.14a-21 to read as follows:

**§ 240.14a-21 Shareholder approval of executive compensation, frequency of votes for approval of executive compensation and shareholder approval of golden parachute compensation.**

(a) If a solicitation is made by a registrant and the solicitation relates to an annual or other meeting of shareholders at which directors will be elected and for which the rules of the Commission require executive compensation disclosure pursuant to Item 402 of Regulation S-K (§ 229.402 of this chapter), the registrant shall, for the first annual or other meeting of shareholders on or after January 21, 2011, or for the first annual or other meeting of shareholders on or after January 21, 2013 if the registrant is a smaller reporting company, and thereafter no later than the annual or other meeting of shareholders held in the third calendar year after the immediately preceding vote under this subsection, include a separate resolution subject to shareholder advisory vote to approve the compensation of its named executive officers, as disclosed pursuant to Item 402 of Regulation S-K.

*Instruction to paragraph (a):*

The registrant’s resolution shall indicate that the shareholder advisory vote under this subsection is to approve the compensation of the registrant’s named executive officers as disclosed pursuant to Item 402 of Regulation S-K (§ 229.402 of this chapter). The following is a non-exclusive example of a resolution that would satisfy the requirements of this subsection: “RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED.”

(b) If a solicitation is made by a registrant and the solicitation relates to an annual or other meeting of shareholders at which directors will be elected and for which the rules of the Commission require executive compensation disclosure pursuant to Item 402 of Regulation S-K (§ 229.402 of this chapter), the registrant shall, for the first annual or other meeting of shareholders on or after January 21, 2011, or for the first annual or other

meeting of shareholders on or after January 21, 2013 if the registrant is a smaller reporting company, and thereafter no later than the annual or other meeting of shareholders held in the sixth calendar year after the immediately preceding vote under this subsection, include a separate resolution subject to shareholder advisory vote as to whether the shareholder vote required by paragraph (a) of this section should occur every 1, 2 or 3 years. Registrants required to provide a separate shareholder vote pursuant to § 240.14a-20 of this chapter shall include the separate resolution required by this section for the first annual or other meeting of shareholders after the registrant has repaid all obligations arising from financial assistance provided under the TARP, as defined in section 3(8) of the Emergency Economic Stabilization Act of 2008 (12 U.S.C. 5202(8)), and thereafter no later than the annual or other meeting of shareholders held in the sixth calendar year after the immediately preceding vote under this subsection.

(c) If a solicitation is made by a registrant for a meeting of shareholders at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all the assets of the registrant, the registrant shall include a separate resolution subject to shareholder advisory vote to approve any agreements or understandings and compensation disclosed pursuant to Item 402(t) of Regulation S-K (§ 229.402(t) of this chapter), unless such agreements or understandings have been subject to a shareholder advisory vote under paragraph (a) of this section. Consistent with section 14A(b) of the Exchange Act (15 U.S.C. 78n-1(b)), any agreements or understandings between an acquiring company and the named executive officers of the registrant, where the registrant is not the acquiring company, are not required to be subject to the separate shareholder advisory vote under this paragraph.

Instructions to § 240.14a-21:

1. Disclosure relating to the compensation of directors required by Item 402(k) (§ 229.402(k) of this chapter) and Item 402(r) of Regulation S-K (§ 229.402(r) of this chapter) is not subject to the shareholder vote required by paragraph (a) of this section. If a registrant includes disclosure pursuant to Item 402(s) of Regulation S-K (§ 229.402(s) of this chapter) about the registrant's compensation policies and practices as they relate to risk management and risk-taking incentives,

these policies and practices would not be subject to the shareholder vote required by paragraph (a) of this section. To the extent that risk considerations are a material aspect of the registrant's compensation policies or decisions for named executive officers, the registrant is required to discuss them as part of its Compensation Discussion and Analysis under § 229.402(b) of this chapter, and therefore such disclosure would be considered by shareholders when voting on executive compensation.

2. If a registrant includes disclosure of golden parachute compensation arrangements pursuant to Item 402(t) (§ 229.402(t) of this chapter) in an annual meeting proxy statement, such disclosure would be subject to the shareholder advisory vote required by paragraph (a) of this section.

3. Registrants that are smaller reporting companies entitled to provide scaled disclosure in accordance with Item 402(l) of Regulation S-K (§ 229.402(l) of this chapter) are not required to include a Compensation Discussion and Analysis in their proxy statements in order to comply with this section. For smaller reporting companies, the vote required by paragraph (a) of this section must be to approve the compensation of the named executive officers as disclosed pursuant to Item 402(m) through (q) of Regulation S-K (§ 229.402(m) through (q) of this chapter).

- 10. Amend § 240.14a-101 by:
  - a. Removing the dash that appears before paragraph (a) of Item 5 and adding in its place an open parenthesis;
  - b. Adding paragraph (a)(5) of Item 5;
  - c. Adding the phrase "to paragraph (a)" following the word "Instruction" that follows new paragraph (a)(5) of Item 5;
  - d. Adding paragraph (b)(3) of Item 5;
  - e. Adding the phrase "to paragraph (b)" following the word "Instruction" that follows new paragraph (b)(3) of Item 5;
  - f. Adding Item 24.

The additions read as follows:

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

SCHEDULE 14A. INFORMATION

\* \* \* \* \*

Item 5. Interest of Certain Persons in Matters to Be Acted Upon.

(a) \* \* \*

(5) If the solicitation is made on behalf of the registrant, furnish the information required by Item 402(t) of Regulation S-K (§ 229.402(t) of this chapter).

\* \* \* \* \*

(b) \* \* \*

(3) If the solicitation is made on behalf of the registrant, furnish the information required by Item 402(t) of Regulation S-K (§ 229.402(t) of this chapter).

\* \* \* \* \*

Item 24. Shareholder Approval of Executive Compensation. Registrants required to provide any of the separate shareholder votes pursuant to § 240.14a-21 of this chapter shall disclose that they are providing each such vote as required pursuant to section 14A of the Securities Exchange Act (15 U.S.C. 78n-1), briefly explain the general effect of each vote, such as whether each such vote is non-binding, and, when applicable, disclose the current frequency of shareholder advisory votes on executive compensation required by Rule 14a-21(a) and when the next such shareholder advisory vote will occur.

- 11. Amend § 240.14c-101 by adding paragraph (c) of Item 3 to read as follows:

§ 240.14c-101 Schedule 14C. Information required in information statement.

SCHEDULE 14C. INFORMATION

\* \* \* \* \*

Item 3. \* \* \*

(c) Furnish the information required by Item 402(t) of Regulation S-K (§ 229.402(t) of this chapter).

\* \* \* \* \*

- 12. Amend § 240.14d-100 by revising Item 11 to read as follows:

§ 240.14d-100 Tender offer statement pursuant to section 14(d)(1) of the Securities Exchange Act of 1934.

\* \* \* \* \*

Item 11. Additional Information.

Furnish the information required by Item 1011(a) and (c) of Regulation M-A (§ 229.1011 of this chapter).

\* \* \* \* \*

- 13. Amend § 240.14d-101 by amending Item 8 to add the words "and (c)" after "Item 1011(b)".

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

- 14. The general authority citation for part 249 continues to read as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

- 15. Amend Form 8-K (referenced in § 249.308), Item 5.07, by revising paragraph (b), adding paragraph (d), and revising Instruction 1 to read as follows:

Note: The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 8-K

\* \* \* \* \*

Item 5.07. Submission of Matters to a Vote of Security Holders

\* \* \* \* \*

(b) If the meeting involved the election of directors, the name of each director elected at the meeting, as well as a brief description of each other matter voted upon at the meeting; and state the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes as to each such matter, including a separate tabulation with respect to each nominee for office. For the vote on the frequency of shareholder advisory votes on executive compensation required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1) and § 240.14a-21(b), state the number of votes cast for each of

1 year, 2 years, and 3 years, as well as the number of abstentions.

\* \* \* \* \*

(d) No later than one hundred fifty calendar days after the end of the annual or other meeting of shareholders at which shareholders voted on the frequency of shareholder votes on the compensation of executives as required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1), but in no event later than sixty calendar days prior to the deadline for submission of shareholder proposals under § 240.14a-8, as disclosed in the registrant's most recent proxy statement for an annual or other meeting of shareholders relating to the election of directors at which shareholders voted on the frequency of shareholder votes on the compensation of executives as required by section 14A(a)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78n-1(a)(2)), by amendment to

the most recent Form 8-K filed pursuant to (b) of this Item, disclose the company's decision in light of such vote as to how frequently the company will include a shareholder vote on the compensation of executives in its proxy materials until the next required vote on the frequency of shareholder votes on the compensation of executives.

\* \* \* \* \*

Instruction 1 to Item 5.07. The four business day period for reporting the event under this Item 5.07, other than with respect to Item 5.07(d), shall begin to run on the day on which the meeting ended. \* \* \*

\* \* \* \* \*

By the Commission.

Dated: January 25, 2011.

Elizabeth M. Murphy, Secretary.

[FR Doc. 2011-1971 Filed 2-1-11; 8:45 am]

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