



SEC's New Proxy Statement Rules

Quarter 1, 2006

On January 27th, 2006 the U.S. Securities and Exchange Commission issued 370 pages of proposed rules that would make significant changes to the executive compensation disclosures required on proxy statements. The proposed rules will be open to public comment for 60 days, at which time the commission will consider any revisions and take a final vote on the rules. The new rules will apply to 2006 compensation disclosed in companies' 2007 proxy statements. The proxy statement will now be filed with (rather than "furnished to") the SEC, and subject to the Sarbanes–Oxley rules and penalties for false information.

Here are some of the most important disclosure changes:

- The current Board Compensation Committee Report and the five-year stock price performance graph will be replaced with a Compensation Discussion and Analysis section, similar to the discussion section provided in the 10k. The proxy must be written in "plain English" and this new discussion section must provide an explanation of each pay element.
- The current proxy provides information on the five highest paid employees based on the amount of salary and bonus paid. The new rules have different requirements for who is reported and the criterion for who gets listed in the proxy. The new rules require information for the CEO, CFO and the next three highest paid, based on their total compensation. Information must be disclosed for up to three additional employees whose compensation exceeds any of the other five named executive officers. The company must disclose a description of their position, but not their names.
- The company must disclose possible compensation triggered by termination, a change in control, or sale of the company.
- The company must disclose company stock pledged as collateral for a loan or other purpose. This may include stock pledged to an exchange fund, which is a commonly used device for diversifying holdings without reporting a sale.



- The company must disclose detail on retirement pay information, e.g., if bonuses and other compensation are included in the final formula, as well as information on company contributions and investment appreciation. The total value of retirement at various retirement ages must also be disclosed.
- Companies would also be required to disclose:
 - the value of equity instruments granted during the year using the same FAS 123R method used in financial statements;
 - the increase in the actuarial value of pension plan benefits accrued during the year;
 - the earnings on deferred compensation;
 - the value of tax gross-ups;
 - the detail on the perquisites in the “all other compensation” column, unless the aggregate amount of such perks is less than \$10,000 (a reduction of the current \$50,000 threshold);
 - the changes to performance goals, after-the-fact, for performance unit plans;
 - the dividends on performance units/shares; and
 - the value of the corporate jet for personal use must be based on the retail price, not the cost of first class air fair.

No item of compensation can be excluded from the summary compensation table total, except perks that are less than \$10,000.

The SEC changes are illustrated in a comparison of the current and proposed Summary Compensation Tables, which are provided in the following section.



The Format of the New Summary Compensation Table

The number of columns stays the same but there are new rules for whom and what is reported. Companies should start developing a pro forma version of the new table to see how their information will look to the public, to change or eliminate any programs that do not support a pay-for-performance philosophy.

PROPOSED SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Total	Salary	Bonus	Stock Awards \$	Option Awards \$	Non-Stock Incentive Plan Compensation	All Other Compensation
CEO								
CFO								
A								
B								
C								

Note: Up to to 3 additional employees may be required, if their pay exceeds any of the top five.

CURRENT SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation			All Other Compensation
		Salary	Bonus	Other	RS \$	Options	LTIP Payout	
1st HP								
2nd HP								
3rd HP								
4th HP								

The “Summary Compensation Table” for the named executive officers will include:

- A new total compensation column. This column will give a single dollar figure including salary, bonus, stock-based incentives and other benefits and perquisites.
- A column with a dollar value for all stock-related awards, including stock options, based on FAS 123R. If an option is repriced, the dollar value of the modified grant would be included in the table. A company would no longer



report the projected option value with a 5% and 10% annual rate of stock appreciation.

- Combine the “Other Annual Compensation” and “All Other Compensation” columns, and increase the amount of disclosure so this column now includes all compensation not reported anywhere else, e.g., dividends on restricted stock, the increase in the value of the pension, the cost of non-qualified deferred compensation arrangements and tax gross-ups.
- Show all perquisites under “all other compensation” unless the aggregate amount of such perks is less than \$10,000 (a reduction of the current \$50,000 threshold). The new rules state that no compensation can be excluded from the table, except perks that are less than the \$10,000 threshold.

Long-Term Incentives

The new rules require the company use the FAS No. 123R valuation if the terms of the option are modified. This differs from financial statement reporting, which requires expensing the incremental value of the modification.

The amount of stock held and the amount of gains realized from all forms of equity compensation (including options, restricted stock and stock units) would be reported in two tables, similar to existing tables for stock options. The new tables include:

- Two supplemental tables to the summary compensation table reporting “Grants of Performance-Based Awards” and “Grants of All Other Equity Awards.”
- An “Outstanding Equity Awards at Fiscal Year-End” table showing outstanding awards and potential amounts that may be received in the future.
- An “Options Exercised and Stock Vested” table showing amounts for the past year.



Perquisites

The SEC will lower the perquisite disclosure threshold to \$10,000 from the current \$50,000 threshold. The perquisite will be listed in a footnote to the “Summary Compensation Table” if its value exceeds \$10,000 and a dollar value given if its value exceeds \$25,000 or 10% of the total amount of all perquisites.

Retirement/Deferred Compensation/Change-of-Control

The new rules expand the amount of disclosure for retirement, change-of-control and post-employment benefits. These include:

- A table showing the annual benefits payable to each of the executives listed in the proxy statement.
- A table showing annual executive contributions, company contributions, earnings, withdrawals and year-end balance for the non-qualified deferred compensation plans.
- A description of and the amount payable to each of the five covered executive officers on termination of employment or change in control.

Related Party Transactions

Item 404(a) of Regulation S-K currently requires disclosure of transactions in which executives, directors and large shareholders, or their family members, have a direct or indirect material interest, if the value of the transaction exceeds \$60,000. The rules will raise the transaction minimum to \$120,000, but otherwise would expand the scope of transactions required to be disclosed. Companies will be required to follow a “principles-based” disclosure requirement for related party transactions

A proposed new Item 407 of Regulations S-K and S-B would require:

- Disclosure of whether each director and director nominee is independent.



- A description of any relationships, not otherwise disclosed, that were considered when determining whether each director and director nominee is independent.
- Disclosure of any audit, nominating and compensation committee members who are not independent.
- Disclosure regarding compensation committees similar to disclosure currently required about audit committees.

Director Independence and Other Corporate Governance Matters

The proposals would expand the disclosure requirements for a company's business relationships with other businesses where a director is employed or is a significant owner, so that the disclosure thresholds more closely conform to the stricter standards applied under New York Stock Exchange and NASDAQ Stock Market. The proposals also would require disclosure of other material relationships that were considered when evaluating a director's independence. Other proposed rule changes would consolidate existing corporate governance requirements into a single set of rules and use the internet availability of committee charters and other information to meet some disclosure requirements.

There is a possibility that compensation consultants will have to disclose if their firm does other business with the company, e.g., actuarial consulting or outsourcing; that would present a possible conflict of interest with executive pay consulting.



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Directors' Compensation

Compensation for each director in the last fiscal year would be provided in a compensation table similar to the executive Summary Compensation Table, with a discussion of the various pay elements used. The other tables required for executives would not be required for directors.

Stock Pledged by Officers and Directors

The company must disclose the number of executive and director shares that are subject to pledges.

Form 8-K

The proposals would revise the scope of executive compensation disclosure requirements on Form 8-K, so that only executive officers' employment arrangements and material amendments to such arrangements are covered. It appears that this rule amendment may eliminate the need for Form 8-K reports on director's compensation. It is unclear whether the proposals also will provide greater clarity on when a Form 8-K may be required to report compensation decisions under bonus and employee benefit plans, although we expect this to be an area that companies will wish to cover in comments submitted to the SEC.

A new Item 407 of Regulations S-K and S-B would require, among other things:

- Disclosure of whether each director and nominee for director is independent.
- A description of any relationships not otherwise disclosed that were considered when determining whether each director and nominee for director is independent.
- Disclosure of any audit, nominating and compensation committee member who is not independent.



Planning for the New Rules

Some companies have started to provide the compensation disclosures that will be required by the new rules, and we expect that more will do this for the 2006 proxy season. Compensation committees should start to consider whether to use the proposed disclosure rules in 2006. The SEC will probably not allow companies to use the new tables until the new rules have been fully approved.

Compensation committees should not view elimination of the Board Compensation Committee Report as easing their disclosure responsibilities. The proposed new Compensation Discussion and Analysis will require more detail on the operation of compensation programs and on the basis for compensation decisions and that disclosure will flow from the decisions made by compensation committees. It is clear that the SEC is not only seeking additional numerical information; the narrative disclosures will cover both the “big picture” and the details of compensation programs.

Compensation committees that are not already using tally sheets to evaluate “total” compensation should do so in 2006, since current compensation decisions will be reflected under the new rules in 2007. Likewise, because of the expense and effort that will be required to precisely quantify the value of change-in-control and severance benefits, compensation committees should plan on undertaking that effort in 2006. Any renegotiations or adjustments to severance programs should be in place by fiscal year-end, since that could be the point in time when those benefits are valued for disclosure purposes. Some companies may want to limit the value of post-employment benefits in order to prevent high cost disclosures.

Companies should determine if any new executives must be disclosed and should consider developing policies to limit their executives’ from pledging or hedging company stock, as this practice looks like an unreported sale to outside investors. Regardless of company policy, executives may wish to cancel existing pledge arrangements over the coming year to limit the disclosure impact.



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