



COMPENSATION & EMPLOYEE BENEFITS LAW BULLETIN

New SEC Rules Forthcoming on Executive Compensation Disclosure Compensation and Employee Benefits

The Securities and Exchange Commission recently voted, 5-0, to adopt changes to the rules requiring disclosure of executive and director compensation, in addition to changes to disclosure rules for related person transactions, director independence and other corporate governance matters, and security ownership of officers and directors. In order to provide for more comprehensive and useful disclosure of executive compensation, the amendments, which will be available in a final release shortly, will improve upon the information currently required in tabular disclosure and supplement it with improved narrative disclosure of compensation of the principal executive officer, principal financial officer, the three other highest paid executive officers, as well as the directors. In addition, the SEC will be proposing rules for disclosing the compensation for up to three other non-executive employees of the registrant whose total compensation exceeds that of the top five officers. It is expected that this proposal will contain what has been coined "The Katie Couric Provision," which will allow registrants to exclude employees with no company or subsidiary policy making function – such as entertainers, athletes, and salespeople.

The following, which is based on a press release issued by the SEC, is a brief summary of the significant changes the new rules will make to the disclosure requirements for executive and director compensation. These changes will become effective for the 2007 proxy season.

Compensation Discussion and Analysis

A new company disclosure, the Compensation Discussion and Analysis, will address the objectives and implementation of the registrant's executive compensation programs - focusing on the most important factors underlying the registrant's compensation policies and decisions. The Compensation Discussion and Analysis section will also require enhanced narrative disclosure about option grants to executives. Registrants will need to analyze and discuss material information such as the reasons a company selects particular grant dates for stock awards or the methods a company uses to select the terms of stock awards, including the exercise prices of stock options.

With regard to the timing of stock options in particular, companies will be called upon to answer questions such as:

- 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 nonpublic information for the purpose of affecting the value of executive compensation?

A registrant will also be required to disclose, when it has not previously disclosed a program, plan or practice of timing option grants to executives, the adoption of such a program, plan or practice or if it has made one or more decisions since the beginning of the past fiscal year to time option grants.

The Compensation Discussion and Analysis will be filed and will therefore be subject to certification by the registrant's principal executive officer and principal financial officer. Similar to the Audit Committee Report, a new Compensation Committee Report will require a statement of whether the compensation committee has reviewed and discussed the Compensation Discussion and Analysis with management and, based on this review and discussion, recommended that it be included in the registrant's annual report on Form 10-K and proxy statement. In addition, the Performance Graph will no longer appear with executive compensation disclosure, but instead will be moved to the disclosure rule covering the market price of common equity and related matters (Item 201 of Regulation S-K). The Performance Graph will be required in annual reports to security holders that accompany or precede proxy statements relating to annual meetings at which directors are to be elected.

Tabular and Narrative Disclosure

Under the new rules, the Compensation Discussion and Analysis will be followed by a detailed executive compensation disclosure, organized into three broad categories:

- compensation over the last three years;
- holdings of outstanding equity-related interests received as compensation that are the source of future gains; and
- retirement plans, deferred compensation and other post-employment payments and benefits.

The Summary Compensation Table will show compensation for each named executive officer over the last three years and will be accompanied by narrative disclosure and a Grants of Plan-

Based Awards Table that will clarify the compensation information presented in the Summary Compensation Table. There will be a phase-in of the Summary Compensation Table, meaning that only the immediately prior fiscal year will be disclosed in 2007. The Summary Compensation Table will include, in addition to columns for salary and bonus:

- the dollar value for all equity-based awards, shown in separate columns for stock awards and stock options, measured at the fair market value on the grant date (computed in accordance with FAS 123R);
- the amount of compensation under non-equity incentive plans;
- the annual change in the actuarial present value of accumulated pension benefits and above-market or preferential earnings on nonqualified deferred compensation (these amounts will be deducted from total compensation for purposes of determining the named executive officers);
- the aggregate amount of all other compensation not reported in the other columns of the table, including perquisites if the aggregate amount of such perquisites is \$10,000 or more (the SEC has promised interpretive guidance on what constitutes a perquisite); and
- total compensation.

Supplemental disclosure to the Summary Compensation Table will include:

- Outstanding equity interests:
 - The Outstanding Equity Awards at Fiscal-Year End Table will show data on each outstanding award representing potential amounts that may be received in the future, and includes award specific data as to the amount of securities underlying exercisable and unexercisable options, and the exercise prices and the expiration dates for each outstanding option.
 - The Option Exercises and Stock Vested Table will show amounts realized on equity compensation during the last fiscal year.
- Retirement plan and post-employment:
 - The Pension Benefits Table will require disclosure of the actuarial present value of each named executive officer's accumulated benefit under each pension plan, computed using the same assumptions (except for the normal retirement age, which will be based on the plan's provisions) and measurement period as used for financial reporting purposes under generally accepted accounting principles (as opposed to the plan's actual formula).
 - The Nonqualified Deferred Compensation Table will require disclosure with respect to nonqualified deferred compensation plans of executive contributions, company contributions, withdrawals, all earnings for the year (not just the above-market or preferential portion which is disclosed in the Summary Compensation Table) and the year-end balance.
 - A narrative description of any arrangement that provides for payments or benefits at, following, or in connection with any termination of services of a named executive officer, a change in his or her responsibilities, or upon a change in control of the company, *including quantification of these potential payments and benefits* assuming that the triggering event took place on the last business day of the company's last fiscal year and the price per share was the closing market price on that date.

Option Grants Disclosure

The Release will provide additional guidance regarding disclosure of company programs, plans and practices relating to the granting of options, some of which will be included in the Compensation Discussion and Analysis and is described above. In addition, required disclosure will include clear tabular presentations of option grants including:

- the grant date fair market value;
- the FAS 123R grant date;
- the closing market price on the grant date if it is greater than the exercise price of the award; and
- the date the compensation committee or full board of directors took action to grant the award if that date is different than the grant date.

Director Compensation

Disclosure of director compensation for the prior fiscal year will be required in a Director Compensation Table (along with related narrative), which will be similar in format to the Summary Compensation Table for executives described above.

If you have any questions or need any additional information, please contact any of the attorneys in the Compensation & Employee Benefits practice group at Troutman Sanders, LLP.

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