

B&B REVIEW

Corporate and Securities Update

THE NEW SEC COMPENSATION DISCLOSURE RULES: WHAT TO DO NOW

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Last month, the Securities and Exchange Commission issued final rules adopting sweeping new public company disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters. These rules, which will generally be effective for the 2007 proxy season, significantly change the type and amount of disclosure required in public companies' proxy statements, annual reports and other SEC filings. The new rules include such major items as:

- ***A new Compensation Discussion and Analysis (CD&A) section***, which will require comprehensive narrative disclosure addressing executive compensation programs, policies and decisions. The CD&A will resemble, in the context of executive compensation, the in-depth Management's Discussion and Analysis (MD&A) section in a company's financial disclosures.
- ***A significantly overhauled Summary Compensation Table***, which will now include a "total compensation" column. In addition, new supplemental tables will provide much more extensive disclosure of particular elements of compensation, including equity and other incentive compensation.
- ***Enhanced retirement, deferred compensation and post-termination benefits disclosure rules***, requiring comprehensive, detailed information, including quantification of benefits.
- ***Greater emphasis on perquisite disclosure***, including a lower disclosure threshold and new interpretive guidance.

- ***Enhanced scrutiny of option grant practices***, including related tabular and narrative disclosures.
- ***A new Director Compensation Table***, which will resemble the Summary Compensation Table.
- ***Overhauled related-party transaction disclosure rules***, including a revised disclosure threshold and disclosure of approval policies and procedures.

The new rules will require significant changes to public companies' disclosure controls and procedures – changes that must be developed and implemented quickly in order to meet 2006 annual report and 2007 proxy statement requirements. As a result, the coming months will require a considerable investment of time and attention on the part of management, the compensation committee, the board of directors and their legal, accounting and other advisors in order to prepare for initial compliance and to plan a suitable approach for ongoing compliance.

WHAT TO DO NOW

We recommend that public companies consider taking the following initial actions to begin preparing for the new requirements:

Act Now! Do not underestimate the scope of these new rules and the work it will take to comply with them. Develop a project timeline to keep the process on schedule.

Assemble the appropriate internal team and appoint a "traffic cop." Determine the appropriate company personnel to be involved in planning the



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project, gathering and analyzing required information and preparing and reviewing various disclosures. In addition to the members of senior management and the disclosure committee, ensure adequate staffing from all interested departments, including the human resources, legal, accounting and finance departments. Appoint a “traffic cop” to coordinate the process.

Get expert help. The new rules are voluminous, complex and subject to interpretation. Begin consultations with your outside attorneys, auditors, actuaries, accounting and executive compensation consultants early in the process.

Assess existing policies, procedures and systems to determine what changes are necessary to comply with the new rules. Clearly, disclosure controls and procedures must be updated to address the new information that must be tracked, processed and reported, and internal control over financial reporting will be affected as well. Because the CD&A will be subject to the CEO/CFO certification requirements under the Sarbanes-Oxley Act, procedures relating to the preparation of this new section will require particular attention. Two examples of procedures that most companies will need to focus on sooner rather than later are:

- *The executive compensation tracking system.* The new rules now look to “total compensation,” rather than simply salary and bonus, in determining the Named Executive Officers (NEOs) to be listed in the proxy statement. Appropriate systems must be instituted to track all components of total compensation for executive officers – and this will likely mean keeping tabs on types and values of compensation differently than in the past, and for more executives.
- *The D&O questionnaire.* The D&O questionnaire will need to be overhauled because the information needed from directors and officers to

address the old rules and the information needed under the new rules is not the same. The D&O questionnaire should be prepared and distributed as early as possible so directors and officers will have adequate time to review the new questions and respond accurately – and so you will have enough time to deal with any issues that emerge from their responses.

Do a “dry run.” Start drafting now. A “dry run” of the new disclosures will help identify deficiencies in the information or procedures necessary to comply with the new rules. It is particularly important to generate a draft of the CD&A as soon as possible, as in this first year that section will require particularly rigorous review and analysis of the company’s compensation programs and procedures. Prepare the working group for the reality that drafting the CD&A will be an iterative process, and it will be necessary for all members to review and provide feedback on multiple drafts.

Engage the compensation committee. Ensure that the compensation committee is fully briefed on the new rules – and management’s compliance plans – as soon as possible. Engage the committee in the ongoing disclosure preparation process, particularly including review of CD&A drafts (since the committee will ultimately be required to recommend the CD&A for inclusion in the proxy statement, and the CEO and CFO will look to this recommendation in their certifications). Work with the committee in developing appropriate changes to executive compensation programs and procedures in light of the new requirements.

Keep directors informed. Keep the board informed of the nature and scope of the new rules and their impact on the company’s compensation programs and disclosures generally as well as their effect on the directors personally.