Paul | Weiss

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Alert Highlighting Important Changes To The SEC's Executive Compensation Disclosure Rules

The purpose of this Alert is to highlight certain important changes to the SEC's executive compensation disclosure rules.

As we previously reported, the SEC completely retooled the executive compensation disclosure system this year. For a detailed discussion of the changes to the rules, see our August 17th memorandum, which is available on our web site (www.paulweiss.com). Companies will be disclosing different kinds of executive compensation from what was disclosed in the past, and they will be disclosing the compensation in completely different ways.

Compensation disclosure must include a Compensation Discussion and Analysis — a comprehensive discussion of the policies and philosophies behind the compensation of a company's named executive officers.

Preparing for the upcoming proxy will be difficult — more forms of compensation will need to be explained and discussed than ever before, using brand new tables and formats.

What You Need To Do Now

- Identify your named executive officers. The revised definition includes your principal executive officer, your principal financial officer, and your three most highly paid executive officers other than your principal executive officer and principal financial officer. Your three most highly paid executive officers are determined based on total compensation (as described in the new SEC rules), so you need to calculate total compensation for any executive officer who might be one of your named executive officers.

- Identify your data keepers. The new disclosures require you to assemble information you never needed before in connection with a securities filing. Be sure to reach out to the following parties:

    1. HR department
    2. Payroll administrator
    3. Fringe benefit coordinator
    4. Stock plan administrators

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5. Retirement plan administrators
6. Pension plan actuaries
7. Accountants
8. Compensation Consultants

- Assign responsibility for preparing your CD&A. Your CD&A will likely evolve through many drafts. The CD&A explains the philosophies and policies of your executive compensation system. All persons responsible for compensation decisions need to participate in the CD&A drafting process so that the discussion coherently explains how each compensation component works, and why.

- Prepare a draft CD&A for your compensation committee to review. Management must draft the CD&A, but your compensation committee will need to formally review the CD&A with management and recommend in its signed compensation committee report that it be filed with the SEC. The CD&A will be covered by Sarbanes-Oxley certifications, so it must be part of your disclosure controls and procedures. It is crucial that the compensation committee participate in its early development. Including the compensation committee in the drafting at the end of the process will just be too late.

- Sketch out your new summary compensation table. Preparing a draft disclosure now will highlight for you what data you still need to gather.

Disclosing the Pay of Executive Officers Who Are Not NEOs

Companies will need to disclose as a related party transaction any pay arrangement with an executive officer who is not a named executive officer if the executive officer's pay exceeds $120,000 and the compensation committee has neither approved the pay nor recommended that the board of directors approve the pay.

When is executive officer pay exempt from related party disclosure? The pay does not need to be disclosed as a related party transaction if:

- It is included in the summary compensation table, **or**

- The following three tests are met:

  1. the executive officer is not an "immediate family member" of a related person (generally a 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 a director or an executive officer, and any person (other than a tenant or employee) sharing the household of a director or executive officer);

  2. the pay in question would have been reported in the summary compensation table if the executive were a named executive officer; ***and***

3. the compensation committee has either approved the pay or recommended such approval to the board of directors.

Who are executive officers? Executive officers include a company's president, any vice president of the company 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 company if they perform such policy making functions for the company.

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This Alert is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this Alert should be directed to any member of the Paul Weiss Securities Group listed below, as well as Robert Fleder ((212) 373-3107), Michael Segal ((212) 373-3364), Lawrence Witdorchic ((212) 373-3237) and Paul Koppel ((212) 373-3040) in our Executive Compensation Group:

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