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# Introduction

While almost everyone who works with registrants on their executive and director compensation disclosure recognized the significance of the Securities and Exchange Commission's new rules when they were adopted in 2006, few would have predicted their central role in the aftermath of the global economic crisis of 2008 and 2009. Following the devastation on both Wall Street and Main Street, executive compensation and the relationship between pay and performance took on even greater significance as we investigated the causes of the crisis, implemented appropriate remedies, and sought to fashion responsible safeguards against a repeat experience. Executive pay also foreshadowed the larger question of income inequality in the United States, which has emerged as one of the central issues of the 2012 presidential election.

Thus, the executive and director compensation disclosure rules have taken on added importance in this environment, as they provide a window into how the senior leaders of corporate America are compensated, along with the rationale for those compensation decisions. They have also altered the way boards of directors and board compensation committees approach compensation decisions, as it is now well understood that the absence of a clear explanation for a specific compensation action may not only put them on the defensive but also erode their support from shareholders.

That registrants have been able to shape their disclosures in response to changes in the environment and expectations is largely the result of the SEC's decision to adopt a "principles-based," rather than a

prescriptive, disclosure system. Under this approach, registrants are required to tailor the general disclosure requirements to their own specific situations. While the transition was not always easy, generally registrants have been able to structure their disclosure not only to set forth, in a comprehensive and clear manner, their key compensation actions and decisions, but also to adjust the disclosure as needed to address the key concerns of investors and regulators at any given point in time; whether it involve equity award grant practices or the potential effect of compensation-related risk on the overall viability of the business.

This principles-based system lays out the key reporting objectives (instead of prescribing exactly what must be disclosed) and then provides guidance explaining the purpose of the objectives and demonstrating how they are to be applied using several common examples. From these objectives and examples, registrants must disclose the material aspects of their executive compensation program so that investors understand how the program works and how the amounts reported in the various compensation tables were determined.

This approach has served two important purposes. First, it ensures that a registrant's disclosure will address all of the compensation earned by and paid to its named executives, thereby eliminating the temptation for some registrants to disclose only those items that fall within the "four corners" of the rules. Second, and perhaps more notably, it establishes a system that effectively encompasses new compensation techniques as they emerge, thereby avoiding the persistent lag between compensation practices and their eventual disclosure.

Even with a half dozen years of complying with the rules under their belts, many registrants continue to face challenges in drafting their disclosure as they introduce increasingly more sophisticated and complex arrangements into their executive compensation programs. Further, although the rules are certainly more flexible, they are still complex and, at times, highly technical in nature, perhaps a reflection of the dynamic nature of executive compensation, a subject that has become a key facet of the ongoing debate about our nation's economic policies and objectives. Thus, even within the parameters of a principles-based disclosure system, most registrants have encountered questions about whether particular compensation items have to be disclosed and, if so, how to disclose them.

This book has been written as an aid to practitioners and other individuals who are responsible for compliance with these requirements. It is intended to provide an in-depth analysis of the executive and director compensation disclosure rules, their interpretation and application

to various common situations, and developing trends. It describes and explains the requirements of the rules, drawing from both the language of the rules themselves as well as the related SEC releases, which contain significant commentary on how the rules are to be construed and applied. It also integrates into the discussion the supplemental guidance that has been issued by the SEC's Division of Corporation Finance since the rules were adopted, as well as the commentary and observations of experienced securities practitioners who regularly advise registrants on their disclosure obligations. Hopefully, it can serve as a single reference source for an understanding of the rules and how they are to be applied.

Chapter 1 discusses the history of executive and director compensation disclosure under the federal securities laws, as well as the evolution of the 2006 rules and their progeny. Subsequent chapters address the rules themselves. Chapter 2 explains concepts of general applicability—the registrants that are subject to the rules, the executives and directors whose compensation must be disclosed, the compensation that must be reported, and the SEC's overarching mandate that the disclosure be drafted in conformity with its plain English principles.

Chapter 3 covers the Compensation Discussion and Analysis, as well as the Compensation Committee Report that must accompany it. Chapter 4 examines the Summary Compensation Table and the various compensation components that must be reported therein. Chapter 5 is devoted to executive perquisites and other personal benefits, a subcategory of the information that must be reported in the Summary Compensation Table, but an item of special interest to investors, regulators, and the media. Chapter 6 addresses the Grants of Plan-Based Awards Table, which contains information supplementing the disclosure in the Summary Compensation Table, while Chapter 7 discusses the narrative disclosure that is to accompany these two required tables. Chapter 8 looks at the Outstanding Equity Awards at Fiscal Year-End Table, and Chapter 9 covers the Options Exercised and Stock Vested Table. These two tables track the life cycle of equity-based awards following their grant until they ultimately result in a compensatory benefit to a named executive.

Chapters 10 through 12 review the disclosure requirements for post-employment compensation arrangements. Chapter 10 covers retirement plans and other defined benefit and actuarial arrangements. Chapter 11 looks at nonqualified deferred compensation plans and arrangements, as well as nonqualified defined contribution plans. Chapter 12 addresses severance and other payments and benefits that are to be provided to the named executives upon a termination of employment or in connection with a change in control of the registrant.

Chapter 13 explains the Director Compensation Table, which, in most respects, parallels the Summary Compensation Table. Chapter 14 looks at several other compensation-related disclosure requirements under the federal securities laws, including the performance graph, equity compensation plan disclosure, compensation plan disclosure under Schedule 14A of the Securities Exchange Act of 1934, the proxy disclosure rules, the corporate governance disclosure requirements for board compensation committees, compensation-related risk disclosure, and the related person transaction disclosure rules. Finally, Chapter 15 discusses the provisions that have so dramatically affected the area of executive compensation disclosure—the various shareholder advisory votes on executive compensation required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

To round out the materials, appendices are provided that contain the current version of the executive and director compensation disclosure rules as set forth in Item 402 of Regulation S-K, various speeches by officials of the SEC's Division of Corporation Finance on the rules and various compliance matters, and the most recent guidance from the Division of Corporation Finance on the application of the rules.

While this book reflects all of the guidance that has been published and interpretations that have been issued by the SEC up to the date of publication, it does not purport to address every issue that may arise (or has already arisen) in applying the rules to current executive and director compensation practices and decisions. It is my hope that the framework that I have established here, which largely follows the outline of the rules themselves as set forth in Item 402 of Regulation S-K, will continue to be updated and expanded to incorporate the additional guidance, interpretations, and practical responses to these issues as they emerge. In addition, I expect that future additions will continue to reflect the practical advice that is developed to address investor expectations and many of the more common disclosure questions that confront registrants.

Unlike other SEC rulemaking projects, which have been adopted and implemented at a satisfactory level within a single reporting cycle, compliance with the executive and director compensation disclosure rules is an evolving and continually changing endeavor. The initial compliance efforts during the 2007 proxy season were subject to extensive review by the Staff of the SEC's Division of Corporation Finance, resulting in a Staff Report in October 2007 that was intended to guide the preparation of registrant disclosures going forward. While the SEC Staff has not issued any subsequent reports on the quality of registrant compliance, the review of executive compensation disclosures has been incorporated

into the Staff's triennial review of registrants' periodic reports under the Securities Exchange Act of 1934 and, as reflected by Staff comments on these filings, continues to be an area of significant attention. Moreover, as disclosure practices evolve in response to the mandatory shareholder advisory vote on executive compensation, which was first required during the 2011 proxy season, it is expected that the form and content of this principles-based disclosure will similarly evolve. Additionally, as the SEC completes its required rulemaking to implement the remaining compensation-related disclosure provisions of the Dodd-Frank Act, the resulting disclosures may prompt a further response from Congress, or the SEC itself, as investors and the general public react to current compensation policies and practices. Consequently, executive and director compensation disclosure is likely to remain an important topic for the foreseeable future. Hopefully, this book will serve as a useful tool to aid registrants and their advisors as we meet these challenges.