

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PART 229**

**[RELEASE NOS. 33-8735; 34-54380; IC-27470; FILE NO. S7-03-06]**

**RIN 3235-AI80**

**EXECUTIVE COMPENSATION DISCLOSURE**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Request for additional comment.

**SUMMARY:** The Securities and Exchange Commission is requesting additional comment on a proposed amendment to the disclosure requirements for executive and director compensation. We are requesting comments regarding the proposal to require compensation disclosure for three additional highly compensated employees.

**DATES:** Comments should be received on or before October 23, 2006.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>): or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-03-06 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549-1090.

All submissions should refer to File Number S7-03-06. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site

(<http://www.sec.gov/rules/proposed/shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC, 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** Anne Krauskopf, Carolyn Sherman, or Daniel Greenspan, at (202) 551-3500, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3010 or, with respect to questions regarding investment companies, Kieran Brown in the Division of Investment Management, at (202) 551-6784.

**SUPPLEMENTARY INFORMATION:** We solicit additional comments on a proposal to amend Item 402<sup>1</sup> of Regulation S-K.<sup>2</sup>

## **I. Background**

On January 27, 2006, we proposed revisions to our rules governing disclosure of executive compensation, director compensation, related party transactions, director

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<sup>1</sup> 17 CFR 229.402.

<sup>2</sup> 17 CFR 229.10 et seq.

independence and other corporate governance matters, current reporting regarding compensation arrangements and beneficial ownership.<sup>3</sup> We received over 20,000 comment letters in response to our proposals. In general, commenters supported the proposals and their objectives. On July 26, 2006 we adopted the rules and amendments substantially as proposed, with certain modifications to address a number of points that commenters raised.<sup>4</sup>

We did not adopt the proposed disclosure requirement regarding the total compensation and job description of up to an additional three most highly compensated employees who are not executive officers or directors but who earn more than any of the named executive officers. Instead we are requesting additional comment. In particular, we have specific requests for comment as to whether the proposal should be modified to apply only to large accelerated filers who would disclose the total compensation for the most recent fiscal year and a description of the job position for each of their three most highly compensated employees whose total compensation is greater than any of the named executive officers, whether or not such persons are executive officers. Under this approach, employees who have no responsibility for significant policy decisions within either the company, a significant subsidiary or a principal business unit, division, or function, would be excluded from the determination of the three most highly compensated employees and no disclosure regarding them would be required.

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<sup>3</sup> Executive Compensation and Related Party Disclosure, Release No. 33-8655 (Jan. 27, 2006) [71 FR 6542] (the “Proposing Release”).

<sup>4</sup> Executive Compensation and Related Party Disclosure, Release No. 33-8732A (Aug. 29, 2006) (the “Adopting Release”) published in this issue of the Federal Register.

## II. Discussion

As part of the Item 402 narrative disclosure requirements, we had proposed an additional item that would have required disclosure for up to three employees who were not executive officers during the last completed fiscal year and whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers.<sup>5</sup> We received extensive comment on this proposal. Some commenters supported the proposal or suggested that it should go further.<sup>6</sup> Many commenters expressed concern that the benefits of this disclosure to investors would be negligible, yet compliance might require the outlay of considerable company resources.<sup>7</sup> Some commenters expressed concern that the proposed disclosure would raise privacy issues or negatively impact competition for employees.<sup>8</sup> While we continue to consider whether to adopt such a requirement as part of the executive compensation disclosure rules, we are requesting additional comment as to whether potential modifications would address the concerns that commenters have raised.

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<sup>5</sup> Proposed Item 402(f)(2).

<sup>6</sup> See, e.g., letters from the Corporate Library; The Greenlining Institute; Institutional Investor Group; and State Board of Administration (SBA) of Florida.

<sup>7</sup> See, e.g., letters from American Bar Association, Committee on Federal Regulation of Securities; Chamber of Commerce of the United States of America (“Chamber of Commerce”); Eli Lilly and Company (“Eli Lilly”); Leggett & Platt, Incorporated (“Leggett & Platt”); Nancy Lucke Ludgus; and Mercer Human Resource Consulting (“Mercer”).

<sup>8</sup> See, e.g., letters from American Bar Association, Joint Committee on Employee Benefits; Business Roundtable; jointly, CBS Corporation, The Walt Disney Company, NBC Universal, News Corporation, and Viacom, Inc. (“Entertainment Industry Group”); Committee on Corporate Finance of Financial Executives International; Chamber of Commerce; Cleary Gottlieb Steen & Hamilton LLP (“Cleary”); CNET Networks, Inc. (“CNET Networks”); Compass Bancshares, Inc. (“Compass Bancshares”); Compensia; Cravath, Swaine & Moore LLP (“Cravath”); DreamWorks Animation SKG (“DreamWorks”); Eli Lilly; Emerson Electric Co.; Fenwick & West LLP; The Financial Services Roundtable (“FSR”); Professor Joseph A. Grundfest, dated April 10, 2006; Investment Company Institute (“ICI”); Intel Corporation (“Intel”); Kellogg Company (“Kellogg”); Kennedy & Baris, LLP (“Kennedy”); Mercer; Peabody Energy Corporation (“Peabody Energy”); Pearl Meyer & Partners; Securities Industry Association (“SIA”); Sullivan & Cromwell LLP; Society of Corporate Secretaries & Governance Professionals (“SCSGP”); and WorldatWork.

We note in particular that some commenters questioned the materiality of the information that would have been required by the proposal, given that the covered employees would not be in policy-making positions as executive officers.<sup>9</sup> After considering the issues raised by these commenters, we remain concerned about disclosure with respect to employees, particularly within very large companies, whether or not they are executive officers, whose total compensation for the last completed fiscal year was greater than that of one or more of the named executive officers. If any of these employees exert significant policy influence at the company, at a significant subsidiary of the company or at a principal business unit, division, or function of the company, then investors seeking a fuller understanding of a company's compensation program may believe that disclosure of these employees' total compensation is important information.<sup>10</sup> Knowing the compensation, and job positions within the organization, of these highly compensated policy-makers whose total compensation for the last fiscal year was greater than that of a named executive officer, should assist in placing in context and permit a better understanding of the compensation structure of the named executive officers and directors.

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<sup>9</sup> See, e.g., letters from California State Teachers' Retirement System; Cleary; CNET Networks; Compass Bancshares; DreamWorks; Entertainment Industry Group; Fried, Frank, Harris, Shriver & Jacobson LLP; FSR; Hewitt Associates LLC; ICI; Intel; Kellogg; Kennedy; Leggett & Platt; Peabody Energy; Pearl Meyer & Partners; SCSGP; SIA; Stradling Yocca Carlson & Rauth; Top Five Data Services, Inc.; Towers Perrin, dated April 10, 2006; and Walden Asset Management.

<sup>10</sup> The Commission expressed similar concerns in 1978, when it stated "a key employee or director of a subsidiary might be the highest-paid person in the entire corporate structure and have managerial responsibility for major aspects of the registrant's overall operations." Uniform and Integrated Reporting Requirements: Management Remuneration, Release No. 33-6003 (Dec. 4, 1978) [43 FR 58151] (the "1978 Release"). See the Adopting Release at n. 327 for a discussion of the term "executive officer." In light of some of the comments that we received, we have clarified that the definition of "executive officer" includes all individuals in a registrant policy-making role. See, e.g., letters from SCSGP and Cravath.

Our intention is to provide investors with information regarding the most highly compensated employees who exert significant policy influence by having responsibility for significant policy decisions. Responsibility for significant policy decisions could consist of, for example, the exercise of strategic, technical, editorial, creative, managerial, or similar responsibilities. Examples of employees who might not be executive officers but who might have responsibility for significant policy decisions could include the director of the news division of a major network; the principal creative leader of the entertainment function of a media conglomerate; or the head of a principal business unit developing a significant technological innovation. By contrast, we are convinced by commenters that a salesperson, entertainment personality, actor, singer, or professional athlete who is highly compensated but who does not have responsibility for significant policy decisions would not be the type of employee about whom we would seek disclosure. Nor, as a general matter, would investment professionals (such as a trader, or a portfolio manager for an investment adviser who is responsible for one or more mutual funds or other clients) be deemed to have responsibility for significant policy decisions at the company, at a significant subsidiary or at a principal business unit, division or function simply as a result of performing the duties associated with those positions. On the other hand, an investment professional, such as a trader or portfolio manager, who does have broader duties within a firm (such as, for example, oversight of all equity funds for an investment adviser) may be considered to have responsibility for significant policy decisions.

We continue to consider whether it is appropriate to require some level of narrative disclosure so that shareholders will have information about these most highly

compensated employees. This consideration includes the appropriate level of information about these employees and their compensation in light of their roles.

As to issues regarding privacy and competition for employees, to the extent that commenters objected that the disclosure could result in a competitor stealing a company's top "talent,"<sup>11</sup> we have tried to address these concerns by focusing the disclosure on persons who exert significant policy influence within the company or significant parts of the company.

### **III. Request for Comment**

We request additional comment on the proposal to require compensation disclosure for up to three additional employees. In addition to general comment, we encourage commenters to address the following specific questions:

- Would the rule more appropriately require disclosure of the employees described above if it were structured in the following or similar manner:

For each of the company's three most highly compensated employees, whether or not they were executive officers during the last completed fiscal year, whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers, disclose each such employee's total compensation for that year and describe the employee's job position, without naming the employee; provided,

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<sup>11</sup> See, e.g., letter from Entertainment Industry Group. In addition, we note our intention is not to suggest that these additional employees, whether or not they are executive officers, are individuals whose compensation is required to be reported under the Exchange Act "by reason of such employee being among the 4 highest compensated officers for the taxable year," as stated in Internal Revenue Code Section 162(m)(3)(B) [26 U.S.C. 162(m)(3)(B)]. See letter from Cleary (expressing concern that the additional individuals not fall within the purview of Section 162(m) of the Internal Revenue Code).

however, that employees with no responsibility for significant policy decisions within the company, a significant subsidiary of the company, or a principal business unit, division, or function of the company are not included when determining who are each of the three most highly compensated employees for the purposes of this requirement, and therefore no disclosure is required under this requirement for any employee with no responsibility for significant policy decisions within the company, a significant subsidiary of the company, or a principal business unit, division, or function of the company?

- Would it be appropriate to determine the highest paid employees in the same manner that named executive officers are determined, by calculating total compensation but excluding pension plan benefits and above-market or preferential earnings on nonqualified deferred compensation plans, and by comparing that amount to the same amount earned by the named executive officers (excluding the amount required to be disclosed for those named executive officers pursuant to paragraph (c)(2)(viii) of Item 402)? If so, should the total amount disclosed include these amounts as it does for named executive officers? Should the pension benefit and above-market earnings be separately disclosed in a footnote so investors can calculate the amounts used in determining highest paid employees?
- Would modifying the proposed rule to apply only to large accelerated filers<sup>12</sup> properly focus this disclosure obligation on companies that are more likely to

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<sup>12</sup> The term large accelerated filer is defined in Exchange Act Rule 12b-2 [17 CFR 240.12b-2].



have these additional highly compensated employees? Would that modification address concerns that the proposed rule would impose disproportionate compliance burdens by limiting the disclosure obligation to companies that are presumptively better able to track the covered employees? Would a different limitation as to applicability be appropriate?

- Is information regarding highly compensated employees, including those who are not executive officers, material to investors? In answering this question, commenters are encouraged to address the following additional questions:
  - Would modifications limiting the disclosure to employees who make significant policy decisions within the company, a significant subsidiary of the company, or a principal business unit, division, or function of the company appropriately focus the disclosure on employees for whom compensation information is material to investors?
  - Would the approach that we are considering provide investors with material information about how policy-making responsibilities are allocated within a company? Are the examples describing responsibility for significant policy decisions too broad or too narrow?
  - Would the proposed rule, with the modifications described above, provide investors with material information necessary to understand the company's compensation policies and structure? How should we address those concerns?
  - What is typically the role of the compensation committee in determining or approving the compensation of the additional employees if they are not executive officers? If the compensation committee does not oversee their

compensation, is the additional employee compensation information material to investors? What types of decisions would investors make based on this information?

- Would the proposed rule, with the modifications described above, raise privacy issues or negatively impact competition for employees in a manner that would outweigh the materiality of the disclosure to investors?
- Should we require that the three additional employees be named? If not, what additional information should be required? Should more information be required regarding the employee’s compensation or job position?
- Should we define “responsibility for significant policy decisions”? Should we use another test to describe those employees who exert a significant policy influence on the company? Do the examples provided above help identify and delimit the number of employees whose compensation would be subject to disclosure under this provision? What would help companies identify these employees?
- What additional work and costs are involved in collecting the information necessary to identify the three additional employees? What are the types of costs, and in what amounts? In what way can the proposal be further modified to mitigate the costs?
- In connection with the original proposal, we solicited comment on all aspects of the proposal, including this one. No commenter supplied cost estimates. We are now considering whether to limit this provision to only large accelerated filers. For some large accelerated filers, the number of employees potentially subject to this requirement may already be known or easy to identify. Other, more complex

companies may need to establish systems to identify such employees. Every large accelerated filer would need to evaluate whether any employees exerted significant policy influence at the company, at a significant subsidiary or at a principal business unit, division or function and would have to track their compensation in order to comply with the proposed requirement. These monitoring costs may be new to some companies. We believe the cost of actually disclosing the compensation would be incremental and minimal. The monitoring and information collection costs are likely to be greatest in the first year and significantly less in later years. We also assume that costs would largely be borne internally, although some companies may seek the advice of outside counsel in determining which employees meet the standard for disclosure. In that event, for purposes of seeking comment, we estimate that 1,700<sup>13</sup> companies will on average retain outside counsel for 8 hours in the first year and 2 hours in each of two succeeding years, at \$400 per hour, for a total estimated average annual cost of approximately \$3 million. Assuming all large accelerated filers spend 60 hours in the first year and 10 hours in each of the two succeeding years, with an average internal cost of \$175 per hour, the total average annual burden of collecting and

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<sup>13</sup> We estimate there are approximately 1,700 companies that are large accelerated filers. See Revisions to Accelerated Filer Definition and Accelerated Deadlines for Reporting Periodic Reports, Release No. 33-8644 (Dec. 21, 2005) [70 FR 76626], at Section V.A.2.

monitoring employee compensation would be approximately 45,000 hours, or approximately \$8 million. The total average annual cost is therefore estimated to be \$11 million. We invite comment on this estimate and its assumptions.

By the Commission.

Nancy M. Morris  
Secretary

Dated: August 29, 2006