

Manual of Publicly Available Telephone Interpretations

J. ITEM 402 OF REGULATION S-K

1. Item 402 of Regulation S-K

A registrant need not report earnings on salary and bonus deferred pursuant to non-tax qualified arrangements where the return on such earnings is calculated in the same manner and at the same rate as earnings on externally managed investments available to employees participating in a tax-qualified plan providing for broad-based employee participation. (For example, many issuers provide for deferral of salary or bonus amounts not covered by tax-qualified plans where the return on such amounts is the same as the return paid on amounts invested in an externally managed investment fund, such as an equity mutual fund, available to all employees participating in a non-discriminatory, tax-qualified plan (e.g., 401(k) plan).)

2. Item 402 of Regulation S-K

Where a named executive officer exercises "reload" options and receives additional options upon such exercise, the registrant is required to report the additional options as an option grant.

3. Item 402 of Regulation S-K

For purposes of Item 402 disclosure, a spin-off is treated like the IPO of the new "spun-off" registrant.

4. Item 402 of Regulation S-K

In a merger situation, there is no concept of "successor" compensation. Therefore, the surviving company in the merger need not report on compensation paid by predecessor corporations that disappeared in the merger. Similarly, a parent corporation would not pick up compensation paid to an employee of its subsidiary prior to the time the subsidiary became a subsidiary (i.e., when it was a target). Moreover, income paid by such predecessor companies need not be counted in computing whether an individual is a named executive officer of the surviving corporation. A different result may apply, however, in situations involving an amalgamation or combination of companies.

5. Item 402 of Regulation S-K

A subsidiary of a public company is going public. The officers of the subsidiary previously were officers of the parent, and in some cases all of the work that they did for the parent related to the subsidiary. The registration statement of the subsidiary would not be required to include compensation previously awarded by the parent corporation. The subsidiary would start reporting as of the IPO date.

6. Item 402 of Regulation S-K

Compensation of both incoming and departing executives should not be annualized.

7. Item 402 of Regulation S-K

Instruction 1 to Item 402(a)(3) states that the generally required compensation disclosure regarding highly compensated executive officers need not be set forth for an executive officer (other than the CEO) whose total annual salary and bonus did not exceed \$100,000. A reporting company that recently changed its fiscal year end from December 31st to June 30th is preparing its transition report for the 6-month period ended June 30th, having filed its Form 10-K for the fiscal year ended 6 months earlier on December 31st. The reporting company generally has a group of executive officers that earn in excess of \$100,000 each year. In addition, during the 6-month period, the company made an acquisition that resulted in new executive officers that, on an annual basis, will earn more than \$100,000. During the 6-month period, however, none of these existing or new officers earned a salary and bonus from the company that exceeded \$100,000. The company asked whether disclosure under Item 402 regarding these officers therefore would not be required in the report being prepared for the 6-month period. The Division staff advised that no disclosure need be provided with respect to executive officers that started employment with the company during the 6-month period and did not, during that period of employment, earn more than \$100,000 in salary and bonus from the company. With respect to executive officers that were employed by the company both during and before the 6-month period, however, Item 402 disclosure would have to be provided for those who earned in excess of \$100,000 from the company during the one-year period ending June 30th (the same ending date as the six-month period, but extending back over 6 months of the preceding fiscal year).

8. Item 402 of Regulation S-K

If plans do not include thresholds or maximums (or equivalent items), the registrant need not include arbitrary sample threshold and maximum amounts. For example, for an LTIP plan that does not specify threshold or maximum payout amounts (for example, a plan in which each unit entitles the executive to \$1.00 of payment for each \$.01 increase in earnings per share during the performance period), threshold and maximum levels need not be shown as "0" and "N/A" because the payouts theoretically may range from nothing to infinity. Rather, an appropriate footnote should state that there are no thresholds or maximums (or equivalent items).

8A. Item 402(b) of Regulation S-K

The summary compensation table must include information for the reporting year and the two preceding years or such shorter period that the company was publicly traded. However, reporting for the CEO is only required for those years that the CEO held the position (or for any portion of the year in which the CEO served). If the CEO was not CEO during either of the two preceding years, no amounts need be reported for the CEO even if the CEO was an executive officer during the prior year. For the year in which the CEO assumed the position, disclosure must be provided of all compensation for the full year for services rendered to the registrant and its subsidiaries, including compensation prior to becoming CEO. In contrast, reporting for each of the other named executive officers must include prior year information for any year in which the individual was an executive officer (even if such person was not included in the summary compensation table in prior years because such person was below the \$100,000 reporting threshold or otherwise was not a named executive officer in prior years). In reporting for any given year, all compensation paid by the company to named executive officers is included, not just amounts attributable to their services as CEO or executive officers.

8B. Item 402(b) of Regulation S-K

A caller inquired whether a filing that is made on January 2 must include compensation for the previous year ended December 31. The Division staff's position is that compensation must be included for such year because registrants should have those numbers available. However, if

bonus amounts for the prior year have not yet been determined, this should be noted in a footnote together with disclosure regarding the date the bonus will be determined, any formula or criteria that will be used and any other pertinent information.

9. Item 402(b) of Regulation S-K

A company with a May 31 fiscal year end changed its fiscal year end to December 31. A caller inquired whether the executive compensation paid to its executives for the past three years should be restated based on a Dec. 31 year end, or whether transition reporting for short years should be used. The Division staff advised that restated compensation is not required (but is acceptable). Instead of restating compensation, a "transitional" approach should be used in lieu of using a stub period approach. Therefore, the registrant should report compensation for two years based on a May 31 year end (as if the fiscal year had not been changed) and then in addition show compensation for the twelve months ended December 31. Since there will be some overlap between the reporting of compensation for the latest twelve month period ended May 31 and the twelve month period ended December 31, a footnote to the summary compensation table should disclose that the fiscal year was changed and discuss any overlap. Then, in next year's proxy, the earliest year ended May 31 will "drop off" and compensation will be shown for one year ended May 31 and two years ended December 31. The Division staff further noted that only two years of reporting with a May 31 year end was required because the amount of the overlap period is only five months and therefore there is 2 1/2 years of reporting, which the Division staff deemed to meet the three-year requirement. In cases where the overlap is greater than six months (for example, where an August fiscal year end is moved to December), then there should be three years of reporting based on the prior year end and one year of reporting based on the new year end.

10. Item 402(b)(2)(iii) of Regulation S-K

Instruction 3 to Item 402(b)(2)(iii)(A) and (B) specifies the permitted treatment of salary or bonus that a named executive officer elects to receive in non-cash form. That Instruction does not permit a registrant to report the value of free stock or other nonrestricted and noncontingent non-cash compensation received as annual salary or bonus in a column other than the Salary or Bonus column. A registrant may elect to use the treatment permitted by Instruction 3 to report salary or bonus awarded in restricted or contingent non-cash form, even where the named executive officer has no election.

11. Item 402(b)(2)(iii)(A) and (B) of Regulation S-K

For purposes of computing whether the salary and annual bonus of an executive officer exceeds the \$100,000 threshold for purposes of the summary compensation table, whether severance payments must be included depends on the particular facts and circumstances. Payments made under severance agreements that were executed many years ago would generally not be included as salary or bonus. Payments made under severance agreements that were negotiated in connection with the termination or departure of the executive require closer scrutiny to determine whether the payments are more appropriately characterized as payments of salary or bonus.

12. Item 402(b)(2)(iv) of Regulation S-K

Restricted stock that has vested need not be included in restricted stock holdings at the end of the year.

13. Item 402(b)(2)(iv) of Regulation S-K

Instruction 2 to Item 402(b)(2)(iv) requires footnote disclosure of "the value of the aggregate restricted stock holdings at the end of the last completed fiscal year" and directs that the value "be calculated as specified in paragraph (b)(2)(iv)(A)." That calculation cross-reference does not mean that the aggregate restricted stock should be valued as of grant date. As Instruction 2 to Item 402(b)(2)(iv) states, the required disclosure is value "at the end of the last completed fiscal year."

14. Item 402(b)(2)(v) of Regulation S-K

A caller inquired regarding the valuation of split dollar life insurance. Assume that the premiums on a life insurance policy for an employee are \$1000 per annum, which is paid by the employer. Of this amount, \$150 is attributable to the term insurance portion and the remaining \$850 is attributable to the non-insurance portion. The employer has the right to a refund of the \$850 portion that is paid each year, but timing of the refund is uncertain because it depends on a number of contingencies. Depending on how the plan is written, the premium may be refundable when the employee leaves the employer, on retirement, death, etc. The employee has or will receive an interest in the cash surrender value.

The Division staff advised that the \$150 portion would be reported under "All Other Compensation" since that was the amount paid in the last fiscal year for term insurance and that amount per year is taxable to the employee as compensation. Although the \$850 may be included in the All Other Compensation column with the \$150 pursuant to Rule 402(b)(2)(v)(E)(1), an alternative method is provided by Rule 402(b)(2)(v)(E)(2). Under this subsection, the employer would compute the present value of an interest-free loan of \$850 for a period, projected on an actuarial basis, between payment of the premium and the refund to the registrant on termination of the policy. Since insurance premiums are generally paid each year, the present value of an annuity relating to the interest portion of the loan would be computed. The relevant period is typically based on the earlier of the insured's natural life expectancy or the earliest time to his or her retirement. For example, if an insured is 60 years old, the company has adopted a mandatory retirement age of 62 and the insured's life expectancy is age 75, then the period used would be two years since that is when the refund to the registrant is expected. The Division staff has not prescribed the interest rate that should be used in computing the present value of an annuity relating to the interest portion on an interest-free loan. However, the applicable federal rate is an acceptable method of computing interest.

15. Items 402(b)(2)(v) and 402(b)(2)(iii)(C) of Regulation S-K

There is no required reporting of dividends or dividend equivalents paid or credited on restricted stock or restricted stock units unless such payments are preferential. If above market or preferential earnings on restricted stock, options, SARs or deferred compensation are earned during the fiscal year or are calculated with respect to that period, they should be reported under Item 402(b)(2)(v), except that if such amounts are paid during the fiscal year or are payable during the period but deferred at the election of the named executive officer, this information should be reported pursuant to Item 402(b)(2)(iii)(C).

16. Item 402(c) of Regulation S-K

Registrants choosing to value option grants using a "Black-Scholes" model are required to include a footnote identifying the model and describing the assumptions used relating to expected volatility, risk-free rate of return, dividend yield, and time to exercise. In addition, any adjustments to the model for non-transferability or risk of forfeiture must be disclosed. If another grant-date methodology is used, the registrant is required to describe that methodology

and any material assumptions. See Instruction 9 to Item 402(c). See also Release No. 34-32723 at Note 46.

17. Item 402(c) of Regulation S-K

Securities underlying options granted prior to the establishment of a trading market for the registrant's stock may be valued using the initial public offering price in lieu of the fair market value at grant date. If other than the IPO price is used in such cases, the fair market value used for option grant disclosure purposes should be the same as the value used by the registrant for accounting purposes to determine if any compensation expense related to options grants is reportable. Where the value assigned is not based on trading of the security in an established public market, the valuation method used should be disclosed in a footnote. See Release No. 34-32723 at IV.C.

18. Item 402(c) of Regulation S-K

Options or other rights to purchase securities of the parent or a subsidiary of the registrant should be reported in the same manner as compensatory options to purchase registrant securities. See Release No. 34-32723 at III.B.

19. Item 402(d) of Regulation S-K

The compensation disclosure rules do not, as a general rule, permit registrants to deviate from the highly formatted tabular presentations required except to omit any column or table otherwise not applicable. A limited exception has been made for the caption of column (b) in the Option/SAR Exercise table. The caption to that column may be modified to read: "Number of securities underlying options/SARs exercised." In all cases, the gross number of securities underlying the options/SARs exercised should be reported in this column.

20. Item 402(d) of Regulation S-K

Even if there were no exercises in the last completed fiscal year, the total number of any options held at year end by each named executive officer and the value of those in-the-money must be reported. See Release No. 34-32723 at III.F.

21. Item 402(d) of Regulation S-K

As defined in Item 402(a)(7)(iii), a "long-term incentive plan" provides compensation intended to serve as incentive for performance to occur over a period longer than one year. Interpretive guidance in determining whether compensation under a particular plan should be considered annual or long-term, and, if long-term, whether the compensation is under a "long-term incentive plan," is provided in Section IV.A. of Release No. 33-7009 (Aug. 1993).

22. Item 402(g) of Regulation S-K

Consulting arrangements between the registrant and a director are disclosable as director compensation under Item 402(g), even where such arrangements cover services provided by the director to the issuer other than as director (e.g., as an economist), and are otherwise disclosable under Item 404. This disclosure need not be repeated in complying with Item 402(j) or Item 404.

23. Item 402(g) of Regulation S-K

With respect to disclosure required for director legacy programs pursuant to the Instruction to Item 402(g)(2), which requires disclosure of the material terms of the arrangement, the amount of the total legacy or award must be specified, not only the amounts of premium paid under a legacy.

24. Item 402(i) of Regulation S-K

In the repricing table, the registrant is required to provide ten-year tabular information with respect to the repricing of options/SARs held by any executive officer over the lesser of the last ten completed fiscal years or the period in which the registrant has been subject to Exchange Act reporting requirements, even if such executive officer served as an executive officer in prior years and then left the company.

25. Item 402(j) of Regulation S-K

Where the only disclosure that a registrant is required to provide pursuant to Item 402(j) is the identity of the members of the compensation committee, because the registrant has no transactions or relationships that trigger a disclosure obligation, the registrant may omit the Item 402(j) caption ("Compensation Committee Interlocks and Insider Participation").

26. Item 402(k) of Regulation S-K

No Compensation Committee Report need be included in the proxy statement if the issuer had not been a public company at any time during the preceding fiscal year. (This is because the report must address the specific relationship of compensation to corporate performance, which is not subject to measure for a company that is not public.)

27. Item 402(k) of Regulation S-K

The Compensation Committee report should disclose the nature of the group with which the Committee is comparing the registrant's compensation (e.g., Fortune 100 companies), the extent to which it differs from the peer group and where in the range established by that comparison the issuer targets its compensation (e.g., high, median, or low end of the range). Where different competitive standards are used for different components of the pay package, that should be made clear.

28. Item 402(k) of Regulation S-K

The Compensation Committee report must be separately captioned to identify it clearly as a report on executive compensation. Where there are multiple committees on the board with responsibility for different components of compensation (e.g., a stock option committee), each of the committees has a disclosure obligation.

29. Item 402(k) of Regulation S-K

The Compensation Committee report must be "published over the names" of the members of the Committee (or the full Board) who participated in the deliberations concerning compensation reported for the last year. New members who did not participate in such deliberations and departed members who are no longer directors need not be included. Members who resigned

from the Committee during the course of the year but remain directors of the issuer may need to be made responsible for the report.

30. Item 402(l) of Regulation S-K

A registrant may plot monthly or quarterly returns in the Performance Graph required by Item 402(l) provided that each return is plotted at the same intervals, and the annual changes in cumulative total return are reflected clearly.

31. Item 402(l) of Regulation S-K

A registrant that presents in the Performance Graph a self-constructed peer or market capitalization index should weight the returns of the component entities of that index according to their market capitalization as of the beginning of each period for which a return is indicated.

32. Item 402(l) of Regulation S-K

As a general rule, when a registrant changes the entities comprising a self-constructed index from the index used in the prior year, the reasons for the change must be explained and the total return must be compared with that of both the newly constructed index and the prior index. See Item 402(1)(4) and Release No. 34-32723 at IV.B.1. Two limited exceptions are set forth in Release No. 33-7009 (Aug. 1993). Presentation on the old basis is not required: (i) if an entity is omitted solely because it is no longer in the line of business or industry or (ii) where the changes in the composition of the index are the result of application of pre-established objective criteria. In these two cases, a specific description of, and the bases for, the change must be disclosed, including the names of the companies deleted from the new index.

33. **** Item 402(l) of Regulation S-K ****

If a company becomes listed on an exchange that is different from the exchange it was listed on in the prior year, the change needs to be reflected in the performance graph if the company also changes its broad market indices as a result. For example, if a company that had been listed on the American Stock Exchange becomes listed on a different exchange and now plans to use the S&P 500 as its broad market index rather than the American Stock Exchange Value Index, the company must provide a narrative explanation of the change in indices and compare returns based upon the old and new index on the graph.

34. Item 402(l) of Regulation S-K

A registrant-constructed peer or market capitalization index may exclude the registrant.

35. Item 402(l) of Regulation S-K

In lieu of data for the last trading day prior to the end of a given fiscal year, a registrant may use data for the last day in that year made available by a third-party index provider.

36. Item 402(l) of Regulation S-K

A registrant created by a spin-off may begin its Performance Graph presentation on the effective date of the registration of its common stock under Section 12 of the Exchange Act.

37. Item 402(l) of Regulation S-K

A registrant that spins off a portion of its business should treat that transaction as a special dividend, make the appropriate adjustments to its shareholder return data, and disclose the occurrence of the transaction and resultant adjustments in its Performance Graph.

38. Item 402(l) of Regulation S-K

A merger or other acquisition involving the registrant, where the registrant remains in existence and its common stock remains outstanding, does not change the presentation of the registrant's Performance Graph.

39. Item 402(l) of Regulation S-K

A registrant with several distinct lines of business may construct a composite peer group index composed of entities from different industry groups, representing each of the registrant's lines of business (with the lines of business weighted by revenues or assets). The basis and amount of the weighting should be disclosed. Alternatively, the registrant may plot a separate peer index line for each of its lines of business.

40. Item 402(l) of Regulation S-K

The performance graph should not be "buried" in a section of the proxy statement unrelated to the executive compensation disclosure. See Release No. 34-32373 at III.I.

41. Item 402(l) of Regulation S-K

If a company selects its own peer group and subsequently changes the group, an additional line showing the newly selected index should be added to the performance graph.

42. Item 402(l) of Regulation S-K

Companies that have a short fiscal year (for example, following an initial public offering, as the result of a spin-off, or after emerging from bankruptcy) must do a stock performance graph for the short year unless the short year is 30 days or less.

43. Item 402(l) of Regulation S-K

A company is preparing its first proxy statement following its emergence from bankruptcy. The stock started trading in March 1995. The measurement period for the graph is from March 1995 through December 1995. However, the company may plot the graph on a monthly basis and can continue the graph beyond December 1995 as long as the December 1995 plotting point is clearly shown. The same principle applies to initial public offerings and spin-off situations with a short fiscal year.

44. Item 402(l) of Regulation S-K

Issuers may not choose between using the price shown in the registration statement for an initial public offering, the opening price on the first trading day, or the closing price in the market on the first trading day. The issuer should use the market close at the end of the first trading day.

45. Item 402(l) of Regulation S-K

A registrant may show both a three-year graph and a five-year graph as long as the compensation committee report discusses both graphs.

46. Item 402(l)(3) of Regulation S-K

A "published industry or line-of-business index" is one that is "accessible to the registrant's security holders" and, if prepared by the registrant or an affiliate, is also "widely recognized and used." Certain guidance concerning the use of trade group indices and of composite indices composed of more than one published index is given in Release No. 33-7009 (Section IV.B.2.) (Aug. 1993). Self-constructed indices (which term includes those prepared by a third party for the registrant and which are not "published") are not prohibited or discouraged by Item 401(l), they just must be weighted by market capitalization (as are most published indices) and include identification of the component issuers. Instruction 5 to Item 402(l).

47. Item 402 of Regulation S-K; Item 404 of Regulation S-K

A parent and its subsidiary are both Exchange Act reporting companies. Some of the executive officers of the parent may receive a portion of their compensation from the subsidiary corporation. The Division staff advised that if an executive spends 100% (or near 100%) of the executive's time for the subsidiary but is paid by the parent, then the compensation paid by the parent has to be reported in the executive compensation table of the subsidiary. However, if an allocation of the monies paid by the parent would be necessary because the executive officer splits time between the parent and the subsidiary, the payments made by the parent need not be included in the subsidiary's executive compensation table. In the event that the subsidiary pays a management fee to the parent for use of the executives, disclosure of the structure of the management agreement and fees would have to be reported under Item 404. Compensation paid by the subsidiary to executives of the parent company must be included in the parent's executive compensation table if such payments are paid directly by the subsidiary. However, if the payments are part of a management contract, disclosure of the structure of the management agreement and fees would have to be reported under Item 404.

48. Item 402 of Regulation S-K; Item 404 of Regulation S-K

A company's reimbursement to an officer of legal expenses with respect to a lawsuit in which the officer was named as a defendant, in her capacity as officer, is disclosable pursuant to Item 404 of Regulation S-K rather than pursuant to Item 402 of Regulation S-K.