

**SOME QUESTIONS AND ANSWERS ABOUT THE SEC'S NEW EQUITY
COMPENSATION PLAN INFORMATION REQUIREMENTS**

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On December 21, 2001, the Securities and Exchange Commission issued a release (No. 33-8048) (the "Adopting Release") in which it adopted new disclosure requirements regarding equity compensation plans. The requirements are contained in a new paragraph (d) to Item 201 of Regulation S-K.¹

This article is designed to provide, in question and answer format, an overview of the new regulatory requirements.

A. The Equity Compensation Plan Information Table

1. Q. Why is the SEC calling for another compensation plan table?

A. Because the new table has a different focus from other required tables. Currently, several compensation tables, all of which are required to be included in proxy statements relating to annual meetings,² deal with compensation for "principal executive officers."³ However, in recent years, many institutional and other security holders have focused on a concern that is not

¹ Similar requirements appear in Item 201(d) of Regulation S-B. For the purposes of simplicity, this article will not reference Regulation S-B or Form 10-KSB requirements; however, they are analogous to the Regulation S-K and Form 10-K requirements referenced in this article.

² The compensation tables are also required to be included in registration statements on Form S-1 and are incorporated by reference in other Securities Act filings. In addition, the tables are required to be included in the Form 10-K, unless the Form 10-K incorporates the information by reference to the proxy statement. Additional information is required to be disclosed in a proxy statement with regard to a compensation plan when the plan or an amendment to the plan is submitted for security holder approval. See Item 10 of Regulation 14A.

³ "Principal executive officers" include a company's chief executive officer and the four other most highly paid executive officers whose salary and bonus exceeded \$100,000 in the most recent fiscal year. Former officers may also be principal executive officers under circumstances described in Item 402(a)(3) of Regulation S-K.

directly addressed in disclosures relating to compensation of executive officers, namely the potential dilution that can result from equity compensation plans. These concerns are exacerbated by the fact that stock exchange and Nasdaq rules do not currently require approval of compensation plans in which officers and directors do not participate (and even if they do participate, security holder approval is not required if the plans are deemed to be “broadly based”).⁴

In adopting the new regulations regarding disclosure of equity compensation plan information, the SEC noted that equity compensation grants and awards “may result in a significant reallocation of ownership between existing security holders and management and employees,” and added that “because these plans may be implemented without the approval of security holders, it is possible that investors may not be able to determine the total size of a registrant’s compensation program.”⁵

2. Q: What type of information must be disclosed?

A. In a tabular format, issuers are required to provide three categories of information with respect to (1) equity compensation plans approved by security holders, (2) equity compensation plans not approved by security holders and (3) all equity compensation plans. The three categories of information are:

- (a) Number of securities to be issued upon exercise of outstanding options, warrants and rights;
- (b) Weighted average exercise price of outstanding options, warrants and rights; and
- (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in (a) above).⁶

⁴ See New York Stock Exchange Listed Company Manual, ¶ 312.03(a), ¶ 312.04(h); Nasdaq Stock Market Rule 4350(i)(1)(A).

⁵ Adopting Release, Section I.

⁶ Item 201(d) of Regulation S-K (“Item 201(d)”).

3. Q: What constitutes an “equity compensation plan” for the purposes of the table?

A: The table seeks information with regard to compensation plans in effect as of the end of the registrant’s last completed fiscal year under which equity securities of the issuer (which can include options, warrants and other rights, as well as company stock) are authorized for issuance.⁷

4. Q: Is disclosure required with regard to plan awards to non-employees?

A: Yes. Disclosure is required without regard to whether participants are employees or non-employees such as directors, consultants, advisors, vendors, customers, suppliers or lenders. An instruction to Item 201(d) states that disclosure must be provided where equity securities are authorized for issuance to employees or non-employees in exchange for consideration in the form of goods or services as described in Statement of Financial Accounting Standards No. 123, Accounting for Stock Based Compensation (“SFAS 123”) or any successor standard.⁸

5. Q: Suppose the company enters into an individual compensatory arrangement with an employee or other person. Does that arrangement constitute a “compensation plan” for the purposes of the table?

A: Yes. The information regarding the individual arrangements may be aggregated with other plan information.⁹

6. Q: Suppose the compensation plan is a plan of the company’s parent or subsidiary rather than the company’s own plan, although company securities are authorized for issuance. Must information about the plan be included in the table?

A: Yes. The same answer also applies to plans of other company affiliates, so long as company securities are authorized for issuance.¹⁰

⁷ Item 201(d)(1); Adopting Release, Section II.A.1.

⁸ Item 201(d), Instruction 1; Adopting Release, Note 26.

⁹ Item 201(d)(1). See also Instructions 2 and 4 to Item 201(d).

¹⁰ Item 201(d), Instruction 1.

7. Q. Suppose the compensation plan has a formula under which the number of shares available for issuance increases based on the number of shares of the company’s stock outstanding. What additional information is required?

A: The formula should be described in a footnote to the table.¹¹

8. Q: Suppose more than one class of a company’s securities may be issued under equity compensation plans. How should this be treated in the table?

A: Instruction 3 to Item 201(d) states that plan information should be provided for each class of security.

9. Q. A company has a restricted stock plan under which shares are available for future issuance. How are the shares available for future issuance reported?

A: As is the case with plans under which options, warrants and rights may be granted, information regarding the number of shares remaining available for future issuance under the restricted stock plan should be included in the table. However, additional footnote disclosure is required with respect to the restricted stock plan. Instruction 9 to Item 201(d) states that if the securities available for future issuance under a compensation plan are issuable other than upon the exercise of an option, warrant or right, footnote disclosure of the number of securities available and type of plan should be provided “separately for each such plan.”

10. Q. The table requires information as of the end of the most recently completed fiscal year with respect to compensation plans under which equity securities of the company are authorized for issuance. Suppose the plan has terminated, and no further options can be granted, although some options remain outstanding. Must disclosure be made with respect to that plan?

A: Yes. The SEC has stated that for purposes of the new regulation, “we consider an equity compensation plan to be in effect as long as securities remain available for future issuance

¹¹ Item 203(d), Instruction 8. This description is required in respect of any compensation plan that “contains a formula for calculating the number of securities available for issuance under the plan. . .”.

under the plan, or as long as options, warrants or rights previously granted under the plan remain outstanding.”¹²

11. Q: Suppose a company is seeking security holder approval to amend a plan to increase the total number of shares authorized. Should it include, in its proxy statement, information in the table with regard to that plan as in effect prior to the amendment?

A: Yes.¹³

12. Q: Should the company include in the table additional securities that would be authorized by the plan if the amendment is approved by security holders?

A: No.¹⁴

13. Q: Suppose a company has a 401(k) plan or other plan intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code, under which company securities can be acquired. Must disclosure regarding these type of plans be included in the table?

A. No. Any employee benefit plan that is intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code need not be included in the table.¹⁵

14. Q: Suppose a company acquires another corporation and, in connection with the acquisition, assumes the other corporation’s compensation plan. Must disclosure be made with regard to the assumed compensation plan?

A: Yes. Tabular disclosure must include information with regard to such plans “pursuant to which the registrant may make subsequent grants or awards of its equity securities,” although the information may be aggregated in the table with information provided about the company’s plans. However, Instruction 5 to Item 203(d) states that a company must disclose, on an aggregated basis in a footnote to the table, the information required by the table with respect to any individual options,

¹² Adopting Release, Note 25.

¹³ Item 10(c) of Regulation 14A, Instruction 1; Adopting Release, Section II.A.2.

¹⁴ Item 10(c) of Regulation 14A, Instruction 1; Adopting Release, Section II.A.2.

¹⁵ Item 201(d), Instruction 1.

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warrants or rights assumed in connection with a merger, consolidation or other acquisition transaction.¹⁶

B. Narrative Disclosure of Non-Security Holder-Approved Plans

15. Q. Aside from the equity compensation plan information table, what information must be provided with regard to non-security holder-approved plans?

A: Companies are required to identify and describe briefly, in narrative form, the material features of each non-security holder-approved equity compensation plan in effect as of the end of the last completed fiscal year that was adopted without security holder approval.¹⁷

16. Q: SFAS 123 requires financial statement disclosures containing descriptions of plans, including plans not approved by security holders. Can companies satisfy the narrative disclosure requirement regarding non-security holder-approved plans by cross-referencing the required SFAS 123 disclosure in the financial statements.

A: Maybe. In the Adopting Release, the SEC stated that companies can satisfy the disclosure requirements “in this manner.” The SEC noted, in footnote 45 to the Adopting Release, that paragraph 46 of SFAS 123 “requires a description of each stock-based compensation plan, including the general terms of awards under the plan, such as vesting requirements, the maximum term of options granted and the number of shares authorized for grants of options or other equity instruments.” However, the SEC added that cross-referencing is not permitted if the SFAS 123 plan description does not contain all of the material features of the plan.¹⁸

¹⁶ Item 201(d), Instruction 5.

¹⁷ Item 201(d)(3); Adopting Release, Section II.A.4.

¹⁸ See Adopting Release, Section II.A.4 and Item 201(d), Instruction 7, which states: “If the description of an equity compensation plan set forth in a registrant’s financial statements contains the disclosure required by . . . paragraph (d)(3), a cross reference to such description will satisfy the requirements of . . . paragraph (d)(3).”

17. Q: Is a company required to make the narrative disclosure regarding non-security holder-approved plans annually?

A: Yes.¹⁹ Therefore, cross-referencing to the SFAS 123 disclosure is a good idea. However, it is important to be sure that the SFAS 123 disclosure contains “all of the material features of the plan” so that cross referencing is permitted.

18. Q: What should be included in the cross reference?

A: The commission stated that the cross reference should identify the specific plan or plans in the required SFAS 123 disclosure that have not been approved by security holders.²⁰

C. Location of Equity Compensation Plan Information Disclosures

19. Q: In what filing must the equity compensation plan information table and narrative disclosure of non-security holder-approved plans be included?

A: The information must always be included in the company’s Form 10-K. In addition, if the company is submitting a compensation plan for security holder approval, the disclosure must also appear in the company’s proxy statement.²¹

20. Q: Suppose a compensation plan submitted for security holder approval involves only cash payments. Must the company include the compensation plan information in the proxy statement?

A: Yes. Footnote 68 of the Adopting Release states that disclosure is triggered by the submission of any compensation plan for security holder action, including cash-only plans.

¹⁹ See Adopting Release, Section II.A.4.

²⁰ Adopting Release, Section II.A.4.

²¹ Form 10-K, Item 12; Schedule 14A, Item 10.

21. Q: Prior to the adoption of the new regulations, general instruction G(3) to Form 10-K provided for the incorporation by reference to the proxy statement of all disclosure items required by Part III of the Form 10-K, provided that the proxy statement was filed within 120 days after the end of the fiscal year covered by the Form 10-K. If a company is required to include the equity compensation plan information table in its proxy statement because it is submitting a compensation plan for security holder action, may the company dispense with the Form 10-K disclosure and incorporate by reference the proxy statement disclosure?

A: Yes.²²

22. Q: Must the compensation plan information be included in a registration statement filed under the Securities Act?

A: No. However, unlike provisions in Item 402 of Regulation S-K relating to the compensation committee report and performance graph, the compensation plan information will be deemed incorporated by reference into a prospectus for the purposes of the Securities Act.²³

D. Exhibit Requirement Relating to Non-Security Holder – Approved Plans

23. Q: Are there any exhibit requirements related to the new regulations?

A: Yes. The SEC amended the exhibit requirements of Item 601(b)(10) of Regulation S-K to require companies to file in the Form 10-K, for the fiscal year in which it was adopted, copies of any equity compensation plan adopted without the approval of security holders in which any employee participates (whether or not the employee is an executive officer of the company) unless immaterial in amount or significance. Nondiscriminatory, broad-based compensatory plans are exempt from the requirement.²⁴

²² Adopting Release, Section II.C.

²³ Item 201(d), Instruction 9. In contrast, see Regulation S-K, Item 402(a)(9), regarding the non-incorporation by reference of information required under paragraphs (k) and (l) of Item 402.

²⁴ Regulation S-K, Item 610(b)(10)(iii)(B); Adopting Release, Note 73.

24. Q: Suppose a company assumes an equity plan in connection with a merger. Must the company file a copy of the assumed equity compensation plan?

A: If the company may make further grants or awards of its equity securities under the assumed plan, it must file the plan if the plan otherwise satisfies the new item 601(b)(10)(iii)(B) requirements.²⁵

E. Effective Dates Pertaining to New Disclosure Requirements

25. Q: When must companies begin including the table and related disclosures in its filings?

A: The table must be included in Forms 10-K filed for fiscal years ending on or after March 15, 2002. In addition, proxy disclosure of the equity compensation plan information table must be made, if required by the new regulations, for meetings of security holders occurring on or after June 15, 2002.

26. Q: When must a company file copies of existing non-security holder-approved plans that are now required to be filed under amended Item 601(b)(10)(iii)(B) of Regulation S-K?

A: The existing plans must be filed as exhibits to the Form 10-K filed by the company for its first fiscal year ending after March 15, 2002.²⁶

F. Foreign Registrants

27. Q: Do the new disclosure requirements relate to foreign registrants?

A: Not “at this time.”²⁷

G. Duplicative Disclosures

²⁵ Regulation S-K, Item 601(b)(10)(iii)(B).

²⁶ Adopting Release, Note 77.

²⁷ Adopting Release, Section II.A.5.

28. Q: Aren't the newly required disclosures already available in other company disclosures?

A: To some extent, although not nearly as much as would have been the case if the rules as proposed were adopted. Because the information is available elsewhere, the SEC determined not to require, as proposed, tabular disclosure of the number of securities authorized for issuance under each equity compensation plan or information about the number of securities issued or the underlying options, warrants or rights granted under each plan during the last fiscal year. However, the SEC is requiring the repetition of some information available elsewhere, such as the number of securities to be issued upon the exercise of outstanding options and other rights and the weighted average exercise price, because "it is not transparent to investors."²⁸

²⁸ Adopting Release, Section II.B.