

AMERICAN BAR ASSOCIATION

Technical Session Between the SEC Staff and the Joint Committee on Employee Benefits

Questions and Answers

May 6, 2003

The following questions and answers are based on informal discussions between private sector representatives of the JCEB and SEC staff members. The questions were submitted by ABA members and the responses were given at a meeting of JCEB and government representatives. The responses reflect the unofficial, individual views of the government representatives as of the time of the discussion, and do not necessarily represent the position of the agency. This report on the discussions was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting, and has not been reviewed by SEC staff members. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.

JCEB Questions for SEC - 2003

S-K Item 201(d)

1. **Narrative Description of Materially Similar Arrangements.** In the case of individual arrangements that are materially similar or identical (other than the number of securities, the price and the vesting schedule), can the registrant use one narrative description, together with a separate description of any material differences, to satisfy the disclosure requirement of Item 201(c)(3)?

Suggested Answer: Where a registrant has multiple individual arrangements outside its equity plans, and the terms of those individual arrangements are substantially similar or identical, no purpose would be served for each individual arrangement to be separately described. Separate descriptions of each materially similar or identical arrangement would substantially lengthen registrants' proxy statements and Form 10-K filings and have the effect of obscuring relevant information about the arrangements. For these reasons, registrants may provide aggregate descriptions of non-security holder approved equity compensation plans that take the form of individual arrangements except to the extent such arrangements differ in their material terms (other than number of securities, price and vesting), in which case the material differences must be separately described.

SEC Response: Where several individual arrangements are substantially the same, the issuer may provide a single narrative description. However, the description must set forth a schedule showing separately for each individual arrangement the number of securities covered by the arrangement, the price, and the vesting schedule.

2. **Identifying Recipients of Individual Equity Compensation Arrangements.** In the case of individual arrangements, whether or not required to be separately described, can registrants disclose only the aggregate number of recipients and the aggregate number of securities granted unless the individual arrangement constitutes an award to an "executive officer" as defined in Exchange Act Rule 3b-7 or to a director?

Suggested Answer: Requiring this disclosure as to a non-executive officer or non-director in an individual non-security holder approved equity compensation plan or arrangement is not needed to achieve the purposes of the required disclosure. Registrants may provide the aggregate number of grantees and the aggregate number of securities granted under the non-security holder approved plans that take the form of individual arrangements rather than separately identifying the individual grantees and grant amounts, except with respect to executive officers and directors, in which case their identities and grant amounts must be disclosed.

SEC Response: In the case of arrangements with executive officers (as defined for purposes of Section 16) and directors, the name of the recipient (and grant amount) must be provided as part of the narrative description. The names of the other recipients need not be provided. The Staff believes the Section 16 definition of executive officer is more appropriate than the Rule 3b-7 definition because the Section 16 definition is a bit broader.

3. **Effect of Plan Amendment Increasing Share Reserve.** Where an equity compensation plan adopted by the registrant and approved by security holders is subsequently amended to increase the number of securities available for future issuance under the plan and the amendment is not itself approved by security holders, for purposes of Item 201(d)(1), is the plan treated as two separate plans such that: (i) the information specified in Item 201(d)(2) relating to the portion of the plan share reserve that has been approved by security holders should be disclosed in the category for compensation plans approved by security holders, and (ii) the information specified in Item 201(d)(2) relating to the portion of the plan share reserve that has not been approved by security holders should be disclosed in the category for compensation plans not approved by security holders?

Suggested Answer: The plan is treated as two separate plans. The portion of the share reserve that was approved by shareholders continues to be treated as shareholder-approved. Only the shares added without shareholder approval need be treated as non-shareholder-approved. However, an issuer could choose to treat the entire plan as non-shareholder-approved if it chose not to separately keep track of the two pools of shares.

SEC Response: Both approaches described in the Suggested Answer are permissible. Footnotes should be used to explain how the issuer has reported the plan.

With respect to non-shareholder-approved amendments other than to add shares, if the amendment was “material”, the entire plan would have to be classified as non-shareholder-approved. The staff was not clear how “materiality” would be defined for this purpose, and at one point stated that any amendment would be material. The Staff is concerned that issuers not be allowed to undercut the shareholder vote by unilaterally changing the terms of a plan after it has been approved by shareholders. The Staff was not inclined to look to the old Rule 16b-3 standards of material amendments. They suggested that Telephone Interpretation 39 under the Section 16 Rules (which provides that any amendment of a material term of a grant needs specific approval for purposes of Rule 16b-3) might provide a useful analogy.

4. **Grants Assumed in Merger.** Where an equity compensation plan is assumed by a registrant but not approved by the security holders of the registrant or where outstanding options (but not the related equity compensation plan) are assumed by a registrant in connection with a merger, consolidation or other acquisition transaction, must the registrant provide a description of the material features of the plan as required by Item 201(d)(3) only if the registrant has reserved the right to make subsequent grants or awards of its securities under such plan (unless the plan is subsequently approved by the security holders of the registrant)?

Suggested Answer: Yes. A description is required only if the registrant will continue to make grants under the plan.

SEC Response: The Staff agreed with the Suggested Answer and referred us to Instruction 5 to S-K Item 201(d), which requires footnote disclosure of assumed options where the registrant will not make new grants under the acquired company's plan. In this way the shareholders can more easily differentiate between grants by the registrant and grants by the acquired company. The answer would be the same if the registrant adopted a "replacement plan" solely to grant replacement options for those assumed in the merger.

5. **Treatment of Cash-Only Plans.** If a plan provides for phantom stock or other derivative securities which can only be settled in cash, is the plan covered by Item 201(d)?

Suggested Answer: No.

SEC Response: No. The purpose of Item 201(d) is to show dilution, and cash-only plans are not dilutive. However, if awards under the plan can be settled in either cash or stock, the plan is required to be included under 201(d). The Staff noted that if a company is seeking shareholder approval of a cash-only plan, this will trigger the requirement to include the 201(d) disclosure in the proxy statement.

6. **Restricted Stock.** How is restricted stock that has been issued subject to forfeiture reported for purposes of the table in Item 201(d)?

Suggested Answer: Once the restricted stock has been issued (i.e. granted) it is not reportable in the table. The shares comprising the award are neither "to be issued upon exercise" nor "available for future issuance." If shares are subsequently forfeited, they would become reportable in the "available for future issuance" column until a new grant is made.

SEC Response: The Staff agreed with the Suggested Answer. *[Note: This is a supplemental response provided by the Staff after the meeting]*

7. **Reporting of Awards.** Are the following reported as shares issuable upon exercise of an option, warrant or right, or as shares available for future issuance:
- (a) **Performance Share Awards** -- shares that may be issued under performance share awards if specified targets are met (i.e. the award is initially denominated in shares, but no shares are issued until the performance targets are met)?
 - (b) **Deferred Compensation** – shares that are credited as phantom shares under a deferred compensation plan, but will be issued as actual shares upon termination of employment?

Suggested Answer: In both instances, it should be permissible for companies to include the shares underlying these awards or rights in either column (a), as shares subject to

outstanding options, warrants and rights, or in column (c), as shares available for issuance. However, if shares subject to these types of arrangements are included in column (a), the company should include a footnote to that effect so as to avoid confusion as to the denominator used to calculate the weighted average exercise price reported in column (b), because investors may not realize that some of the shares included in column (a) are issuable under arrangements that in effect have no exercise price.

SEC Response: These awards should be reported in Column (a) of the table (i.e. as shares subject to outstanding options, warrants, or rights), with a footnote describing the nature of the award. The footnote should also say that the weighted average exercise price does not take these awards into account. If the number of shares subject to awards overstates expected dilution (such as where the award reflects the maximum number of shares to be awarded in the event of “best case” performance which is not likely to be achieved), the footnote can explain the situation. *[Note: This answer was provided at the meeting and subsequently confirmed by the Staff]*

8. **Approval by Bankruptcy Court.** Does a Bankruptcy Court’s approval of an equity plan as part of a plan or reorganization, after distribution and approval of a disclosure statement for the reorganization which contains a description of the equity plan, constitute shareholder approval of the equity plan for purposes of Item 201(d)?

Suggested Answer: Yes. The Bankruptcy approval process serves as the functional equivalent of shareholder approval.

SEC Response: No. Bankruptcy Court approval is not the same as shareholder approval. The plan should be reported as non-shareholder-approved, but the registrant can add a footnote describing the situation.

9. **Foreign Retirement Savings Plans.** Instruction 1 to Item 201(d) provides that no disclosure is required with respect to plans intended to meet the qualification requirements of Internal Revenue Code Section 401(a). Are foreign plans covering broad classes of employees and subject to home country regulation or qualification standards also exempt from disclosure?

Suggested Answer: Yes. No disclosure is required with respect to a foreign employee benefit plan that (a) provides for broad-based employee participation and (b) either (i) has been approved by the taxing authority of a foreign jurisdiction or (ii) is eligible for preferential treatment under the tax laws of a foreign jurisdiction.

SEC Response: Yes, if the plan is truly similar to a 401(a) plan. The analysis is based on substance rather than form. Key factors are whether the plan is broad-based, compensatory, and non-discriminatory in favor of the highly paid.

10. **Treatment of Options under Section 423 Plan.** What is the proper method of tabular reporting of “options” under a Section 423 plan which are “outstanding” at year-end (i.e. in the midst of an ongoing purchase period) if the price to be paid for the shares is a

percentage of the lower of market price on the date of grant or the date of purchase (given that the market price on the date of purchase is not known at year-end)?

Suggested Answer: Consistent with treatment under the proxy disclosure rules, rights to purchase stock under ESPPs with floating exercise prices should not be treated as outstanding options when preparing the table. The shares that may be issued in an on-going purchase period should be included in column (c), together with other shares remaining issuable under the plan.

SEC Response: Shares available under a 423 plan should be reported in Column (c) with a footnote disclosing the total number of shares remaining available as well as the number of shares subject to purchase during any ongoing purchase period. The shares should not be treated as subject to option.

S-K Item 601

11. Required Filing of Non-Security Holder Approved Plans

- (a) Please confirm that immateriality should be determined from the registrant's, as opposed to the grantee's, perspective, based on the number of securities available for grant under the plan compared to the total number of securities available for grant under all of the registrant's equity compensation plans or arrangements.

Suggested Answer: The materiality of such plans and arrangements is determined based on the registrant's perspective.

SEC Response: Materiality should be determined from the shareholders' perspective.

- (b) Please confirm that registrants would not be required to file every non-security holder approved equity compensation plan that takes the form of an individual arrangement and that is determined not to be "immaterial" where the terms of such arrangements are materially similar, except where filing is otherwise required for directors or executive officers under Item 601(b)(10)(iii)(A). Where the terms of such individual awards are materially similar, but there remain differences in such awards, such as different pricing or vesting periods, registrants should be permitted to file a "form" of these similar arrangements. Requiring the filing of each such individual arrangement, despite the fact the material terms of each are materially similar, would frustrate investors' access to such information, as investors would be confronted with a proliferation of filings. To avoid such a proliferation of filings, and the resulting difficulty in locating and discerning the terms of a registrant's plans and arrangements, we believe it would be appropriate to require filing of each individual arrangement only if the arrangement is materially different from other filed arrangements. Where individual arrangements are materially similar or identical only a "form" of the agreement and an appendix listing the differences between awards should be required to be

filed. Because the material terms of the arrangements would be set forth in the required narrative description, and a “form” of the arrangement would be filed, together with an appendix describing the differences between the awards, the provision’s goal of providing more accessible and informative disclosure information would not be adversely impacted.

Suggested Answer: Registrants may satisfy the filing requirement for materially similar individual arrangements that are not determined to be “immaterial” for purposes of Item 601(b)(10) by filing the form of the arrangement, together with an appendix describing the material differences between the arrangements and specifying the aggregate number of recipients who have entered into those arrangements and the aggregate number of securities that are subject to such arrangements, except with respect to officers and directors, in which case their identities and grant amounts must be disclosed.

SEC Response: Yes. If the arrangements are substantially the same, the company can file a single “form” of agreement together with an Appendix showing the number of shares, price, and vesting schedule for each award, as well as the aggregate number of recipients (but specifically identifying the grant information for each executive officer or director).

12. **Excluding Names of Individual Employees other than Executive Officers and Directors.** Where a non-shareholder-approved individual arrangement is required to be filed, can the issuer exclude the names of the individuals who are the recipients of such arrangements, other than executive officers and directors, from the filed copy?

Suggested Answer: Yes. The names of individuals who are not executive officers or directors is not material and is not necessary to achieve the intended purposes of Item 201(d). If a “form” of agreement is being filed, it is sufficient to disclose the aggregate number of recipients and the aggregate number of shares awarded under that form of arrangement (in addition to specifically identifying the number of shares awarded to each executive officer or director). If an arrangement for a particular employee is materially different from others, and is thus required to be separately filed, the issuer should be permitted to redact the name of the employee.

SEC Response: Yes. The analysis is the same as for Question 2. As long as the individual recipients are not Section 16 officers or directors, their names need not be disclosed.

13. **Filing of 401(k) Plan.** Paragraph (b)(10)(iii)(C) of Item 601 of Regulation S-K provides that “[n]otwithstanding paragraph (b)(10)(iii)(A) above,” the management contracts or compensatory plans, contracts or arrangements specified in the paragraph need not be filed as an exhibit. Subparagraph (b)(10)(iii)(C)(4) of Item 601 includes “[a]ny compensatory plan, contract or arrangement which pursuant to its terms is available to employees, officers or directors generally and which in operation provides for the same method of allocation of benefits between management and nonmanagement participants.” Can paragraph (b)(10)(iii)(C) of Item 601 also be read to apply to paragraph (b)(10)(iii)(B) of Item 601?

Suggested Answer: Yes. The exception from the filing requirement of Item 601(b)(10)(iii) of Regulation S-K for the management contracts or compensatory plans, contracts or arrangements enumerated in paragraph (b)(10)(iii)(C) may be read to encompass paragraph (b)(10)(iii)(B) as well as paragraph (b)(10)(iii)(A). Consequently, a Section 401(k) or other employee benefit plan qualified under Internal Revenue Code Section 401(a) that has not been approved by the security holders of the registrant would not be required to be filed as an exhibit (without regard to whether the plan is “immaterial in amount or significance”).

SEC Response: There is no need to file a 401(k) plan under S-K Item 601 as long as the plan is exempt from disclosure under S-K 201(d). The same rule would apply for foreign plans that are substantially similar to 401(a) plans.

14. **Severance Agreement of Former NEO.** A person who was a named executive officer for 2002 is fired early in 2003, at a time when his compensation is such that he is not likely to be a named executive officer for 2003. Is the severance/settlement agreement entered into at the time he is fired required to be filed as an Exhibit to the issuer’s 10-Q?

SEC Response: Yes. The severance agreement must be filed if, based on the company’s most recent disclosure, the person was a named executive officer at the time the agreement was entered into. Note that this is a topic addressed by the pending rule proposal regarding Form 8-K disclosure (Rel. 33-8106).

Form 10-K

15. **Disclosure of Item 201(d) Information in Form 10-K.** Must a registrant disclose the information required by Item 201(d) of Regulation S-K under Item 5 or Item 12 of Form 10-K, or both?

Suggested Answer: The disclosure required by Item 201(d) of Regulation S-K should be provided under Item 12 of Form 10-K and not under Item 5. The reference to Item 201 in Item 5 should be read as referring to Item 201(a) - (c). In responding to Item 5, it is not necessary to cross-reference the disclosure being made in Item 12.

SEC Response: The disclosure should be provided under Item 12, not Item 5. This will eventually be the subject of a technical correction.

S-K Item 701

16. **Sales of Unregistered Securities.** S-K Item 701 requires certain information about securities “sold by the registrant” that were not registered under the 1933 Act. Does this Item require reporting of securities issued in “no-sale” transactions? In particular, is reporting required for (i) issuance of shares as a bonus (meeting the requirement of a stock bonus in Release No. 33-6188 and related guidance) or (ii) matching contributions made in stock to a 401(k) plan where no employee contributions can be invested in company stock?

Suggested Answer: No. Such securities have not been “sold” and thus need not be reported.

SEC Response: If there is no “sale” for 1933 Act purposes, S-K Item 701 does not require disclosure of the share issuance. Note, however, that this is another item in the pending Form 8-K proposal (Rel. 33-8106). The answer could be different depending on the language in the final rule (for example, if the rule as adopted calls for disclosure of shares “issued” rather than “sold” without registration).

Proxy Rules

17. **Retention Bonus.** A named executive officer is told that he or she will receive a bonus for year #1 if the officer is still employed by the registrant on the payment date in year #2. In which year should the bonus be disclosed in the Summary Compensation Table? Would it matter if the amount of bonus to be paid were dependent on year #2 earnings?

SEC Response: The answer depends on when the amount of the bonus is known. If the amount of the bonus is not known in time for the year #1 proxy statement, no amount should be shown in the Table for year #1. However, there should be a footnote to the bonus column for year #1 stating that a bonus of unknown amount was granted, giving the formula for determining the amount, and stating the date it is payable and any applicable vesting conditions. (See the Telephone Interpretations Manual, S-K 402, Item 8B.) The entry for year #2 should show the amount actually paid.

If the amount of the bonus is known in time for year #1 and the only uncertainty is whether the officer will vest, the bonus should be reported in the Table for year #1, with a footnote stating that the bonus is subject to vesting. No amount need be reported in the Table for year #2. *[Note: This is a supplemental response provided by the Staff after the meeting]*

18. **Repricing – Exclusion of NEOs.** The issuer conducted a six-month-and-a-day repricing transaction in which the cancellation occurred in 2002 and the new grant occurred in 2003. The terms of the offer excluded the named executive officers named in the proxy statement for the 2002 annual meeting (i.e. based on 2001 compensation). During 2002, one of the excluded NEOs terminated employment, and as a result one of the officers who participated in the exchange offer became one of the NEOs in the proxy statement for the 2003 annual meeting. Is the issuer required to include the option repricing disclosure in its proxy statement for its 2004 annual meeting?

SEC Response: Yes. The repricing disclosure is required since someone who was an NEO did participate in the repricing.

19. **Personal Use of Company Plane.**
- (a) What is the correct measure of the incremental cost of an officer’s personal use of the company plane? Is it permissible to use the tax tables?

Suggested Answer: Yes, use of the tax tables is permissible. Any other reasonable measure of incremental cost is also permitted.

Discussion: Use of the tax tables should be permitted as a means to readily quantify incremental cost. Use of this standard assists in comparability when comparing use of corporate aircraft among executives at different companies. Other measures of incidental cost can result in wide variations, depending on factors such as whether a company owns the planes or has a time share arrangement, pays pilots a fixed salary or a per hour amount or allocates routine maintenance costs of aircraft. Companies using the tax tables to quantify incidental cost should, however, disclose in the perquisites footnote that the value is being valued in that manner.

SEC Response: It should be valued based on the incremental cost to the company. As to whether the tax tables can be used as a proxy for incremental cost, the Staff would need to better understand the basis for the tax table amounts.

- (b) Is there any compensation that must be disclosed if the Board determines that it is desirable for the executive to use the company plane for security reasons?

Suggested Answer: No.

SEC Response: Yes. It's still for personal travel, and therefore a disclosable perquisite, even though the company gets the benefit of greater security.

20. **Reporting of Performance Plan.** An issuer adopts a "3-year plan" under which the amount earned is measured over Year 1, but the award is not paid unless the executive continues in employment throughout Years 2 and 3. What is the proper reporting of this plan in the Summary Compensation Table? Does it make a difference if at the end of Year 1 the executive is given (i) restricted stock, (ii) a promise to pay stock, or (iii) a promise to pay cash in each case subject to vesting by continued employment through the end of Year 3? Does it make a difference if a portion of the award is actually paid at the end of Year 1, with the remainder treated as described above?

Suggested Answer: Because performance is measured only over a 1-year period, this is an annual plan, notwithstanding the multi-year vesting provision. As a result, under all of the scenarios, the full amount earned (subject to vesting) would be counted as bonus for purposes of determining the named executive officers. Awards payable in cash would be reported in the Bonus column. Awards payable in stock could be reported either in the Bonus column or the Restricted Stock column.

SEC Response: The Staff agrees with the suggested answer. S-K Item 402(a)(7)(iii) defines a long-term incentive plan as a plan where performance is measured over a period of more than one year. So the plan in the Question is an annual plan even though the bonus is subject to multi-year vesting. The full amount of the bonus earned (whether or not subject to vesting) is counted for determining the named executive officers.

Section 16

21. **Cash Settlement of Phantom Stock Units.** A deferred compensation plan or excess benefit plan provides for the crediting of phantom stock units, which are required to be settled in cash. Can the settlement be reported solely on Table II as a disposition of the phantom stock units to the issuer?

Suggested Answer: Yes. Although this “single-line” reporting approach may be inconsistent with the position taken in *American Bar Association* (Dec. 20, 1996), Q. 4(d)(4), it seems to be a reasonable extension of the staff’s subsequent position in the Telephone Interpretations Manual (July 1997, Part R, Item 7) permitting such reporting for the cash settlement of phantom stock units in a Discretionary Transaction under rule 16b-3(f).

SEC Response: No. The Telephone Interpretation dealt with a discretionary transaction reportable under Code I (i.e. a transaction that qualified for exemption under Rule 16b-3(f)). In that situation, the Staff is willing to permit reporting the disposition of the phantom stock unit as a single transaction. By contrast, the situation in the Question involves a transaction which may or may not be exempt under Rule 16b-3, and therefore single line reporting is not permitted.

22. **Reporting of Performance Unit Payout.** A plan awards performance units which are later converted into shares based on the share price at the later date. What is the transaction date that triggers Section 16 reporting of the acquisition of the shares?

Suggested Answer: The transaction date is the date when the number of shares is determinable, not the earlier date when the level of earn-out is determined.

SEC Response: The Suggested Answer is correct.

23. **401(k) Excess Plan as Excess Benefit Plan.** Please confirm that the “plain vanilla” 401(k) excess plan described below is an “Excess Benefit Plan” within the meaning of Rule 16b-3.

Assume a 401(k) plan is a Qualified Plan (within the meaning of Rule 16b-3). Assume that the plan permits participants to contribute up to 15% of compensation as 401(k) contributions, and that the employer matches 50% of the first 6% of compensation so contributed. (This is a common 401(k) plan formula.) Under the 401(k) plan, contributions are subject to three applicable 2003 statutory limitations (i) \$12,000 maximum 401(k) contribution (Code Section 402(g)), (ii) \$200,000 maximum compensation taken into account (Code Section 401(a)(17)), and (iii) \$40,000 maximum overall contributions (Code Section 415). Assume the employer maintains a 401(k) excess plan, which “soaks up” the amounts that would be contributed to the 401(k) plan but for the above statutory limits.

Assume an executive officer subject to Section 16 makes an election to participate in the 401(k) plan and the related 401(k) excess plan and has elected to contribute 15% of compensation to the 401(k) plan, with the understanding that the maximum permitted

under the Internal Revenue Code will be contributed to the 401(k) plan and any excess over the Internal Revenue Code contribution limitations will be soaked up by the 401(k) excess plan. (This is how these plain vanilla 401(k) excess plans commonly operate.) Assume the executive's compensation is \$300,000. *But for* the contribution limits under the Internal Revenue Code, the Qualified Plan contribution for the executive's benefit would be \$54,000 (a 401(k) contribution of \$45,000 (15% of \$300,000), plus a matching contribution of \$9,000 (50% of 6% of \$300,000)). Of this amount only \$18,000 could actually be contributed to the Qualified Plan for 2003 (\$12,000 in 401(k) contributions and \$6,000 in matching contributions). The balance would automatically be credited to the employee under the 401(k) excess plan.

Suggested Answer: This "plain vanilla" 401(k) excess plan is an Excess Benefit Plan as defined in Rule 16b-3.

Discussion:

"Excess Benefit Plan" is defined in Rule 16b-3 to include a plan that provides benefits or contributions "that would be provided under a Qualified Plan but for any benefit or contribution limitations set forth in the Internal Revenue Code." The three limitations described above have been part of the Internal Revenue Code since at least 1986. Typical excess, or supplemental, plans "soak up" the excess from some or all of these limitations.

The type of 401(k) excess plan described above has been commonplace since 401(k) plans became popular in the early- to mid-1980s. The plans have routinely been thought of as "Excess Benefit Plans" under Rule 16b-3, but the scope of the definition had little practical relevance given the Staff's interpretation allowing aggregate reporting of acquisitions under deferred compensation plans generally. However, 401(k) excess plans such as the plan described above have become the focus of renewed attention since the passage of the Sarbanes-Oxley Act because post-Sarbanes-Oxley, transactions in Excess Benefit Plans are exempt from 2-day Form 4 reporting, whereas transactions under non-qualified plans that don't qualify as Excess Benefit Plans are subject to the 2-day reporting requirements.

In seeking guidance on this issue, practitioners have looked again at the 1999 letter issued to the ABA (2/10/99). That letter, involved three interrelated plans, a profit sharing plan that was a Qualified Plan, an Excess Benefit Plan (described in the incoming letter as a "supplemental" plan), and a non-qualified plan allowing employees to make elective deferrals of compensation ("NQDC Plan"). Under the facts described in the incoming ABA letter, the Qualified Plan did not have a 401(k) feature but the Excess Benefit (supplemental) Plan operated essentially in the same manner as the "plain vanilla" plan described above. However, in addition, under the Excess Benefit (supplemental) Plan, an employee was credited with amounts that would have been contributed to the Qualified Plan but for the employee's deferral election under the NQDC Plan which reduced the amount of compensation taken into account under the Qualified Plan. The incoming ABA letter asked, in essence, whether the additional employer contributions that would have been made to the Qualified Plan if the executive had not deferred compensation into the NQDC Plan could be made to the "supplemental" plan without causing the

“supplemental” plan to lose its status as an Excess Benefit Plan for Rule 16b-3. The answer was yes.

The incoming ABA letter specifically stated it was excluding from the request “any non-qualified plan (whether or not operated in conjunction with a qualified plan) that accepts employee deferrals or that provides matching contributions on amounts that an employee defers into a non-qualified plan.” Clearly the term “employee deferrals” in the context of the incoming letter referred to amounts contributed to the NQDC Plan, and not to employee 401(k) contributions (which are also a form of deferral) which were not in issue in the letter. Accordingly, we think that the carve-out is properly read to refer to “amounts that an employee defers into *another* non-qualified plan.” Similarly, the reference to “matching contributions on amounts that an employee defers into a non-qualified plan” was intended to refer to any matching contributions in a plan like the NQDC Plan. Paralleling the language of the incoming letter, the staff response contained the following language:

“However, the following plans, even if operated in conjunction with a Qualified Plan, are not Excess Benefit Plans. This is because the amount of issuer securities acquired will be determined based on the amount of salary the officer or director chooses to defer, rather than an objective measure derived from the Internal Revenue Code.

- Any non-qualified plan that permits participants to defer a portion of their compensation into the plan (a “non-qualified deferred contribution [*sic*] plan”); and
- Any supplemental plan that provides an employer matching contribution based on the employee’s deferral into a non-qualified plan.”

Under the facts presented in the 1999 ABA letter, it is clear that the staff response was directed at an independent deferral of compensation into a NQDC Plan, not the deferral that results directly from an election to make 401(k) contributions and that is therefore soaked up in an excess plan that makes up for the limitations imposed on 401(k) contributions. In other words, we believe the 1999 ABA letter was clarifying that the NQDC Plan itself would not qualify as an Excess Benefit Plan even if it is operated in conjunction with a Qualified Plan. However, taken out of context, the staff response could be read to disqualify most typical 401(k) excess plans from being Excess Benefit Plans under Rule 16b-3.

If an executive makes a 401(k) election under the Qualified Plan, we believe that amounts (including applicable matching contributions) that would be contributed to the Qualified Plan pursuant to that election *but for* any applicable Internal Revenue Code limit on contributions or benefits may instead be credited to a plan otherwise qualifying as an Excess Benefit Plan under Rule 16b-3 without causing that plan to fail to qualify as an Excess Benefit Plan under Rule 16b-3.

Employers have been operating 401(k) excess plans like the plain vanilla plan first described above under the assumption that such plans qualified as Excess Benefit Plans. This practice has continued after the 1999 ABA letter, notwithstanding that the language of the 1999 ABA letter could be read out of context to create a contrary result. Any interpretation of the 1999 ABA letter that would result in denying Excess Benefit Plan status under Rule 16b-3 to such typical 401(k) excess plans would come as a great surprise to the greater practitioner community.

SEC Response: The Staff would need more information before answering this question. In particular, they want to know more about how this type of plan is treated under ERISA, whether compensation deferred into the “excess” plan would be counted for Code Section 415 purposes, and how to draw the line between this type of plan and a traditional non-qualified deferred compensation plan.

Form S-8

24. **Validity Opinion.** An S-8 was filed which did not include a legal opinion as to the valid issuance of the shares because at the time of filing the issuer intended to use only treasury shares for the plan. What are the consequences if the issuer subsequently issues newly issued shares under the plan without amending the S-8 to add the legal opinion?

Suggested Answer: The issuer should file a post-effective amendment, which is effective automatically.

SEC Response: The Staff won’t address what the consequences are of issuing the shares before filing the legal opinion. There could be enforcement consequences. A company in this situation should amend the S-8 to file the opinion as soon as possible. The opinion should address both already issued and to-be-issued shares.

Miscellaneous 1933 Act Questions

25. **Covered Security under NSMIA.** A non-US company has ADRs listed on the Nasdaq National Market and the underlying common stock listed on the London Stock Exchange. It would like to offer an employee stock purchase plan to the employees of its US subsidiaries (which will be registered on Form S-8) and would prefer to offer the underlying shares rather than the ADRs. Is the underlying common stock a “covered security” under Section 18(b) of the 1933 Act, which would preempt State regulation of the offering?

Suggested Answer: Yes. A covered security includes a security listed on the NYSE or the Nasdaq National Market and any security of the same issuer that is equal in seniority to such listed security.

SEC Response: The Staff was not ready to say whether the underlying shares would be a “covered security.” The “issuer” of the ADRs is the legal entity created by the deposit agreement, which is a different entity than the issuer of the

underlying shares. So as a technical matter, the underlying shares don't qualify as shares of the "same issuer" equal in seniority to the listed security (i.e. the ADR). If both the ADRs and the underlying shares are listed on the NYSE or Nasdaq, it might be easier to conclude that the underlying shares are covered securities. The Staff initially questioned how widespread a concern this was, why a company would want to issue the underlying shares if it had ADRs listed, and whether US employees would lose the benefits of a US market in this situation. After a discussion of these issues, the Staff agreed to give the matter further consideration. *[The Staff is still considering this issue]*