

AMERICAN BAR ASSOCIATION

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

Questions and Answers May 5, 2009

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 – 2009

Proxy Rules (including Executive Compensation Disclosure)

1. **Tax Gross-Up Payment.** An employee who is a named executive officer for Year One becomes entitled to a gross-up payment in respect of taxes paid on certain perquisites

provided during Year One. By its terms, the gross-up payment is not payable until Year Two. Must the gross-up be reported as compensation in the Summary Compensation Table in Year One?

Suggested Answer. No. Item 402(c)(ix)(B) of Regulation S-K expressly provides that gross-ups are reportable for the year in which “reimbursed,” which, under these facts, is Year Two, regardless whether the gross-up might have been “earned” or “accrued” during Year One. This would be the case even if it is not expected that the employee will be a named executive officer for Year Two. Likewise, if an executive was a named executive officer in the Year Two but not in Year One, the gross-up would be reportable in the Summary Compensation Table for Year Two.

SEC Response: The gross-up payment should be reported for the same year in which the related perquisites are to be reported so that investors receive a clear picture of all of the costs associated with the perquisites.

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance’s Compliance and Disclosure Interpretations, Regulation S-K, Question 119.19 (May 29, 2009).]

2. **Compensation Disclosure in Summary Compensation Table.** An employee is a named executive officer for Years One and Three. For Year Two, the employee is an executive officer but not a named executive officer. In the proxy statement filed with respect to Year Three, must the employee’s Year Two compensation be disclosed in the Summary Compensation Table? Would the employee’s Year One compensation have to be disclosed in the Summary Compensation Table.

Suggested Answer. Compensation information is required for Year One and Year Three, but not for Year Two. It is unclear whether Item 402(a)(4) of Regulation S-K is intended to address this situation or, as the caption to that Item suggests, addresses only the fact that, when a named executive officer is an executive officer during any part of the fiscal year, information for the full fiscal year is required. The ambiguity arises because of the Summary Compensation Table’s requirement for disclosure of the compensation of named executive officers for each of the registrant’s last three completed fiscal years.

However, Question 119.01 of the Compliance and Disclosure Interpretations for Regulation S-K suggests that disclosure is required only for a fiscal year for which an executive officer is a named executive officer (in which case, disclosure of compensation is required for the entire year, even if the individual did not serve as an executive officer for the entire year). The answer would be the same regardless whether the individual is an executive officer for none, any part of, or all of, Year Two, provided that the individual is not a named executive officer with respect to that year.

SEC Response: Question 119.01 should not be applied beyond its specific facts. In this situation, there is no policy reason to permit a company to omit the compensation information for Year Two.

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance's Compliance and Disclosure Interpretations, Regulation S-K, Question 119.18 (May 29, 2009).]

3. **Long-Term Incentive Plan with Successive Single-Year Performance Periods.** A registrant adopts a three-year performance share plan that establishes performance objectives and measures performance on an annual basis but does not pay out until the end of the three-year period. Under the plan, the named executive officers receive an award for a target number of shares at the commencement of the three-year period, with one-third of this amount allocated to each of the three years. An annual performance objective is established at the beginning of each year with performance assessed at the end of each year to determine the number of shares (if any) that have been earned for that period. All shares that are earned vest and are paid out at the end of the three-year period, contingent upon the named executive officer's continued service until that time. (In other words, the shares (if any) earned for Year One vest two years after the end of Year One. The shares (if any) earned for Year Two vest one year after the end of Year Two. The shares (if any) earned for Year Three vest immediately.)

Under SFAS 123(R), the award tranches for Years Two and Three do not give rise to compensation expense for financial statement reporting purposes until Years Two and Three, respectively.

- (a) How should this award be reported in the Summary Compensation Table?

Suggested Answer: Consistent with Item 402(c)(2)(v) of Regulation S-K, the amount reported in the Summary Compensation Table for each year that the award is outstanding will be based on the dollar amount recognized for the award for financial statement reporting purposes with respect to the fiscal year in accordance with SFAS 123(R).

SEC Response: Agree with the principle reflected in the Suggested Answer, which simply indicates compliance with Item 402(c)(2)(v).

- (b) How should the award be reported in the Grants of Plan-Based Awards Table?

Suggested Answer: Consistent with Item 402(d)(2)(iv) of Regulation S-K, the target number of shares to be paid out upon satisfaction of the conditions in question under the equity incentive plan award should be reported in column (g) of the table. In addition, to the extent that the award provides for a range of estimated payouts, the threshold and maximum numbers of shares to be paid out under the equity incentive plan should be reported in columns (f) and (h), respectively.

In the case of Item 402(d)(2)(viii), the grant date fair value of the award computed in accordance with SFAS 123(R) for the first tranche of the award or alternatively, the entire award (depending on the Division's response to Question __ below) should be reported in column (l) of the table, accompanied (in the case of the former outcome) by a footnote explaining that the fair value of the remaining two tranches cannot be reported because, for purposes of SFAS 123(R), they have yet to be calculated, but such amounts will be reported in subsequent years in the Summary Compensation as required.

SEC Response: The reporting treatment is governed by paragraphs 67 and 68 of SFAS 123(R). As provided in paragraph A.67, if the related performance objectives are known at the time the award is granted, then the award's entire granted date fair value should be reported. However, if, at the time the award is granted, the performance objectives for the first tranche only have been established, then, as provided in paragraph A.68, only this amount should be reported in column (l).

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance's Compliance and Disclosure Interpretations, Regulation S-K, Question 120.06 (May 29, 2009).]

- (c) How should the award be reported in the Outstanding Equity Awards at Fiscal Year-End Table?

Suggested Answer: Consistent with Item 402(f)(2)(ix) of Regulation S-K, with respect to the year of grant, the total target number of shares under the equity incentive plan award should be reported in column (i) of the table and the aggregate market or payout value of the shares should be reported in column (j) of the table. In subsequent years, the number of shares that have been earned under the equity incentive plan award should be reported in column (g) of the table (along with the aggregate market or payout value of the shares being reported in column (h)) and the total target number of shares remaining under the equity incentive plan award should be reported in column (i) of the table and the aggregate market or payout value of these shares should be reported in column (j) of the table.

SEC Response: Agrees with the principle reflected in the Suggested Answer. Once number of shares earned is determined and they become subject to time-based vesting requirement, they should be reported in columns (g) and (h) of the table.

In all cases, the equity incentive plan award should be discussed in the registrant's Compensation Discussion and Analysis and a description of the equity incentive plan and individual awards should be included in the narrative disclosure to the Summary Compensation Table and the Grants of Plan-Based Awards Table as required by Item 402(e) with respect to the year of grant and in the narrative disclosure accompanying the Outstanding Equity Awards at Fiscal Year-End Table in subsequent years.

4. **Long-Term Incentive Plan Where Shares Earned Determined After Year-End.** A registrant adopts a performance-based restricted stock unit (“RSU”) plan that establishes performance objectives at the time of award and measures performance over a three-year period coinciding with the registrant’s next three fiscal years (including the year of the award). Under the plan:
- each named executive officers receives an award for a target number of RUSs (payable in shares of the registrant’s common stock), although the award also provides for a range of estimated outcomes between pre-established threshold and maximum levels
 - Following the end of the three-year performance period, performance is evaluated by the compensation committee of the board of directors to determine the number of RSUs (and underlying shares), if any, that have been earned by the named executive officers
 - The shares earned by a named executive officer are subject to a two-year service based vesting requirement (in other words, the shares earned are paid out to a named executive officer two years after the end of the three-year performance period, contingent upon the named executive officer’s continued service until that time
 - The evaluation and determination by the compensation committee are conducted in the first fiscal quarter following the end of the three-year performance period but prior to the filing of the registrant’s annual proxy statement (therefore, the number of shares earned by the named executive officers is known prior to the filing of the registrant’s annual proxy statement)

For purposes of the Outstanding Equity Awards at Fiscal Year-End Table, should information about the RSU award be reported in columns (g) and (h), or columns (i) and (j), of the table?

Suggested Answer: Even though the outcome of the RSU award was not known as of the end of the registrant’s fiscal year, to the extent that the outcome is determined prior to the filing of the registrant’s annual proxy statement, the reporting of the award in the Outstanding Equity Awards at Fiscal Year-End Table should be based on that determination. This would be consistent with the reporting standard applied for non-equity incentive compensation. Consequently:

- (i) The number of shares reported should be based on the actual number of shares earned, even though determined after the end of the last completed fiscal year, rather than the target number of shares subject to the award as of fiscal year-end; and

- (ii) The information about these shares should be reported in columns (g) and (h) of the table as they are no longer subject to performance-based conditions.

SEC Response: Agrees with the principle reflected in the Suggested Answer.

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance's Compliance and Disclosure Interpretations, Regulation S-K, Question 122.03 (May 29, 2009).]

5. **Amendment to Equity Incentive Plan Award Performance Objectives.** In the event that the amendment or other modification of the performance objectives for an outstanding equity incentive plan award held by a named executive officer results in additional compensation expense for financial statement reporting purposes, must that incremental fair value amount expense be reported in the Grants of Plan-Based Awards Table for the year of amendment or modification?

Suggested Answer: Consistent with Item 402(d)(2)(viii) of Regulation S-K, any incremental fair value amount resulting from the amendment or modification of the performance objectives for an outstanding equity incentive plan award held by a named executive officer should be reported in column (l) of the table.

SEC Response: Assuming that the amendment or modification results in the grant of a new award for financial statement reporting purposes, the full fair value resulting from the amendment or modification must be reported. Although couched in terms of "options, SARs or similar option-like instruments," the Staff considers the provisions to cover stock awards as well. See also Instruction 7 to Item 402(d).

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance's Compliance and Disclosure Interpretations, Regulation S-K, Question 120.07 (May 29, 2009).]

6. **Disclosure of Life Insurance Proceeds.** An executive officer dies during the last completed fiscal year. In determining the compensation to be reported in the Summary Compensation Table (in the case of the Chief Executive Officer and the Chief Financial Officer) and in determining the compensation to be considered in determining whether the executive officer would have been one of the registrant's three most highly-compensated executive officers (as well as the compensation to be reported in the Summary Compensation Table), must the proceeds from a life insurance policy funded by the registrant and paid to the deceased executive officer's surviving spouse be taken into consideration?

Suggested Answer: Yes. Item 402(a)(2) of Regulation S-K states that "all such compensation shall be reported. . . ,including transactions between the registrant and a third party where a purpose of the transaction is to furnish compensation to any such named executive officer. . . ." Thus, the fact that the insurance proceeds are paid by the

life insurance company, rather than the registrant, does not insulate the payment from disclosure.

SEC Response: Agrees with the principle reflected in the Suggested Answer. In view of the argument that the previous disclosure of the premiums paid by, or on behalf of, the company with respect to life insurance for the benefit of the named executive officer, may lead to “double counting,” the Staff will reconsider its position. The Staff also noted that the disclosure required by Item 402(j) involves different reporting concepts and doesn’t necessarily govern the reporting treatment in the Summary Compensation Table.

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance’s Compliance and Disclosure Interpretations, Regulation S-K, Interpretation 217.14 (May 29, 2009).]

7. **Reporting Grant Date Fair Value Information.** Item 402(d)(2)(viii) requires that a registrant disclose the grant date fair value of each equity award computed in accordance with FAS 123(R) in column (l) of the Grants of Plan-Based Awards Table. In the case of a stock award that will payout (if at all) at various levels depending upon the actual performance results over the relevant performance period, it is not clear whether the reportable grant date fair value information should be computed on the basis of target or maximum performance. We understand that, at the April 17, 2007 meeting between the Office of the Chief Accountant and the Center for Audit Quality’s Securities Regulation Committee, the OCA was of the view that the amount to be reported in column (l) should be based on maximum performance.

It would appear that, under a principles-based disclosure system, there is a basis for reporting the amount that would be initially computed using both the measurement and recognition criteria of FAS 123(R) (ignoring only service-based forfeitures). However, we would like to confirm the Division’s view on this question.

SEC Response: The amount reported in column (l) should be based on maximum performance.

[Update: The SEC Staff position has been memorialized in the Division of Corporation Finance’s Compliance and Disclosure Interpretations, Regulation S-K, Question 120.05 (May 29, 2009). Subsequently, Question 120.05 was withdrawn on February 28, 2010.]

Form S-8

No questions at this time.

Rule 701

8. **Acquisition by Exchange Act Company.** At the May 9, 2000 meeting between the JCEB and the SEC Staff, the Staff was asked the following question:

“A 1934 Act reporting company acquired a private company. In the acquisition, the stock and stock options of the private company, which were issued under Rule 701, were converted into stock and stock options of the public company. Please confirm that the converted stock and stock options continue to be governed by Rule 701 (with respect to both exercise of the options and resale of the stock).

The suggested answer proposed by the JCEB was yes, based on the conclusion that this result would be consistent with the position taken by the SEC Staff in *Devon Energy Corporation* (May 12, 1989). At the time, the Staff concurred with the suggested answer.

Question 271.04 of the Compliance and Disclosure Interpretations for the Securities Act Rules contains the following question and answer:

“Question. A company that is not subject to the reporting requirements of Exchange Act Section 13 or 15(d) issued options in reliance on Rule 701. This company is acquired by another company, which is subject to the reporting requirements of Exchange Act Section 13(a) or 15(d) and assumes the private company’s outstanding options so that they become exercisable for shares of the acquiring company. May the acquiring company rely on Rule 701(b)(2) to exempt their exercise?”

Answer: No. [Jan. 26, 2009]”

Did the Division of Corporation Finance intend to reverse its position in the *Devon Energy Corporation* no-action letter and the prior guidance to the JCEB, or are there distinguishing factors that registrants should consider in determining compliance with the Securities Act?

SEC Response: The Staff has been giving the response reflected in Question 271.04 for some time now. In other words, the *Devon Energy Corporation* no-action letter does not cover a former employee of an acquired private company. Employees of the acquired company who subsequently work for the acquirer can rely on Form S-8, but those who never worked for the acquirer are subject to Question 126.14, which doesn’t make Form S-8 available. The interplay between Rule 701 and Form S-8 create this gap in coverage. The Staff will work with the ABA to determine the best approach for addressing this issue.

Form 8-K

9. **Equity Awards in Connection with Director Appointment.** A registrant appoints a new director under circumstances requiring the filing of a current report on Form 8-K

pursuant to Item 5.02(d). The director, consistent with the registrant's previously-disclosed standard compensation arrangements for non-employee directors, receives an equity award upon his appointment. Must the Form 8-K describe the award pursuant to Item 5.02(d)(5)?

Suggested Answer. It is unclear whether, when the award is made under a compensation plan that was neither adopted nor materially amended in connection with the director's appointment, a description of the equity award is not required. Item 5.02(d)(5) of Form 8-K states that the information to be disclosed includes "a brief description of any material plan, contract or arrangement (whether or not written) to which the director is a party or in which he or she participates *that is entered into or material amendment in connection with the triggering event* or any grant or award to any such covered person or modification thereto, *under any such plan*, contract or arrangement in connection with any such event" (emphasis added). Given that many compensation plans for directors provide for an automatic grant or award upon appointment or election to the Board of Directors, it appears that Item 5.02(d)(5) may not require a description of the grant or award in the Form 8-K *unless* the grant or award is made pursuant to a compensation plan, contract, or arrangement that is entered into or materially modified in connection with the appointment.

This result is analogous to the requirements of Item 5.02(e), which only requires disclosure of "material grants or awards." In other words, the omission of the term "material" in connection with the reference to a "grant or award" in Item 5.02(d)(5) is offset by the requirement that the grant or award be made under a plan that was adopted or materially amended in connection with a director's appointment for disclosure to be warranted. While this would appear to be consistent with the intent of Item 5.02(e), which requires a brief description of "material" grants or awards, the absence of the materiality modifier raises the question of whether this provision is intended to have a broader scope.

SEC Response: Yes. All of the compensation being provided to a new director must be disclosed, even if there have been no changes to the plan pursuant to which the award is being granted. The Commission intentionally drafted Item 5.02(d)(5) to be different from Item 5.02(e). The disclosure is intended to pick up ordinary course, as as extraordinary, awards.

Regulation BTR

10. **Filing Obligation for ERISA Blackout Periods.** Item 5.04 of Form 8-K, *Temporary Suspension of Trading Under Registrant's Employee Benefit Plans*, requires a registrant to file a current report on Form 8-K containing the information specified in Rule 104(b) of Regulation BTR within four business days after, among other things, the registrant "receives the notice required by section 101(i)(2)(E) of the Employment Retirement Income Security Act of 1974." As explained in Section II.7.(c) of Exchange Act Release No. 47225, this notice requirement is intended to ensure widespread dissemination of

information about an impending blackout period that triggers the trading prohibition of Section 306(a) of the Sarbanes-Oxley Act of 2002 and Rule 101(a) of Regulation BTR.

At the time that Regulation BTR was adopted, the requirements of Form 8-K were amended to add a new Item 11 to read as follows:

“Not later than the date prescribed for transmission of the notice required by Rule 104(b)(2) of Regulation BTR, provide the information specified in [Rule] 104(b) of this chapter and the date the registrant received the notice required by section 101(i)(2)(E) of the Employment Retirement Income Security Act of 1974.”

When the Form 8-K disclosure requirements were expanded on March 16, 2004 (see Securities Act Release No. 8400), Item 11 renumbered as Item 5.04 and revised to read as follows:

“No later than the fourth business day after which the registrant receives the notice required by section 101(i)(2)(E) of the Employment Retirement Income Security Act of 1974 (29 U.S.C. 1021(i)(2)(E)), or, if such notice is not received by the registrant, on the same date by which the registrant transmits a timely notice to an affected officer or director within the time period prescribed by Rule 104(b)(2)(i)(B) or 104(b)(2)(ii) of Regulation BTR (17 CFR 245.104(b)(2)(i)(B) or 17 CFR 245.104(b)(2)(ii)), provide the information specified in Rule 104(b) (17 CFR 245.104(b)) and the date the registrant received the notice required by section 101(i)(2)(E) of the Employment Retirement Income Security Act of 1974 (29 U.S.C. 1021(i)(2)(E)), if applicable.”

While ostensibly this revision was made to conform the filing date of the report with the general “four business days” requirement of Form 8-K (see Section II.F.6 of Release No. 8400), it also introduced into the provision a potential ambiguity as to whether a Form 8-K filing is required where a transaction constitutes a “blackout period” for purposes of ERISA, but not for purposes of Regulation BTR.

For purposes of Regulation BTR, Rule 100(b)(1) defines the term “blackout period,” with respect to the equity securities of any issuer (other than a foreign private issuer) to mean:

“any period of more than three consecutive business days during which the ability to purchase, sell or otherwise acquire or transfer an interest in any equity security of such issuer held in an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan with respect to not fewer than 50% of the participants or beneficiaries located in the United States and its territories and possessions under all individual account plans (as defined in paragraph (j) of this section) maintained by the issuer that permit participants or beneficiaries to acquire or hold equity securities of the issuer.”

However, for purposes of ERISA, Section 101(i)(7)(A) defines the term “blackout period,” in connection with an individual account plan, generally to mean:

“any period for which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited, or restricted, if such suspension, limitation, or restriction is for any period of more than 3 consecutive business days.”

As is apparent from the foregoing, a Regulation BTR “blackout period” exists only where at least 50% of the participants or beneficiaries located in the United States are subject to a temporary trading restriction. An ERISA “blackout period” contains no such minimum threshold. Consequently, it is possible for a registrant to conduct a “blackout” for ERISA purposes that would not be a “blackout” for purposes of Regulation BTR.

In this situation, is it required that a registrant file a Form 8-K even though the substantive (trading restriction) provisions of Regulation BTR would not be operative?

Suggested Answer: No. A Form 8-K need not be filed where a registrant receives a notice required by section 101(i)(2)(E) of the Employment Retirement Income Security Act of 1974 where the restrictions creating a “blackout period” for purposes of ERISA do not also constitute a “blackout period” for purposes of Regulation BTR.

SEC Response: Agrees with the principle reflected in the Suggested Answer. A Form 8-K need be filed with respect to restrictions that create a “blackout period” for purposes of Regulation BTR.

Section 16

No Questions

Other

11. **Rabbi Trust as Material Contract.** Is a rabbi trust established under a nonqualified deferred compensation plan for executive officers, including named executive officers, a “material contract” within the meaning of Item 601(b)(10) of Regulation S-K?

Suggested answer. No. A rabbi trust is an arrangement between the company and one or more trustees to help fund the company’s obligations under the plan. The assets of the trust are considered the property of the company, not the executive officers or the plan, for tax purposes. The executive officers are not parties to the rabbi trust. Thus, the trust is not a “management contract” or “compensatory plan, contract or arrangement” in which any executive officer “participates” within the meaning of Item 601(b)(10).

SEC Response: See Question 246.10 regarding non-qualified deferred compensation plans, which focuses the analysis on the plan itself. The issue should be analyzed as a “plan” under Regulation S-K. Unless it modifies the executive’s

rights under the previously-filed plan, the rabbi trust is simply an internal company funding mechanism, which, in a typical case, need not be filed under Item 601(b)(10). To determine the appropriate answer, ask whether the rabbi trust materially modifies the rights of the named executive officer under the NQDC plan. The company needs to examine the issue from the executive's point of view.