

# Frederic W. Cook & Co., Inc.

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## SEC Adopts New Disclosure Rules for Equity Incentive Plans<sup>1</sup>

### Summary

In its continuing effort to provide full and fair disclosure to the investing public, the Securities and Exchange Commission voted unanimously on December 19, 2001, to adopt amendments to the disclosure requirements applicable to proxy statements and annual reports under the Securities Exchange Act of 1934. These amendments enhance disclosure of the number of shares to be issued upon exercise of outstanding options, warrants and rights granted to participants in equity incentive plans, as well as the number of securities that remain available for future issuance under these plans, including plans which have not been approved by shareholders. Companies must be in compliance with the new disclosure rules for their Form 10-K filed for fiscal years ending on or after March 15, 2002, and for proxy statements for shareholder meetings on or after June 15, 2002.

### Background

The use of equity incentives has dramatically increased during the last decade due to both larger individual grants and broader employee participation. This surge has sparked concern among institutional investors and shareholders over a variety of issues, including:

- the lack of information and disclosure required by companies about existing and proposed equity incentive plans,
- the potential dilutive effect that equity incentive plans have on shareholders, and
- the ability of companies to adopt equity incentive plans without shareholder approval.

Prior to the SEC's new changes, companies were under no obligation to disclose the total number of securities remaining available for future issuance.<sup>2</sup> Some companies voluntarily disclosed the remaining number of shares that were available for future grant under existing plans in the text or tables of an annual report footnote. Often, however, this number was difficult to find since it was not required to be in a designated location or format.

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<sup>1</sup> Final Rule: Disclosure of Equity Compensation Plan Information [Release Nos. 33-8048, 34-45189; File No. S7-04-01], December 21, 2001.

<sup>2</sup> See the Investor Responsibility Research Center's annual study on stock plan dilution (IRCC Dilution Study) which found that approximately 22% of the companies surveyed did not disclose the number of shares available for future issuance under their employee stock plans.

Additionally, the issue of whether stock option plans should require shareholder approval has been an ongoing debate between companies, institutional investors and concerned individual shareholders. Currently, companies are able to avoid shareholder approval if the stock option plan is “broadly based” or, for companies listed on the New York Stock Exchange, if they use treasury shares to satisfy option exercises.

Prior to the new changes, disclosure rules made it difficult to determine whether a company had adopted a stock option plan without shareholder approval or was using treasury shares to satisfy option exercises.

### **New Amendments**

Companies are required to disclose, at least annually, information about two categories of equity incentives: 1) plans approved by shareholders; and 2) plans *not* approved by shareholders. For each plan category, information must be disclosed regarding:

- The number of securities to be issued upon the exercise of outstanding options, warrants and rights,
- The weighted-average exercise price of outstanding options, warrants and rights, and
- The number of securities remaining available for future issuance under equity incentive plans.

The disclosure rules allow companies to present the required information on an aggregate basis per plan category rather than on a plan-by-plan basis as originally proposed.<sup>3</sup> The new disclosure table will follow the format below:

### **Equity Compensation Plan Information**

	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by shareholders			
Equity compensation plans not approved by shareholders			
Total			

<sup>3</sup> Refer to our prior letter entitled “Proposed SEC Disclosure Rules for Equity Compensation Plans” dated February 23, 2001. <http://www.fwcook.com/publications/pub2001/022301LCT.html>

### *Amended existing plans*

With regard to amending existing equity incentive plans, the table should include information about the securities previously authorized for issuance under the plan, not the additional shares subject to plan amendment for which the company is seeking shareholder approval.

### *Individual arrangements and assumed plans*

Consistent with aggregate plan disclosure, information about individual arrangements and assumed plans (where further grants and awards can be made under these plans) may be combined with information about other plans, all in the appropriate disclosure category reflecting whether such arrangements are shareholder-approved.

### *Non-shareholder approved plans*

Any plan adopted without shareholder approval and in effect as of the end of the last completed fiscal year must be identified and described briefly, in narrative form below the table, outlining the material features of the plan. However, companies are permitted to cross-reference the portion of their required annual report disclosure containing descriptions of their non-shareholder-approved plans to satisfy this requirement. Also, companies are required to file as an exhibit to their Form 10-K, any equity incentive plan adopted without shareholder approval in which any employee participates, unless “immaterial in amount or significance.”

The table and plan descriptions must be placed each year in the Form 10-K, and additionally, in the proxy statement during years when shareholders are voting on an equity incentive plan(s).<sup>4</sup> Plans and arrangements covered by the new rules include those in which employees participate, as well as those that cover directors, consultants, advisors, and other non-employees.

## **Compliance Date**

Companies must be in compliance with the new disclosure rules for Form 10-K for fiscal years ending on or after March 15, 2002, and for proxy statements for shareholder meetings on or after June 15, 2002. These changes will not affect companies who are currently preparing year-end regulatory filings and proxy statements unless they elect to voluntarily comply with the new disclosure requirements before the compliance dates.

## **Our View**

We are supportive of the move toward better disclosure. With these new changes, investors and shareholders will be able to ascertain more readily:

- Whether an equity incentive plan has been approved by shareholders,

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<sup>4</sup> When required to include the information in both filings (i.e., years in which an equity incentive plan is to be amended, such as to increase the number of securities authorized for issuance under the plan, or a new plan is to be adopted), companies may satisfy the Form 10-K disclosure requirement by incorporating the information by reference from their proxy statement.

- The total number of shares reserved under such plans to cover outstanding stock option awards, along with the weighted average exercise price of such awards, and
- The total number of shares available for future issuance under all plans in a company's equity incentive program.

With this knowledge, investors can make more informed decisions regarding the approval of new equity incentive plans or modification of existing plans.

### **Further Information**

Copies of the new amendments can be obtained from the SEC website at <http://www.sec.gov/rules/final/33-8048.htm>

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General questions about this letter can be addressed to Louis C. Taormina in our New York office at 212-986-6330 or by e-mail at [lctaormina@fwcook.com](mailto:lctaormina@fwcook.com). Specific questions about the applicability of the new rules to a particular company's situation should be addressed to corporate counsel. Copies of this letter and published materials are available on our website at [www.fwcook.com](http://www.fwcook.com).