Chapter 3 Determination of "Named Executive Officers"

I. History....3-4

II. SEC Rules and Regulations....3-6

III. SEC Staff Guidance....3-7

a. Compliance and Disclosure Interpretations....3-7

1. No Exclusion of Recovered Compensation....3-7
2. Forfeited Equity Award Values & Calculating NEO Status....3-8
3. Item 402 Disclosure After Fiscal Year End & Before Proxy Statement....3-8
4. CFO as One of Three Most Highly Compensated Executive Officers....3-8
5. Limited Disclosure for First-Time NEO....3-9
6. NEO in Years 1 & 3 but Not Year 2....3-9
7. Exclusion of a Discretionary Bonus that is Refused Before Grant....3-9
8. Earned Less Than $100,000 Due to Fiscal Year Change....3-10
9. NEO Becomes Non-Executive Officer....3-10
10. Life Insurance Proceeds for Deceased Executive Officers....3-10
11. NEO Clawback Disclosure Under Form 20-F....3-11
12. NEO Clawback Disclosure Under Form 40-F....3-11

b. Comment Letters....3-12

IV. How the Rule Works....3-12

- Early Step When Preparing Executive Compensation Disclosures....3-12
- Sometimes More Than Five NEOs....3-12
- Process to Determine NEO Status....3-13
- Formula to Determine NEO Status....3-13
- Excluding Pension & Nonqualified Deferred Compensation Amounts from NEO Formula....3-14
- Officers With "Policy-Making Function" Are Executives....3-14
- Title Not Dispositive....3-15
- Different From Section 16 "Officers"....3-15
- CFO as One of Three Most Highly Compensated Executive Officers....3-15
- Include Forfeited Awards in NEO Calculation....3-16
- Include All Compensation Once Determined NEO....3-17
- Include All Recovered Compensation....3-17
- Inclusion of Directors' Compensation in Total....3-17
- Executive Officer of Subsidiary Could Be NEO....3-17
- Limited Exclusion for Overseas Executive Officers....3-18
- Limited Disclosure for First-Time NEO....3-18
- Shifting NEO Status From Year to Year....3-18

- Only Three NEOs for Smaller Reporting Companies and EGCs....3-19
- Downsides of Expansive "NEO" Approach....3-19

V. Common Questions and Our Analysis....3-19

a. Fewer than Five NEOs....3-19
b. Same Individual is PEO & PFO....3-19
c. Order of NEOs Presented....3-20
d. Tie for Third Highest Paid NEO....3-20
e. Voluntary Additional NEOs....3-21
f. "Officer" with Higher Compensation than NEOs....3-21
g. "Executive Chair" May Be NEO....3-22
h. Retiring PFO or PEO....3-22
i. Other Departing NEOs....3-22
j. NEO Departs After End of Fiscal Year....3-23
k. Highly Paid "Officer" Becomes "Executive" After Fiscal Year-End....3-23
l. NEO Death....3-24
m. Serving As of End of Fiscal Year....3-25
n. Former CEO Departed for More Than One Year....3-25
o. No Longer PEO, But Still Executive Officer....3-25
p. PEOs Who Become Non-Executive Officers....3-26
q. NEOs Who Become Non-Executive Officers....3-26
r. Former PEO Still an NEO?....3-26
s. Consultant as NEO....3-27
t. Consultant Reimbursements Included in Named Executive Officer Calculation....3-27
u. Interim PFOs....3-27
   1. Interim PFO is NEO....3-27
   2. Interim PFO Doesn't Count as "Supplemental" NEO....3-28
   3. Interim PFO for Only Short Time Period Still Included as NEO....3-28
v. "Supplemental" NEOs....3-29
   1. Include Officers Who Earned More Than Lowest Paid Current NEO....3-29
   2. Highly Paid Executive Who Resigns Before Midnight of Year-End is "Supplemental" NEO....3-29
w. Subsidiary Officers as NEOs....3-30
x. Joint Venture Pay....3-30
y. Working Outside of the U.S....3-31
   1. Scope of "Cash Compensation" Exclusion....3-31
   2. Executive Officer Who Works Part-Time Overseas....3-31
   3. Full-Time Executive of Foreign Subsidiary....3-32
   4. Can Exclude Foreign National's Pay During US Assignment....3-33

z. NEO in Years 1 & 3, But Not 2 3-33
aa. NEO in Years 2 & 3, But Not Year 1 3-33
ab. Disclosure of Prior Executive Compensation for New NEO 3-34
ac. Include Severance Payments in NEO Determination 3-34
1. Severance Paid at Termination 3-34
2. Reporting Severance Tied to Future Performance 3-35
ad. Include Director Compensation in NEO Determination 3-35
ae. NEO Group Changes After Determination of Actual Compensation 3-36
af. Determining NEO Status Following Acquisition 3-37
1. Compensation Paid by Acquiror to Officer of Acquired Company 3-37
2. Reverse Merger with Shell Company 3-38
3. Determination of NEO Status Related to CIC Payments & Termination Date 3-39
4. Post-Merger NEOs Include Current & Former "Highest Paid" Executives 3-40
ag. Determining NEOs for Purpose of Filing Employment Agreement 3-40
ah. Beneficial Ownership Disclosure for NEO Who No Longer Is an Employee 3-42

I. History

As far back as the 1940s, the proxy rules required disclosure of the total aggregate amount of compensation paid to all directors and officers and some individualized disclosure for certain officers. Beginning in the late 1970s, the SEC began to require more individualized disclosure for the most highly compensated "executive officers" and directors, while retaining aggregate disclosure of all pay to executive officers as a group.

In the 1992 revisions to its executive compensation disclosure rules, the SEC eliminated "group" disclosure about executive and director compensation in favor of specific "named executive officers," or "NEOs," which included the Chief Executive Officer (regardless of pay level), and the four most highly compensated executive officers with salary and bonus that exceeded $100,000 for the last completed fiscal year (as well as up to two executive officers who would have been NEOs had they been serving as executive officers at fiscal year-end).

In the 2006 rule changes, the SEC kept the number of NEOs at five, but reduced the number of NEOs determined by being among the most highly compensated executive officers to three—in favor of including both the principal executive officer ("PEO") and principal financial officer ("PFO") regardless of their compensation for the last completed fiscal year. The PFO was added because of the enhanced importance of a PFO's compensation to investors, given the PFO's role in providing certifications and being responsible for the fair presentation of the company's financial statements and other financial information. The SEC decided not to require compensation disclosure for all of the "principal" officers for whom disclosure is required under Item 5.02(b) and (c) of Form 8-K.

With respect to the determination of the most highly compensated executive officers for NEO status, the SEC also decided to peg the determination to an adjusted total compensation amount from the Summary Compensation Table, rather than just using salary and bonus as was required previously. In doing so, the SEC cited the proliferation of various forms of compensation other than salary and bonus as the basis for this change, but there were also concerns about possible incentives to characterize compensation as other than salary or bonus in order to avoid disclosure as an NEO.

In response to comments, for purposes of determining the most highly compensated NEOs, the SEC decided to exclude any amounts related to changes in pension value and above-market non-qualified deferred compensation earnings from total compensation, so as to avoid skewing the NEO group toward the longest-serving executive officers. Notably, the requirement to base NEO status on an adjusted total compensation figure likely results in more fluctuations in the NEO group over time (which the SEC acknowledged in its 2006 adopting release). The adjusted total compensation figure also adds more complexity in tracking executive officer compensation for the purposes of determining NEOs.

Also as part of the 2006 rule changes, the SEC eliminated the flexibility for companies to exclude executive officers who attained NEO status due to the receipt of an unusually large cash payment that was not part of a recurring arrangement and was unlikely to continue. The SEC pared down this potential basis for exclusion to only those situations where executive officers received large cash payments that made them an NEO due to an overseas assignment that is attributable predominantly to that assignment.

In 2006, the SEC had proposed an additional disclosure item that would have required disclosure for up to three employees who were not executive officers during the last completed fiscal year and whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers. Dubbed the "Katie Couric" rule—due to the news anchorwoman, Katie Couric, signing a generous contract to work for CBS News at the time—the SEC received extensive comment on this proposal. While some commenters supported the proposal or suggested that it should go further, most commenters expressed significant concerns, notably with respect to the extensive compliance costs, privacy concerns and the perceived lack of materiality of the proposed disclosure.

Based on the extensive public comment, the SEC did not adopt the proposed requirement as part of its mid-2006 amendments, but did solicit additional comment on whether potential modifications would address commenters' concerns. The September 2006 release in which the SEC solicited additional comment on a revised version of the proposal noted the SEC's concern about disclosure with respect to employees whose total compensation for the last completed fiscal year was greater than that of one or more of the named executive officers, particularly if the employee exerts significant policy influence at the company, at a significant subsidiary of the company or at a principal business unit, division or function of the company.

Under the proposed modifications, disclosure of the compensation of such employees would be required, whether or not they are executive officers, if their total compensation for the last completed fiscal year was greater than that of a named executive officer and the employee exerted significant policy influence by having responsibility for significant policy decisions. The re-proposing release attempted to explain the concept of "significant policy influence," noting that the director of a news division might have policy influence, but not an actor, professional athlete or trader. The SEC has not acted on this re-proposal and it appears unlikely that it will do so given the overall opposition to the concept. For additional discussion of this proposal, see Chapter 1: "History of Executive Compensation Disclosure Rules."

In the 2009 executive compensation and proxy disclosure enhancements adopting release, the SEC did not change the methodology for determining the status of named executive officers, nor did the SEC require specific compensation disclosure regarding a larger group of executives or employees, outside of the requirement in new paragraph (s) to Item 402 to discuss its compensation policies and practices for all employees, including non-executive officers, if those policies and practices create risks that are reasonably likely to have a material adverse effect on the company. However, the SEC did change the requirement to report the amounts recognized

as compensation expense for financial reporting purposes in the "Stock Awards" and "Option Awards" columns of the Summary Compensation Table to instead require that the grant date fair value of such awards be reported.

In the 2009 adopting release, the SEC stated that it believes this change will make the named executive officer list more consistent year-over-year, providing investors more meaningful disclosure and reducing executive compensation tracking burdens for companies.

II. SEC Rules and Regulations

The determination of who is covered by the executive compensation rules is dictated by Item 402(a)(3) of Regulation S-K:

(3) ***Persons Covered.*** Disclosure shall be provided pursuant to this Item for each of the following (the "named executive officers"):

(i) All individuals serving as the registrant's principal executive officer or acting in a similar capacity during the last completed fiscal year ("PEO"), regardless of compensation level;

(ii) All individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year ("PFO"), regardless of compensation level;

(iii) The registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year; and

(iv) Up to two additional individuals for whom disclosure would have been provided pursuant to paragraph (a)(3)(iii) of this Item but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year.

Instructions to Item 402(a)(3).

1. *Determination of Most Highly Compensated Executive Officers.* The determination as to which executive officers are most highly compensated shall be made by reference to total compensation for the last completed fiscal year (as required to be disclosed pursuant to paragraph (c)(2)(x) of this Item) reduced by the amount required to be disclosed pursuant to paragraph (c)(2)(viii) of this Item, *provided, however,* that no disclosure need be provided for any executive officer, other than the PEO and PFO, whose total compensation, as so reduced, does not exceed $100,000.

2. *Inclusion of Executive Officer of Subsidiary.* It may be appropriate for a registrant to include as named executive officers one or more executive officers or other employees of subsidiaries in the disclosure required by this Item. *See* Rule 3b-7 under the Exchange Act (17 CFR 240.3b-7).

3. *Exclusion of Executive Officer Due to Overseas Compensation.* It may be appropriate in limited circumstances for a registrant not to include in the disclosure required by this Item an individual, other than its PEO or PFO, who is one of the registrant's most highly compensated executive officers due to the payment of amounts of cash compensation relating to overseas assignments attributed predominantly to such assignments.

Note that Item 402(m)(2) of Regulation S-K specifies the basis for determining the named executive officers that smaller reporting companies may include if they rely on the scaled disclosure provisions of Item 402. Under Item 402(m)(2), the NEO group consists of all individuals serving as the PEO and the company's two other most highly compensated executive officers serving at the end of the last completed fiscal year whose adjusted total compensation exceeded $100,000, as well as up to two additional individuals who would have been NEOs but for the fact that they were not serving as executive officers at the end of the fiscal year.

III. SEC Staff Guidance

a. Compliance and Disclosure Interpretations

Below are ten SEC Staff Regulation S-K Compliance and Disclosure Interpretations that apply to the determination of "named executive officers" (we have added the headings):

1. No Exclusion of Recovered Compensation

Question 117.03

Question: During 2009, a company recovers (or "claws-back") a portion of an executive officer's 2008 bonus. How does this affect the company's 2009 Item 402 disclosure for that executive officer?

Answer: The portion of the 2008 bonus recovered in 2009 should not be deducted from 2009 bonus or total compensation for purposes of determining, pursuant to Items 402(a)(3)(iii) and (iv), whether the executive is a named executive officer for 2009. If the executive is a named executive officer for 2009, the Summary Compensation Table should report for the 2008 year, in the Bonus column (column (d)) and Total column (column (j)), amounts that are adjusted to reflect the "clawback," with footnote disclosure of the amount recovered. As the instruction to Item 402(b) provides, if "necessary to an understanding of the registrant's compensation policies and decisions regarding the named executive officers," the Compensation Discussion and Analysis should discuss the reasons for the "claw-back" and how the amount recovered was determined. [August 14, 2009]

2. Forfeited Equity Award Values & Calculating NEO Status

Question 117.04

Question: During 2009, a company grants an equity award to an executive officer. The same award is forfeited during 2009 because the executive officer leaves the company. Should the grant date fair value of this award be included for purposes of determining 2009 total compensation and identifying 2009 named executive officers?

Answer: Yes. [January 20, 2010]

3. Item 402 Disclosure After Fiscal Year End & Before Proxy Statement

Question 117.05

Question: A registrant with a calendar fiscal year end has filed a Securities Act registration statement (or post-effective amendment) for which it seeks effectiveness after December 31, 2009 but before its 2009 Form 10-K is due. Must it include Item 402 disclosure for 2009 in the registration statement before it can be declared effective?

Answer: If the registration statement is on Form S-1, then it must include Item 402 disclosure for 2009 before it can be declared effective. This is because 2009 is the last completed fiscal year. Part I, Item 11(l) of Form S-1 specifically requires Item 402 information in the registration statement, which includes Summary Compensation Table disclosure for each of the registrant's last three completed fiscal years and other disclosures for the last completed fiscal year. General Instruction VII of Form S-1, which permits a registrant meeting certain requirements to incorporate by reference the Item 11 information, does not change this result because the registrant has not yet filed its Form 10-K for the most recently completed fiscal year.

On the other hand, Form S-3's information requirements are satisfied by incorporating by reference filed and subsequently filed Exchange Act documents; for example, there is no specific line-item requirement in Form S-3 for Item 402 information. Accordingly, a non-automatic shelf registration statement on Form S-3 can be declared effective before the Form 10-K is due. Securities Act Forms C&DI 123.01 addresses the situation in which a company requests effectiveness for a non-automatic shelf registration statement on Form S-3 during the period between the filing of the Form 10-K and the definitive proxy statement. [February 16, 2010]

4. CFO as One of Three Most Highly Compensated Executive Officers

Question 117.06

Question: An individual who was the company's principal financial officer for part of the last completed fiscal year was serving the company as an executive officer in a different capacity at the end of that year, and was among the company's three most highly compensated executive officers. Does the company include this individual as a named executive officer pursuant to Item 402(a)(3)(iii), as one of its three most highly compensated executive officers other than the

principal executive officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year?

Answer: No. The company includes this individual as a named executive officer pursuant to Item 402(a)(3)(ii), as an individual who served as principal financial officer during the fiscal year. The company identifies its three most highly compensated executive officers pursuant to Item 402(a)(3)(iii) from among individuals serving as executive officers at the end of the last completed fiscal year who did not serve as its principal executive officer or principal financial officer at any time during that year. [June 4, 2010]

5. Limited Disclosure for First-Time NEO

Question 119.01

Question: If a person that was not a named executive officer in fiscal years 1 and 2 became a named executive officer in fiscal year 3, must compensation information be disclosed in the Summary Compensation Table for that person for all three fiscal years?

Answer: No, the compensation information only for fiscal year 3 need be provided in the Summary Compensation Table. [January 24, 2007]

6. NEO in Years 1 & 3 but Not Year 2

Question 119.18

Question: A person who was a named executive officer in year 1, but not in year 2, will again be a named executive officer in year 3. Must compensation information for this person be disclosed in the Summary Compensation Table for all three fiscal years?

Answer: Yes. [May 29, 2009]

7. Exclusion of a Discretionary Bonus that is Refused Before Grant

Question 119.26

Question: A company has a practice of granting discretionary bonuses to its executive officers. Before the board of directors takes action to grant such bonuses for 2010, an executive officer advises the board that she will not accept a bonus for 2010. Should the company report in column (d) of the Summary Compensation Table the bonus award it would have granted her and include that amount in total compensation for purposes of determining if she is a named executive officer for 2010?

Answer: No, because the executive declined the bonus before it was granted, and therefore, no bonus was granted. [March 12, 2010]

8. Earned Less Than $100,000 Due to Fiscal Year Change

Interpretation 217.04

Instruction 1 to Item 402(a)(3) states that the generally required compensation disclosure regarding highly compensated executive officers need not be set forth for an executive officer (other than the principal executive officer or principal financial officer) whose total compensation for the last fiscal year, reduced by the amount required to be disclosed by Item 402(c)(2)(viii), did not exceed $100,000. A reporting company that recently changed its fiscal year-end from December 31st to June 30th is preparing its transition report for the 6-month period ended June 30th, having filed its Form 10-K for the fiscal year ended 6 months earlier on December 31st. The reporting company generally has a group of executive officers that earn in excess of $100,000 each year. In addition, during the 6-month period, the company made an acquisition that resulted in new executive officers that, on an annual basis, will earn more than $100,000. During the 6-month period, however, none of these existing or new officers earned more than $100,000 in total compensation. The company asked whether disclosure under Item 402 regarding these officers therefore would not be required in the report being prepared for the 6-month period. The Division staff advised that no disclosure need be provided with respect to executive officers that started employment with the company during the 6-month period and did not, during that period of employment, earn more than $100,000. With respect to executive officers that were employed by the company both during and before the 6-month period, however, Item 402 disclosure would have to be provided for those who earned in excess of $100,000 during the one-year period ending June 30th (the same ending date as the six-month period, but extending back over 6 months of the preceding fiscal year). [January 24, 2007]

9. NEO Becomes Non-Executive Officer

Interpretation 217.07

A caller asked whether an executive officer, other than the principal executive officer or principal financial officer, could be considered a "named executive officer" if the executive officer became a non-executive employee during the last completed fiscal year and did not depart from the registrant. If an executive officer becomes a non-executive employee of a registrant during the preceding fiscal year, consider the compensation the person received during the entire fiscal year for purposes of determining whether the person is a named executive officer for that fiscal year. If the person thus would qualify as a named executive officer, disclose all of the person's compensation for the full fiscal year, *i.e.,* compensation for when the person was an executive officer and for when the person was a non-executive employee. [January 24, 2007]

10. Life Insurance Proceeds for Deceased Executive Officers

Interpretation 217.14

Item 402(c)(2)(ix)(G) requires Summary Compensation Table disclosure of the dollar value of any insurance premiums paid by, or on behalf of, the registrant during the covered fiscal year

with respect to life insurance for the benefit of a named executive officer. Item 402(j) requires description and quantification of the estimated payments and benefits that would be provided in each covered termination circumstance, including the proceeds of such life insurance payable upon a named executive officer's death. However, if an executive officer dies during the last completed fiscal year, the proceeds of a life insurance policy funded by the registrant and paid to the deceased executive officer's estate need not be taken into consideration in determining the compensation to be reported in the Summary Compensation Table, or in determining whether the executive is among the registrant's up to two additional individuals for whom disclosure would be required under Item 402(a)(3)(iv). [May 29, 2009]

Below are two "Exchange Act Rules" Compliance and Disclosure Interpretations that apply to the determination of "named executive officers" (we have added the headings):

11. NEO Clawback Disclosure Under Form 20-F

Question 121H.02

Question: Which persons will be considered named executive officers for purposes of determining the parties for whom individualized disclosure pursuant to Item 6.F of Form 20-F must be provided?

Answer: Item 6.F of Form 20-F provides for individualized disclosure for an issuer's named executive officers. Foreign private issuers that file on domestic forms and provide executive compensation disclosure under Item 402 of Regulation S-K should provide individualized disclosure for their named executive officers to the extent required by Form 20-F. For foreign private issuers that use Form 20-F, individualized disclosure is required about members of their administrative, supervisory, or management bodies for whom the issuer otherwise provides individualized compensation disclosure in the filing. [January 27, 2023]

12. NEO Clawback Disclosure Under Form 40-F

Question 121H.03

Question: Which persons will be considered named executive officers for purposes of determining the parties for whom individualized disclosure pursuant to Item B.(19) of Form 40-F must be provided?

Answer: Item B.(19) of Form 40-F provides for individualized disclosure for an issuer's named executive officers. Such individualized disclosure is required about executive officers for whom the issuer otherwise provides individualized compensation disclosure in the filing. [January 27, 2023]

b. Comment Letters

The SEC Staff typically does not comment on the determination of "named executive officers," probably because the Staff does not have access to the facts involved in making NEO determinations. In some cases, when there are less than five NEOs, the SEC Staff will ask about the determination of the most highly compensated executive officers under Item 402(a)(3)(iii). Corp Fin Staff typically will not object if a company has fewer than five NEOs if the company can confirm that the number of NEOs is the same as the number of executive officers and that its executive compensation disclosure includes all of the NEOs. In order to avoid these questions, it may be appropriate to include explanatory disclosure about the circumstances, *i.e.,* the company has a small number of executive officers or the most highly compensated executive officers received less than $100,000 in compensation.

IV. How the Rule Works

Early Step When Preparing Executive Compensation Disclosures

One of the first steps when drafting executive compensation disclosure is determining which executive officers must be covered. The covered executive officers are called "named executive officers" or "NEOs." Under Regulation S-K Item 402(a)(3), at least five executives must be included: the principal executive officer ("PEO") and principal financial officer ("PFO"), regardless of their compensation level, and the company's three other most highly compensated executive officers serving at the end of the last completed fiscal year whose total compensation exceeded $100,000, as well as up to two individuals for whom disclosure would have been required but for the fact that they were not serving as executive officers at the end of the last completed fiscal year.

For many companies, it is necessary to have the information that is reportable in the Summary Compensation Table before you will be able to identify your named executive officers. So often this tabular data needs to be collected first, before the NEOs are determined. Then the tables can be completed and, finally, the narrative drafted.

Sometimes More Than Five NEOs

There will be a surprising number of circumstances when more than five executives will be deemed to be NEOs for purposes of the rules. In fact, this occurs more frequently than one would guess; one study revealed that about 25% of the companies surveyed disclosed six NEOs and 15% disclosed seven NEOs. We have even seen cases where eight—and even nine—NEOs have been listed, perhaps in at least some of those cases because the company was sensitive to how its officers and the market might interpret disclosure naming some officers and not others.

For example, under Item 402(a)(3)(i) and (ii), anyone who served as the PEO or PFO at any time during the last completed fiscal year must be treated as an NEO. In addition, under Item 402(a)(3)(iv), up to two additional executive officers for whom disclosure would have been required if they had still been serving as an executive officer at the end of the last completed fiscal year also must be treated as NEOs. So, if a PEO or PFO is terminated or retires (or there is a change in control), there may well be more than five NEOs. In addition, if a former executive officer—who is not a PEO or PFO—receives a significant severance payment, this person may be determined to be an NEO.

Additionally, the 2009 executive compensation and proxy disclosure enhancements adopting release stated that in circumstances where a large "new hire" or "retention" grant results in the omission from the Summary Compensation Table of another executive officer whose compensation otherwise would have been subject to reporting, the company can consider including compensation disclosure for that executive officer to supplement the required disclosures.

Process to Determine NEO Status

A key to determining who is an NEO is having a sound disclosure control process where there is close coordination among the Human Resources department and any other groups within the company that have information relating to how much executive officers are paid. For some companies, this can be more complicated than one would imagine. Companies will need to track a broad group of executive officers (including, in some cases, executive officers of subsidiaries) in order to determine their most highly compensated executive officers.

In the case of perquisites and other personal benefits, complexities may arise particularly in determining the aggregate incremental cost of such items provided to executive officers. In addition, companies need to consider the determination of NEO status when deciding when to award bonuses, etc. so that the NEO determination can be made well in advance of preparing the executive compensation disclosure. *See* Chapter 2: "Disclosure Controls and Procedures."

Formula to Determine NEO Status

Under Instruction 1 to Item 402(a)(3), the formula to determine which executive officers serving at the end of the last completed fiscal year are the "most highly compensated" is based on the total compensation required to be reported in the Summary Compensation Table, after excluding the amounts included in the "Change in Pension Value and Nonqualified Deferred Compensation Earnings" column of that table. In other words, the "total compensation" for determining NEO status will likely not be the same amount as the "total compensation" that must be disclosed in the Summary Compensation Table.

Excluding Pension & Nonqualified Deferred Compensation Amounts from NEO Formula

In its 2006 rule changes, the SEC decided to change the formula to determine NEOs by moving away from just salary and bonus toward "total compensation," excluding amounts that were typically deferred or accumulated until retirement, because these amounts theoretically were beyond the control of the compensation committee (and often skewed the determinations towards the longest-serving officers).

This changed formula heightens the importance of equity awards in NEO determinations, and often leads to more frequent changes to a company's list of its NEOs, particularly when executives receive extraordinary one-time payments.

Officers With "Policy-Making Function" Are Executives

Item 402 looks to Exchange Act Rule 3b-7 for the definition of "executive officers" whose compensation must be disclosed, and the definition of "executive officer" under Rule 3b-7 focuses on whether an officer has a "policy-making function" rather than on whether they hold a specific title. That said, there's a presumption baked into the rule that any vice president "in charge of a principal business unit, division or function" is performing a policy-making function and is an "executive officer"—particularly since the rule goes on to include within the definition "any *other* officer who performs a policy-making function."

The term "policy- making function" isn't defined, but it isn't limited to the individuals who have final say over a corporate decision. Here's an excerpt from the May – June 2013 issue of *The Corporate Counsel* discussing the concept of a policy-making function:

> The criteria for determining who is "performing" a significant "policy making function" have always been a little murky, and often registrants base the determination largely on a subjective assessment of an individual's influence within the organization. Based on the limited case law on the subject, most registrants consider such factors as: (i) whether the person reports directly to the chief executive officer; (ii) whether other employees at the person's level on the organization chart are considered to be executive officers; (iii) whether the person's compensation is comparable to that of persons considered to be executive officers; (iv) whether the person is a member of any committee or other CEO-appointed group that meets periodically (usually with the CEO) to discuss corporate policy; and (v) whether the person has significant influence over corporate policy.

A September 2013 Williams Mullen memo also looks at an SEC civil action on the topic. Here's an excerpt:

> In this case, a highly valued member of the CEO's inner circle was not performing such a function, because the CEO retained final decision-making authority. This analysis suggests that high-level, influential employees may not be performing

a policy-making function where they do not exercise final decision-making authority over major policy decisions.

While this analysis is helpful, it is important to keep in mind that Prince headed the company's M&A program, an area in which final decisions necessarily are made at the highest corporate levels. In addition, the court opened the door for the SEC to argue in the future that the type of influence and authority enjoyed by Prince with respect to the M&A program, even without final decision-making authority, is similar to the policy-making function of a "vice president in charge of a principal business unit, division or function"—who, by definition, would be an officer or executive officer under Rule 16a-1(f) or Rule 3b-7, respectively. The SEC did not present this argument, however, and the court did not directly address it.

Title Not Dispositive

In determining who is a PEO, PFO or NEO, an individual's title is not dispositive. Particularly for PEOs and PFOs, a consultant or a temporary "contract" officer—or even an officer of a subsidiary—might be captured as an NEO.

Different From Section 16 "Officers"

Item 402 looks to Rule 3b-7 under the Exchange Act for the definition of "executive officers" whose compensation must be disclosed. That's very close to the definition of "officer" under Rule 16a-1(f), but the overlap isn't complete. For many companies though, their "executive officers" whose compensation is subject to disclosure under Item 402 are going to be identical to the group included within the "officer" category for purposes of Section 16(a).

In terms of numbers, a 2017 Latham & Watkins blog said that companies may typically have between six and twelve Rule 16a-1(f) officers.

But in any event, the determination of whether a person is an executive officer for Item 402 purposes is determined by looking at Rule 3b-7, not Rule 16a-1(f).

CFO as One of Three Most Highly Compensated Executive Officers

Question 117.06 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations addresses a situation that comes up from time to time. It involves an individual who was a company's principal financial officer for part of the last completed fiscal year, but who was serving as an executive officer in a different capacity at the end of that year, and, in this latter capacity, was among the company's three most highly compensated executive officers.

The question is whether this individual should be included in the company's executive compensation disclosure as a named executive officer pursuant to Item 402(a)(3)(iii) (that is, as one of its three most highly compensated executive officers other than the principal executive

officer and principal financial officer who were serving as executive officers at the end of the last completed fiscal year)?

If this is the case, then the company has its three most-highly compensated executive officers to fill out its named executive officers' group. If not, then this individual will be included in the named executive group as one of its PFOs pursuant to Item 402(a)(3)(ii), and the company will need to identify an additional individual as one of its three most highly compensated executive officers (other than the PEO and PFO) who were serving as executive officers at the end of the last completed fiscal year for the NEO group.

Not surprisingly, the SEC Staff requires that this individual be included in the NEO group pursuant to Item 402(a)(3)(ii), as an individual who served as principal financial officer during the fiscal year. This is based on the clear reading of this sub-Item, which expressly states that it includes "[a]ll individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year."

This provision seems to supersede the identification of named executive officers pursuant to Item 402(a)(3)(iii), and the Staff confirms that conclusion in its response. As the Staff notes, a company is to identify its three most highly compensated executive officers pursuant to Item 402(a)(3)(iii) from among individuals serving as executive officers at the end of the last completed fiscal year who did not serve as its PEO or PFO at any time during that year.

Include Forfeited Awards in NEO Calculation

According to the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations Question 117.04, if an equity award is granted to an executive in the same year that the executive departs, and therefore forfeits the award, the grant date fair value of the award still must be included for purposes of determining whether the executive qualifies as a named executive officer. The underlying rationale for this position seems to be that the disclosure is aimed at showing the compensation that the company intended to deliver to its named executive officers. Consequently, subsequent events, such as a termination of employment, which may alter the compensation opportunity, should not affect the amount reported.

By contrast, the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations Question 119.26 indicates that if it is anticipated that an executive officer is going to receive a discretionary bonus (*i.e.,* based on past practice) and the executive officer declines the bonus before it is granted, the amount of the declined bonus need not be included in total compensation for the purposes of determining if the executive officer is an NEO, because no bonus is granted in these circumstances. This same analysis would presumably also apply to awards other than discretionary bonuses.

Include All Compensation Once Determined NEO

Once it is determined that an executive officer is an NEO, *all* of his compensation for *all* services rendered in *all* capacities must be reported. Note that "total compensation" as reported in the Summary Compensation Table is not the same as the total amount used for determining NEO status.

Ever since then-Division of Corporation Finance Director Alan Beller's "All Means All" speech at our "1st Annual Executive Compensation Conference" in 2004, the SEC has continuously reminded companies that the executive compensation rules require disclosure of all compensation—so much so, that the principles-based requirement to disclose all compensation takes precedence over the detailed requirements of the various tables. *See* Chapter 6: "Summary Compensation Table."

Include All Recovered Compensation

The SEC Staff indicated in Question 117.03 of the Regulation S-K Compliance and Disclosure Interpretations that when a company recovers (or "clawsback") a portion of an executive officer's prior fiscal year's bonus, then the amounts recovered should not be deducted from the executive officer's current fiscal year bonus for the purposes of determining whether the executive officer is an NEO under Item 402(a)(3)(iii) and (iv).

Inclusion of Directors' Compensation in Total

An open issue is whether it is appropriate to exclude compensation for service as a director from "total compensation" for purposes of determining NEO status. For example, if an executive officer terminates service mid-year—but is elected to the board of directors later that year, should the compensation for service as a director (such as cash retainer fees or a stock award) be included in total compensation to determine whether the former executive officer should be included as an additional NEO?

Under a "principles-based" analysis, in trying to ascertain the compensation payable to executive officers for their service as executive officers, there may be a basis for excluding the director compensation from the computation. On the other hand, SEC Staff interpretations requiring inclusion of other forms of post-termination compensation, such as compensation for continuing to serve as an employee in a non-executive capacity, may weigh against that position. We believe that, pending further Staff clarification, it is probably better to include the director compensation in the computation. *See* Chapter 11: "Director Compensation."

Executive Officer of Subsidiary Could Be NEO

Based on the definition of "executive officer" and Instruction 2 to Item 402(a)(3), an executive officer of a subsidiary of a reporting company may be an NEO if that individual serves in a policy-making role for the reporting company.

Limited Exclusion for Overseas Executive Officers

Under a limited exclusion, companies may exclude disclosure regarding an individual, other than their PEO or PFO, who is one of the three most highly compensated executive officers due to the payment of cash compensation relating to an overseas assignment that is attributable predominantly to that assignment. For this purpose, Instruction 3 to Item 402(a)(3) appears to allow exclusion of cash expenses, such as tax equalization payments.

But overseas expenses picked up by the company may include other benefits, such as use of company aircraft to fly the executive officer and her family members back to the United States periodically and use of the company's country club membership, neither of which involves a cash payment. Also, an executive officer may receive housing, domestic services, tuition for children to attend private school and relocation expenses.

There are differing views on whether these expenses may be excluded in determining NEO status, particularly those that don't involve a direct payment of cash. It is rumored that there is an old internal Staff memorandum that allows exclusion of even non-cash items, but the Staff has never publicly taken this position in a written interpretation. Under the internal Staff position, the reference to cash was intended to be illustrative rather than exclusive. Regardless of the amount that a company decides to exclude from total compensation for purposes of determining NEO status, if it is determined that an executive officer engaged in an overseas assignment is an NEO, all of these items are reportable in the "All Other Compensation" column of the Summary Compensation Table, even those items that were excluded in determining whether the executive officer is an NEO.

Limited Disclosure for First-Time NEO

In Question 119.01 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations, the Staff stated that when an executive officer becomes an NEO for the first time, the Summary Compensation Table need include only the executive officer's compensation for the last completed fiscal year, and does not need to include the executive officer's compensation for the two preceding fiscal years.

Shifting NEO Status From Year to Year

Because of fluctuations in compensation from year to year, particularly under the formula for determining NEOs, it is not uncommon for some executive officers (other than the PEO and PFO) to be NEOs one year but not the next, only to regain NEO status in a later year.

Question 119.18 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations clarifies that where an executive officer was an NEO in the second preceding fiscal year (*e.g.,* 2011), was not an NEO in the first preceding fiscal year (*e.g.,* 2012), but will be an NEO for the last completed fiscal year (*e.g.,* 2013), compensation information for the executive officer must be disclosed for *all three* fiscal years. This Compliance and Disclosure Interpretation is consistent with similar guidance provided in the 2009 adopting release.

Only Three NEOs for Smaller Reporting Companies and EGCs

In the case of companies that qualify as "smaller reporting companies" and elect to provide scaled disclosure under that reporting regime, the NEO group consists of only three (rather than five) executive officers (specifically, the PEO and the company's two other most highly compensated executive officers serving at the end of the last completed fiscal year whose adjusted total compensation exceeded $100,000). A company's PFO is not part of the NEO group unless he happens to be one of the two other most highly compensated executive officers. An emerging growth company may also follow this approach.

Downsides of Expansive "NEO" Approach

Defining Section 16 "officers" and Item 402 "named executive officers" is one area where an expansive approach could backfire. There are various disclosure implications of being a Section 16 officer and/or an NEO—but there may also be compensation-related implications, for example, with the SEC's clawback rules requiring recoupment of erroneously awarded incentive compensation of current and former officers.

V. Common Questions and Our Analysis

a. Fewer than Five NEOs

Question: Under Item 402(a)(3), companies must provide disclosure for the PEO, the PFO and the three most highly compensated executive officers other than the PEO and PFO. If a company has fewer than five executive officers as defined in Exchange Act Rule 3b-7, is it permissible for the proxy statement to include fewer than five NEOs?

Answer: Yes, it is permissible to report fewer than five NEOs in the proxy statement if the PEO and PFO are included and the number of other NEOs who have attained NEO status by virtue of being the most highly compensated is less than three. This situation may arise when the company has a small number of "executive officers" as defined in Exchange Act Rule 3b-7, or because one or more of the three most highly compensated executive officers makes less than $100,000. In some instances, the Staff has raised comments asking the company to explain why there were fewer than five NEOs, so it may be appropriate in some circumstances to include an explanation of the applicable circumstances.

b. Same Individual is PEO & PFO

Question: Can a company have fewer than five NEOs if the same executive officer was acting as both the principal executive officer and the principal financial officer during the last completed fiscal year (*i.e.,* he filled both the PEO and PFO positions under Items 402(a)(3)(i) and (ii) of Regulation S-K)? Or would the company need to include the next-highest-paid executive officer to have a total of five NEOs?

Answer: We think that if one executive officer is serving as both the PEO and the PFO, then you would report compensation for that executive officer, the three most highly compensated executive officers other than the executive officer serving as both the PEO and the PFO, and up to two other executive officers who would have been in the table but for the fact that they were not serving as executive officers at the end of the year.

c. Order of NEOs Presented

Question: Has the SEC clarified the order in which it expects to see named executive officers listed in the Summary Compensation table? In other words, do the principal executive officer and principal financial officer have to be listed first and in that order—or can a company list its NEOs on any other basis (*e.g.,* by seniority, or highest-to-lowest total compensation)?

Answer: The rules specify the order of presentation—at least with respect to the principal executive officer and the principal financial officer—in that each of the tables included within Item 402 show the PEO appearing first and the PFO appearing second. Nothing, however, specifies the order of presentation for the other three NEOs (who are shown just as A, B and C in the blank tables in Item 402).

We are not aware of any SEC Staff guidance on this point, but it is likely that the Staff would want to see the PEO and PFO listed first and in that order. After that, the Staff should not necessarily care about the order of the other NEOs.

Question: If you had two principal executive officers during the last completed fiscal year, how would you order them? I am inclined to have current PEO, current PFO, then the former PEO and then the remaining NEOs.

Answer: This approach makes sense. You could probably also group the two PEOs together at the beginning—but from a presentation perspective, it is probably better to have the former PEO shown separately following the two currently serving "fixed" NEOs.

d. Tie for Third Highest Paid NEO

Question: The Summary Compensation Table requires that the three most highly compensated executive officers (in addition to the PEO and PFO) be included. What if there is a tie in compensation? Do four executive officers need to be included? If not, how is the tie broken?

Answer: While we believe that this situation is much less common now that NEO status is based on adjusted total compensation (rather than just salary and bonus, as under the former rules), assuming that you have a tie for the third most highly compensated NEO, we believe that the Staff has always indicated that the compensation (and related disclosure) for both executive officers must be reported in the Summary Compensation Table.

Be aware that some companies decide to voluntarily disclose more than the minimum required NEOs, particularly in a situation like this, because the companies are sensitive to how their officers and the market might interpret disclosure naming some officers and not others.

e. Voluntary Additional NEOs

Question: May a company include an additional NEO on a voluntary basis (the person in question was an NEO last year and was close to being one this year; also, the company wants to include his compensation information), so long as the company provides all the relevant information (including Form 8-K disclosure, where triggered)?

Answer: We believe that you can permissibly include supplemental NEOs, so long as the presentation of those additional NEOs is not somehow misleading and you otherwise provide all of the required information.

Also remember that in the 2009 adopting release—where the SEC switched from requiring stock awards to be shown based on grant date fair market value rather than compensation expense—the SEC said that if a one-time new hire or retention grant causes someone to be omitted from the Summary Compensation Table whose compensation would have otherwise been subject to reporting, the company can consider including compensation disclosure for that person to supplement the required disclosures.

Additional food for thought: In-house counsel are constantly benchmarking how many "executive officers" their companies have against their peers. One downside to a larger executive officer group (besides incrementally more Form 3 and Form 4 reporting) is that the financial websites pick up additional trades, and it looks like the company has more insider trading by NEOs than its peer companies. For more on benchmarking the number executive officers, see the February 2011 study by Broc Romanek and LogixData entitled, "Benchmarking the Number of 'Executive Officers,'" available on TheCorporateCounsel.net.

f. "Officer" with Higher Compensation than NEOs

Question: We have officers who are not deemed to be "executive officers," as that term is defined in Exchange Act Rule 3b-7, who have significantly higher annual compensation than some of our executive officers. Our understanding of the executive compensation disclosure rules is that highly compensated "officers" would not be included in the Summary Compensation Table, despite having higher compensation than some of the NEOs because they are not "executive officers," and therefore cannot be "named executive officers." Do you agree?

Answer: We agree with this analysis. As long as these officers do not fit within any of the prongs of Item 402(a)(3) of Regulation S-K, their compensation does not need to be disclosed. This would require a determination that these officers are not the PEO or PFO (or acting in similar capacities) or "executive officers," as that term is defined in Exchange Act Rule 3b-7. While we have seen companies provide this type of disclosure for individuals with total compensation in excess of that paid to the named executive officers, it is not required.

g. "Executive Chair" May Be NEO

Question: An "executive chair" of a board is not separately compensated for service as executive chair, but does receive compensation (over $100K) for service as a director on the same basis as other directors. Any guidance on whether this director is an NEO and if NEO related disclosure is required in a proxy?

Answer: The term "executive chair" can have different meanings, so it all depends on the facts of your particular situation and the executive chair's role in your company. Exchange Act Rule 3b-7 defines the term "executive officer" very broadly. Essentially, anybody who performs a significant policy-making function for the company can be an executive officer. We've seen many instances where an executive chair is named as an NEO, particularly if their role is to be more involved with the business (versus just presiding at meetings) and they're compensated for additional services.

h. Retiring PFO or PEO

Question: If the PFO retired during the last completed fiscal year, should she be included in the executive compensation disclosure for that fiscal year?

Answer: Yes, the retired PFO would need to be included, because Item 402(a)(3)(ii) requires that the executive compensation disclosure include "all individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year." As a result, the company would have to present compensation information for the retired PFO and for the new PFO who took her place, regardless of compensation level of either executive officer.

i. Other Departing NEOs

Question: If an NEO who was not the PFO or PEO leaves the company during the last completed fiscal year, does he still need to be included in the executive compensation disclosure for that fiscal year?

Answer: Under Item 402(a)(3)(iv), companies are required to include as named executive officers any executive officers, up to a maximum of two, who departed during the last fiscal year, but whose total compensation that was actually paid during the fiscal year would have placed them among the three most highly compensated executive officers (*i.e.,* those other than the PEO and PFO). When including these persons as NEOs, all of their compensation should be reported.

Question: Our company has six executive officers (including its PEO and PFO). Two executives left the company during the last completed fiscal year. The departing executives earned $150K and $200K in the last completed fiscal year, while the remaining executives (other than the PEO and PFO) earned $300K and $400K. All four remaining executives will be included in the summary compensation table (leaving one empty spot for the next highest paid executive, which will not be filled). As neither departed executive earned more than the lowest paid remaining

executive ($300K), does the company include neither of the departed executives in the summary compensation table?

Answer: The departing executive making $200,000 would be in the table, because he or she would have been in the third (now empty) NEO slot, but for the fact that he or she left before the end of the year. You would not pick up the $150,000 person, because they would not have made the table under any circumstances given the amounts earned by the other.

j. NEO Departs After End of Fiscal Year

Question: When an NEO resigns, retires, loses the position of executive officer or was terminated after the end of the fiscal year, does compensation information for the executive officer who was the next highest compensated executive officer need to be included in the proxy statement, on the theory that the company knows at the time of the proxy statement that the next highest paid executive officer would have been an NEO?

Answer: We don't think that there is any requirement to include the next highest paid executive officer, although in some cases companies may elect to include the additional NEO. The company would need to include disclosure about the executive's departure after the end of the fiscal year, and it may also be necessary to mention the executive's successor, if any.

k. Highly Paid "Officer" Becomes "Executive" After Fiscal Year-End

Question: Executive A serves in a senior capacity with the company, but based on their duties is determined not to be an "executive officer" as defined by the SEC. After conclusion of the 2016 fiscal year, but before the company files its proxy statement disclosing 2016 compensation, the board determines that in light of the emerging importance of the areas overseen by Executive A to the company's overall business strategy, Executive A will be designated as an executive officer beginning in the 2017 fiscal year. Had Executive A been an executive officer in the 2016 fiscal year, they would've been one of the three highest-paid non-CEO/non-CFO employees, and hence would have been an NEO included in the compensation disclosures for the proxy statement related to the 2016 fiscal year.

I've seen some guidance suggesting that the provision of Item 402(a)(3)(iv)—designating up to two additional NEO's for whom disclosure would have been provided "but for the fact that the individual was not serving as an executive officer" as of fiscal year-end—applies only to former NEOs whose employment (or service as an NEO) terminates during the year. But it seems like Executive A arguably also fits within the definition of 402(a)(3)(iv).

Is there any guidance from the SEC making clear that 402(a)(3)(iv) doesn't apply to someone in Executive A's position, or otherwise justifying the exclusion of Executive A for the proxy statement covering the 2016 fiscal year? Is the individual outside of 402(a)(3)(iv) because—having not served as an executive officer at any point during the year—they were never at any point during the year "an individual for whom disclosure would have been provided pursuant to" 402(a)(3)(iii)?

Answer: The best support for the position that you don't need to include the new executive officer's salary for the prior fiscal year is provided in the 1993 adopting release (Release No. 33-7032) that first installed this requirement into Item 402.

It's pretty clear that the intention was to catch departing executives, not newly appointed ones:

> "Item 402(a)(3) previously required compensation disclosure of the CEO and each of the four most highly paid executive officers (whose compensation exceeded $100,000) employed at fiscal year-end. Finding that these requirements provided an incomplete picture of the registrant's compensation package when highly paid executives departed prior to fiscal year end, the Commission proposed to amend the rule to apply as well to any person who served as CEO during the latest fiscal year and any other executive officer who departed during such year but whose reportable salary and bonus would place them in the group of four highest paid executive officers."

The adopting release for the 2006 amendments (Release No. 33-8732A) also supports the position that this was the rule's intent:

> "In addition, as was the case prior to these amendments, up to two additional individuals for whom disclosure would have been required but for the fact that they were no longer serving as executive officers at the end of the last completed fiscal year shall be included."

We've also received similar questions in which a director was appointed as an interim PEO in fiscal year 2019 and then stepped down from the PEO role once a new CEO was hired. In this situation, the above analysis applies and the interim PEO would be reported in the proxy statement for fiscal year 2019 and so long as the individual was not serving as an executive officer at any time during fiscal year 2020, the individual would not need to be included as an NEO for 2020. We haven't seen any guidance to suggest that Item 402(a)(3)(iv) would require disclosure of persons who did not serve in an executive officer capacity at any time during the most recent fiscal year.

l. NEO Death

Question: If an NEO dies but is still one of the top three in terms of compensation for the fiscal year, do you have to include him as one of the extra two who would have been included except that he was not an executive officer at fiscal year-end? Or is there an exception for death?

Answer: We don't think the Staff has made an exception to permit excluding an executive who has died in the executive compensation disclosure. The Staff did make an exception in the beneficial ownership disclosure in Question 129.03 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations, but we don't think that interpretation has been read more broadly to apply to other disclosure items. In fact, we believe the Staff has informally told

companies that any payments made for services provided by an NEO while he was still alive—but paid to the NEO's estate—would still be reportable in the Summary Compensation Table. However, Interpretation 217.14 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretation notes that if an executive officer dies during the last completed fiscal year, the proceeds of a life insurance policy funded by the company and paid to the deceased executive officer's estate need not be taken into consideration in determining whether the executive is among the up to two additional individuals for whom disclosure would be required under Item 402(a)(3)(iv).

m. Serving As of End of Fiscal Year

Question: One of our executive officers is resigning effective December 31, 2013, so his last day of service will be December 31st. We know he will be an NEO for our 2014 proxy statement, but we are trying to determine what category he fits in. If we say he was not serving as of the end of the year, we would have an extra NEO. However, if we say he was serving as of the end of the year, then we would only have five NEOs. Do you know how companies have typically handled this? The other thing to consider is the change of control/severance payment discussion. Can we just show what he will be getting as severance (he has a severance agreement)?

Answer: In that situation, we would characterize him as an "serving at the end of the last completed fiscal year" under Item 402(a)(3)(iii) of Regulation S-K.

n. Former CEO Departed for More Than One Year

Question: If a principal executive officer leaves the company, do we need to include her in future Summary Compensation Tables after the fiscal year in which she departed, given the Summary Compensation Table covers three fiscal years?

Answer: No, unless she served as principal executive officer for some portion of the last completed fiscal year, she will not be part of the named executive officer group simply because she served as PEO at some time during the three-year period covered by the Summary Compensation Table.

o. No Longer PEO, But Still Executive Officer

Question: Does a principal executive officer that reduces his status so that he is no longer a CEO—but still is an executive officer—need to be included in the executive compensation disclosure for the fiscal year in which the reduction in status occurs?

Answer: If the PEO were serving in that role at any time during the fiscal year, then the PEO would be included as an NEO. In addition, even though he may not have served as the PEO for the entire covered fiscal year, all compensation paid to, or earned by, him during the full fiscal year must be reported.

p. PEOs Who Become Non-Executive Officers

Question: Does a principal executive officer that reduces his status so that he is no longer an executive officer need to be included in the executive compensation disclosure for the fiscal year in which the reduction occurs?

Answer: If the PEO were serving in that role at any time during the fiscal year, then the PEO would be included as an NEO. In addition, even though he may not have served as the PEO for the entire covered fiscal year, all compensation paid to, or earned by, him during the full fiscal year must be reported.

q. NEOs Who Become Non-Executive Officers

Question: Does a named executive officer that reduces their status so that they're no longer an executive officer need to be included in the executive compensation disclosure for the fiscal year in which the reduction occurs?

Answer: It depends. Interpretation 217.07 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations states that the determination of the executive officers to be included in the disclosure is based on the total compensation the executive officers received during the last completed fiscal year in any capacity. For example, if an individual was an executive officer for part of the year and became a non-executive employee of the company later in the year, the total compensation for the entire year would be used to determine whether the individual is to be included.

Sometimes, a PEO or PFO may step down from that position but still be serving as another type of executive officer at the end of the fiscal year. The question has arisen as to whether this person should be included in his old capacity or as one of the company's other three most highly compensated executive officers. CDI 117.06 addresses this scenario—and requires including the person as a former PEO or PFO. In other words, that person would not replace another who was among the three most highly compensated executive officers, even if their total compensation exceeds that of those officers.

r. Former PEO Still an NEO?

Question: A smaller reporting company's only current executive officers are the PEO and PFO. In 2012, the prior PEO resigned and executed a separation agreement. During 2013, he served as a paid consultant and also received severance (over $100,000). He was not an employee during any part of 2013.

Should the prior PEO be included in the Summary Compensation Table as a named executive officer for both 2012 and 2013, with the severance and consulting amounts disclosed under the "All Other Compensation" column for 2013?

Answer: The ex-PEO would have been required in the 2012 Summary Compensation Table since he was a PEO at some time during the last completed fiscal year. Whether the ex-PEO is a named executive officer in 2013 really depends on the nature of his consulting services. If he was performing some sort of policy-making function during 2013, then it may be the case that he should be deemed an executive officer and be included in the table as one of the highest paid executives other than the PEO and PFO. If not, then we don't think any disclosure would be required regarding his compensation in the 2013 Summary Compensation Table.

s. Consultant as NEO

Question: If a company engages a consultant who reports directly to the PEO and has a policy-making role within the organization, should that person be considered an executive officer and, given high enough compensation, a named executive officer? In other words, does the Exchange Act Rule 3b-7 provision for "any other person who performs similar policy making functions for the registrant" extend to persons not actually employed by the company?

Answer: The definition of executive officer in Exchange Act Rule 3b-7 is very broad, notably referencing "persons" as opposed to "employees." We think that the definition is broad enough to pick up a consultant serving in a policy-making function with the company. However, as a practical matter, it is rare to see a consultant have so much influence that they are deemed to have a policy-making function within the organization, as opposed to making recommendations to those who make the policy.

t. Consultant Reimbursements Included in Named Executive Officer Calculation

Question: In making the NEO determination, is there any support for excluding from the calculation a certain amount of the fee paid to a consultant/executive officer in reimbursement for expenses generally paid by the company for all other executives/employees? An example would be a lump sum payment included in the consulting fee to cover the cost of office space.

Answer: We would not think that reimbursement of expenses of the sort that you describe (as long as the expenses are not for perquisites, as in, *e.g.,* a perks allowance) should be considered to be compensation.

u. Interim PFOs

1. Interim PFO is NEO

Question: What must a company report in the summary compensation table for an interim principal financial officer, who replaced a principal financial officer that has departed?

Answer: We think you're required to provide the interim officer's compensation information in the summary compensation table (as well as in a Form 8-K at the time of appointment).

Item 402 of Regulation S-K defines "named executive officers" to include all individuals serving as PFO or acting in a similar capacity during the last completed fiscal year. Because the interim officer has acted in the PFO capacity, they meet the definition of NEO and need to be included in the summary compensation table, etc.

Note that if the person was employed by the company before/after being interim PFO, you'll need to report their compensation for the full fiscal year (not just the portion of the year when they were interim PFO). However, the summary compensation table doesn't need to include their pay for any other fiscal year covered by the table in which served in a different capacity, even if they were an executive officer.

2. Interim PFO Doesn't Count as "Supplemental" NEO

Question: A calendar year company had a principal financial officer vacancy for the first three months of 2013. During this time, the principal operating officer served officially as Interim PFO (and signed the company's Section 302 and 906 certifications in such capacity). A new PFO was appointed in April 2013 and was still serving as PFO on December 31, 2013. The POO is the second most highly compensated executive officer of the company and was serving as POO (but no longer Interim PFO) on December 31, 2013. Because the POO served as PFO for a part of the year, does this result in a six-person NEO group for purposes of the executive compensation tables: (1) PEO, (2) Interim PFO/POO, (3) current PFO, and then the three other most highly compensated executive officers serving at the end of the last completed fiscal year, or may the POO count as one of the next other three most highly compensated executive officers for purposes of Item 402(a)(3)(iii)?

Answer: "Six" is the correct answer under this fact pattern, as the interim PFO will be an NEO under Item 402(a)(3)(i) and the "next three most highly compensated" list is comprised of persons "other than the PEO and PFO." *See* CDI 117.06.

Note that even though the PFO may not have served for the entire fiscal year, all compensation paid and earned by that executive during the year must be reported. In addition, in the case of the Summary Compensation Table, the full year's compensation information must be provided for any fiscal year in which the PFO served in that capacity, either for the full year or any part of the year. However, it's unnecessary to report his compensation for any other fiscal year covered by the table in which served in a different capacity, even if he was an executive officer. *See* Chapter 6: "Summary Compensation Table."

3. Interim PFO for Only Short Time Period Still Included as NEO

Question: We had someone who served as Interim CFO and Interim PFO for about a week during the 2020 fiscal year. We know that Item 402 of Regulation S-K defines "named executives officers" to include all individuals serving as PFO or acting in a similar capacity during the last completed fiscal year. But we were wondering if you knew of any support to exclude as an NEO someone who served in that role for such a short period of time?

Answer: No, we're not aware of any guidance that would allow exclusion of an interim PFO even when serving in that role for a short time period. We think the intent of the rule is to cover short-timers as well as those who served for a longer period.

v. "Supplemental" NEOs

1. Include Officers Who Earned More Than Lowest Paid Current NEO

Question: Assume that three executive officers (other than the principal executive officer and principal financial officer) made $2.5 million, $1.5 million and $500,000, respectively, during the last completed fiscal year, but two individuals who were not executive officers as of the end of the last completed fiscal year made $900,000 and $750,000 during the year. The individual who made $900,000 clearly must be included as a named executive officer since he would have been one of the three most highly compensated executive officers, but for the fact that he was not an executive officer at fiscal year-end. However, how should the individual who made $750,000 be treated? He made more than the third most highly compensated executive officer, but less than the individual who made $900,000 during the year (who we now must include as a "supplemental NEO"). Must he be included as an NEO?

Answer: We believe that the SEC Staff would likely take the position that a company should measure each former executive officer separately (that is, without regard to the other individual), so if each one is paid more than the lowest paid executive officer—he would be considered a "supplemental" NEO.

2. Highly Paid Executive Who Resigns Before Midnight of Year-End is "Supplemental" NEO

Question: A company's fiscal year ends on December 31. Executive officer resigns between 5:00pm and 11:59pm on December 31. Must the executive officer be disclosed as one of the "three most highly compensated executive officers" under Item 402 (a)(3)(iii) or as one of the "two additional individuals" under Item 402(a)(3)(iv)?

The question basically turns on whether the fiscal year for a company technically ends at market close on the last day of the fiscal year or whether the fiscal year ends at 11:59pm on the day of the fiscal year end. The exact time of the fiscal year end is not specified in the corporate bylaws or board resolutions.

Answer: Absent something specific in the organization documents, we believe that from an accounting perspective, the fiscal year would not end until right up until midnight. For NEO determination purposes, where an executive officer resigns on the last day of the fiscal year but it's effective after 5:00pm, we would consider such executive (other than the PEO or PFO) to be potentially one of the "two additional individuals" specified in Regulation S-K Item 402(a)(3)(iv) (and not as a person who was serving as an executive officer at the end of the last completed fiscal year as specified in Item 402 (a)(3)(iii)). However, we aren't aware of any informal SEC

Staff interpretation and expect that there are examples of companies that have handled this differently.

w. Subsidiary Officers as NEOs

Question: Should executive officers of subsidiaries be analyzed as potential NEOs?

Answer: Yes, executive officers of subsidiaries who perform policy-making functions for the reporting company must be considered under the "named executive officer" analysis, as provided in Instruction 2 to Item 402(a)(3) (and addressed by footnote 327 in the 2006 adopting release).

If a parent and its subsidiary are both Exchange Act reporting companies, and the executive officers of the parent receive a portion of their compensation from the subsidiary corporation, then the Staff has advised in Interpretation 217.08 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations that "if an executive spends 100% (or near 100%) of the executive's time for the subsidiary but is paid by the parent, then the compensation paid by the parent has to be reported in the executive compensation table of the subsidiary."

However, if an allocation of the monies paid by the parent would be necessary because the executive officer splits time between the parent and the subsidiary, the payments allocable to services for the parent need not be included in the subsidiary's executive compensation tables. In addition, in the event that the subsidiary pays a management fee to the parent for use of the executive, disclosure of the structure of the management agreement and fees would have to be reported by the subsidiary under Regulation S-K Item 404.

Compensation paid by the subsidiary to executives of the parent company must be included in the parent's executive compensation tables if such payments are paid directly by the subsidiary. If the payments are part of a management contract, disclosure of the structure of the management agreement and fees would have to be reported by the parent under Item 404.

x. Joint Venture Pay

Question: Company A contributes subsidiary to create a 50/50 joint venture with Company B effective mid-2013 (during fiscal 2013 for Company A). NEO regularly has been a named executive officer for Company A over the past several years, served as president of Subsidiary before contribution and serves as an executive officer of the JV following contribution. Company A pays all of NEO's compensation following the contribution of the Subsidiary to the JV, but is substantially reimbursed (approximately 75%) by Company B.

Is the amount of NEO's compensation reimbursed to Company A by Company B considered when making the named executive officer determination for 2013, or can it be excluded?

Seems to me that we may not be able to exclude amounts reimbursed by Company B because this would be tantamount to Company B paying NEO directly for services rendered to a parent or subsidiary and, in any event, Company A is paying the compensation in the first place. Any thought as to whether not treating the JV as a subsidiary could serve as a work around?

Answer: Item 402(a)(2) provides that disclosure of all plan and non-plan compensation awarded to, earned by, or paid to a company's named executive officers by any person for all services rendered in all capacities to the registrant and its subsidiaries ... All such compensation shall be reported pursuant to this Item ... 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 or director.

It seems to us that, under the facts presented, that the amounts reimbursed to Company A by Company B would fit squarely within this requirement. As you note, to exclude these amounts would be tantamount to Company B paying the executive officer directly for services rendered to Company A or a subsidiary.

While we believe that it would be possible to check the definition of the term "subsidiary" for purposes of the Exchange Act to see whether the joint venture could be excluded from coverage, our instinct is that this compensation should be taken into consideration in determining the named executive officers group and, if an NEO, reported for the last completed fiscal year.

y. Working Outside of the U.S.

1. Scope of "Cash Compensation" Exclusion

Question: Instruction 3 to Item 402(a)(3) allows for exclusion of "payment of cash compensation relating to overseas assignments attributed predominantly to such assignments" in determining whether an executive is an NEO. I understand there is no guidance from the SEC on this point.

If you read the instruction literally to include only cash payments, does it make a difference whether the cash payment is made directly to the executive or whether the cash payment is made to a third party (*e.g.,* to a rental agency for housing payments)?

Answer: Our approach has always been to interpret this provision flexibly to capture the spirit, rather than the technical constraints, of the exclusion. So, for example, it should make no difference whether a payment is made directly to an executive officer or indirectly to a third party for the executive officer's benefit. The key question is whether the item can fairly be characterized as predominantly attributable to the overseas assignment.

2. Executive Officer Who Works Part-Time Overseas

Question: How do we handle a person who might be an NEO, but for the fact that he spends half his time working at a location outside the United States?

Answer: Under a limited exclusion, companies may exclude disclosure regarding an individual, other than the PEO or PFO, who is one of the three most highly compensated executive officers due to the payment of cash compensation relating to an overseas assignment that is attributable predominantly to that assignment. Instruction 3 to Item 402(a)(3) appears to allow exclusion of cash expenses, such as tax equalization payments.

But overseas expenses picked up by the company may include other benefits, such as use of company aircraft to fly the executive officer and her family members back to the U.S. periodically and use of the company's country club membership, neither of which involves a cash payment. Also, an executive officer may receive housing, domestic services, tuition for children to attend private school, and relocation expenses.

There are differing views on whether these expenses may be excluded in determining NEO status, particularly those that don't involve a direct payment of cash. It is rumored that there is an old internal Staff memorandum that allows exclusion of even non-cash items, but the Staff has never publicly taken this position in a written interpretation.

Regardless of the amount that a company decides to exclude from total compensation for purposes of determining NEO status, if it is determined that an executive officer engaged in an overseas assignment is an NEO, all of these items are reportable in the "All Other Compensation" column of the Summary Compensation Table, even those items that were excluded in determining whether the executive officer is an NEO.

3. Full-Time Executive of Foreign Subsidiary

Question: Should we analyze executive officers of foreign subsidiaries as potential NEOs? If so, how should we calculate the exchange rate?

Answer: Yes, executive officers of foreign subsidiaries, who perform policy-making functions for the reporting company, must be considered under the "named executive officer" analysis, as provided in Instruction 2 to Item 402(a)(3) (and addressed by footnote 327 in the 2006 adopting release).

Compensation might be excludable for the purpose of determining if an executive officer is an NEO where the individual (other than the PEO or PFO) is one of the three most highly compensated executive officers due to the payment of cash compensation attributable predominantly to an overseas assignment. This exclusion is basically intended for the expatriate situation and not for a foreign national that is serving in the company's overseas office or subsidiary.

For the purposes of computing the executive's compensation, the SEC Staff has informally indicated that companies should convert compensation based on the dollar value at the point in time the compensation was paid. However, companies have historically used other methodologies, including conversion as of the end of the fiscal year and conversion using an average rate for the entire year. The rule requires that where compensation was paid to or

received by a named executive officer in a currency other than dollars, a footnote must be provided to identify that currency and describe the rate and methodology used to convert the payment amounts to dollars.

4. Can Exclude Foreign National's Pay During US Assignment

Question: I have not found a definition of overseas assignment under Instruction 3 to Regulation S-K 402(a)(3). Is it appropriate to treat a foreign national whose primary work location is outside the United States, but who is on an extended assignment in the United States, as on an "overseas assignment"? Under that approach, we'd exclude compensation predominantly attributable to the temporary US assignment in determining NEO status.

Answer: We aren't aware of guidance on this, but we see no reason why the "overseas assignment" concept wouldn't apply when making the NEO determination for a foreign employee on assignment in the United States. However, figuring out what payments are directly attributable to the overseas assignment can be a challenge.

z. NEO in Years 1 & 3, But Not 2

Question: We have a situation where we had an executive officer who was an NEO for 2011 but dropped off of the NEO list for 2012. In January 2013 the executive officer was terminated and he received a severance large enough to put him back on the NEO list (even though he was no longer employed at the end of 2013). Do we need to include compensation information in the Summary Compensation Table for all three years? Based on the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations, it appears as though we would only include 2011 and 2012, but based on language in the 2009 adopting release, it appears as though all three years are required. Here is the language from the release:

> In addition, if a person who would be a named executive officer for the most recent fiscal year (2009) also was disclosed as a named executive officer for 2007, but not for 2008, the named executive officer's compensation for each of those three fiscal years must be reported pursuant to the amendments.

Answer: We believe that the intent of this latest guidance in the 2009 adopting release is to require all of the compensation information in the Summary Compensation Table for the prior three fiscal years. This is consistent with Question 119.18 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations, which clarified that where an executive officer was an NEO in the second preceding fiscal year (*e.g.,* 2011), was not an NEO in the first preceding fiscal year (*e.g.,* 2012), but will be an NEO for the last completed fiscal year (*e.g.,* 2013), compensation information for the executive officer must be disclosed for all three fiscal years.

aa. NEO in Years 2 & 3, But Not Year 1

Question: Company has two NEOs that were first-time NEOs in 2015. Per CDI 119.01, limited disclosure was provided (*i.e.,* compensation information only for 2015).

Now, these two NEOs are second-time NEOs. Would it be appropriate to only provide compensation information for 2015 and 2016 (excluding 2014)? CDIs 119.01 and 119.18 aren't exactly on point, but the spirit of 119.01 appears to suggest that only 2015 and 2016 would be required.

Answer: We read CDIs 119.01 & 119.18 to say that the clock starts on pay disclosure the year somebody first becomes an NEO. In your scenario, that means that the 2015 and 2016 compensation would be subject to disclosure, but not 2014.

ab. Disclosure of Prior Executive Compensation for New NEO

Question: If a new named executive officer is included in a company's 2013 executive compensation disclosure, and she was an executive officer during 2011 and 2012 (but not an NEO), should the company disclose her 2011 and 2012 compensation in the Summary Compensation Table, just as it would for the continuing NEOs?

Answer: If any executive officer is required to be included in the compensation tables, then all compensation paid to that individual during the entire fiscal year in which she was an executive officer must be disclosed, even if the individual was an executive officer for only a portion of the year. However, in the situation described above, no disclosure of the 2011 and 2012 compensation would be necessary under Question 119.01 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations:

> **Question:** If a person that was not a named executive officer in fiscal years 1 and 2 became a named executive officer in fiscal year 3, must compensation information be disclosed in the Summary Compensation Table for that person for all three fiscal years?
>
> **Answer:** No, the compensation information only for fiscal year 3 need be provided in the Summary Compensation Table. [January 24, 2007]

ac. Include Severance Payments in NEO Determination

1. Severance Paid at Termination

Question: Late in the 2013 fiscal year, an officer's employment was terminated by mutual agreement. Had the officer's employment continued through the end of 2013, his total compensation would not have been sufficient to make him one of the three most highly compensated officers other than the PEO and the PFO. However, as a result of severance paid at the time of his termination, his total compensation for 2013 was among the top three highest compensated executive officers other than the PEO and PFO. Should we include that severance payment when making our determination regarding his NEO status?

Answer: Yes. The departed executive officer would be included as an NEO because the determination of whether he or she would have been an NEO is based on the total compensation for the prior fiscal year, which would have to include the severance payment.

2. Reporting Severance Tied to Future Performance

Question: For purposes of determining whether a former executive officer who leaves in the middle of the year is one of the two additional NEOs that must be added to the Summary Compensation Table, the SEC Staff has provided guidance that severance payments that are tied to future performance are not accrued and need not be included in the executive's total compensation for these purposes. At what date do you determine whether or not the severance has actually accrued—the individual's termination date, or the company's fiscal year end?

For example, if an executive of a calendar-year company terminates in March with a noncompetition agreement that runs through November, and receives significant severance benefits during those months in connection with the noncompetition agreement, would those payments need to be included in the executive's total compensation for the year for purposes of determining whether he is an NEO? Or would you only consider the compensation paid and accrued as of his termination date, which would not include the non-compete payments?

Answer: We've given this some thought, and while our conclusion is not free from doubt, we believe that the company should include payments to the executive through the end of the company's fiscal year for purposes of determining whether the former executive is part of the NEO group based on Item 402(a)(3)(iv). This is based on our understanding that, for disclosure purposes, compensation is to be measured for the entire fiscal year. While it certainly seems reasonable to measure the accrual of compensation as of the termination date, the SEC Staff might object to this interpretation because of its obvious susceptibility to manipulation.

ad. Include Director Compensation in NEO Determination

Question: A company is hiring a new executive officer who currently serves as a director of the company. The new executive officer's salary alone would not make her one of the company's three most highly compensated executive officers. However, she would be one of the five most highly compensated executive officers if her compensation for her service as a director is included. Should director compensation be included in determining which executive officers are NEOs?

Answer: Under Instruction 3 to Item 402(c), if a named executive officer is also a director who receives compensation for services as a director, that compensation must be reflected in the Summary Compensation Table. In determining status as a named executive officer by virtue of being among the three most highly compensated executive officers pursuant to Item 402(a)(3)(iii), the company must look to Instruction 1 to Item 402(a)(3), which specifies that the determination is to be made based on total compensation for the last fiscal year, excluding the change in pension value and above-market or preferential earnings on non-qualified deferred compensation.

Because the director compensation would be reportable in the Summary Compensation Table if the executive officer were in fact an NEO, then the director compensation must also be included in making the NEO determination.

ae. NEO Group Changes After Determination of Actual Compensation

Question: What happens if the company's NEO group changes "after the fact?"

Answer: This query was addressed in Mark Borges' Blog on CompensationStandards.com:

> As you know, Instruction 1 to Item 402(c)(2)(iii) and (iv) provides that, if the amount of salary or bonus earned in a given fiscal year is not calculable through the latest practicable date, a footnote should be added to the "Salary" or "Bonus" column, as the case may be, disclosing that fact and indicating the date that this amount is expected to be determined. The Instruction goes on to require that the salary or bonus (along with the affected named executive officer's recalculated total compensation) be disclosed in a subsequent Form 8-K filing when the amount is known.
>
> The Instruction assumes that a company would proceed to prepare its Summary Compensation Table without the undetermined compensation and file its proxy statement on that basis. The question involves the determination of the three most highly compensated executive officers for the NEO group. Presumably, you would ignore the unknown pay element in making this determination (which would affect not only the identities of the three most highly compensated executive officers, but also whether any former executive officers must also be included in the NEO group).
>
> What happens if, when the salary or bonus amount is actually calculated, it turns out that your NEO group is now different? That is, one of your executive officers who was among the three most highly compensated before the omitted amount was added in is no longer one of the top three. In addition to updating the previously-identified NEO's total compensation, do you now have to report the compensation of the individual who should have been an NEO in the first place? And, if you do, how much information must be provided?
>
> It seems to me that, in addition to complying with the Instruction, you should, at a minimum, note in the Form 8-K that the NEO group changed as a result of the recalculation. Beyond that, how much additional information I'd provide depends on how many executive officers are involved. If it was just one individual, I would identify the "new" NEO and provide the total compensation and other SCT information. I'm not inclined to include all of the supplemental information that would have been presented had the officer been included in the other disclosure tables (although, arguably, since this information hasn't been presented anywhere

else, you can make a plausible argument that it should be disclosed as well). I'm just trying to strike a balance between investors' interests and the company's compliance burden.

Where previously undisclosed salary or bonus amounts involve all of the company's executive officers (which it easily could if dealing with an annual incentive program), and two or more of the NEOs have now changed, I'd probably recommend restating all of the disclosure tables with the reconstituted NEO group. Here, I believe investors' interests trump the inconvenience of preparing new tables.

What's the lesson here? Be sure that you get your bonus decisions made before you file your proxy statement. That way, we won't have to address this situation.

af. Determining NEO Status Following Acquisition

1. Compensation Paid by Acquiror to Officer of Acquired Company

Question: A company completed an acquisition close to the end of its fiscal year. One of the executive officers of the target company became an executive officer of the acquiring company following the closing of the transaction. A question has arisen concerning the inclusion of a bonus payment by the company to this executive officer. Interpretation 217.02 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations states that the surviving company in a merger need not report on compensation paid by predecessor companies and that compensation paid by such predecessor companies need not be counted in computing whether an individual is a named executive officer of the surviving company.

In this case, the bonus was actually paid in full by the acquiring company following the acquisition; however, the bonus was based upon financial metrics that were almost entirely achieved prior to the acquisition; only a small portion of the metrics was achieved subsequent to the acquisition. Thus, the bonus was substantially "earned" prior to the closing of the transaction. Nevertheless, from a technical standpoint, the bonus was "at risk" until the end of the fiscal year because, although highly unlikely, the acquired company could, theoretically at least, have suffered a horrible catastrophe and the prior achievements could have been lost (a result that, obviously, did not happen).

In calculating this executive officer's compensation, should the entire bonus amount paid by the acquiring company following the acquisition be included, which would make the executive officer a named executive officer, or only a pro rata portion reflecting the brief period when she was an executive officer of the acquiring company be included, in which case she would not be an NEO?

Answer: Our inclination would be to report (and include in the determination of NEO status) the entire bonus amount paid by the acquiring company to the executive officer following the acquisition. This conclusion is based on the view that SEC Staff's Regulation S-K Compliance

and Disclosure Interpretation 217.02 is relatively narrow, in that it refers specifically to compensation "paid" by the predecessor.

If an executive officer continues as an employee following the merger and has compensation at risk that is then paid by the acquiring company, we do not believe that this compensation would be excludable from the determination of NEO status under Interpretation 217.02.

2. Reverse Merger with Shell Company

Question: What compensation must a company disclose in its proxy statement for its first annual meeting following a reverse merger?

Company A was a public shell. In March 2013, it consummated a reverse merger with Company B, which was not previously subject to SEC reporting requirements. Company A filed its Form 10-K for fiscal year 2012 prior to the merger, including an executive compensation section disclosing prior fiscal year compensation to Company A's NEOs. The combined company filed a "super Form 8-K" after the merger closed.

As none of the pre-merger Company B executive officers were officers of the company at the end of 2012, is there any requirement to provide full-blown compensation information for them (tables, etc.) in the company's 2013 proxy statement, except in the narrative as needed to provide updated disclosure under Exchange Act rules?

Answer: We think it would be appropriate to follow the guidance in Interpretation 217.12 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations:

> Shareholders of a shell company, as defined in Securities Act Rule 405, will vote on combining the shell company with an operating company. The combination will have the effect of making the operating company subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act. The disclosure document soliciting shareholder approval of the combination (whether a proxy statement, Form S-4, or Form F-4) needs to disclose: (1) Item 402 disclosure for the shell company before the combination; (2) Item 402 disclosure regarding the operating company that the operating company would be required to make if filing a 1934 Act registration statement, including Compensation Discussion and Analysis disclosure; and (3) Item 402 disclosure regarding each person who will serve as a director or an executive officer of the surviving company required by Item 18(a)(7)(ii) or 19(a)(7)(ii) of Form S-4, including Compensation Discussion and Analysis disclosure that may emphasize new plans or policies (as provided in the Release 33-8732A text at n. 97). The Form 10-K of the combined entity for the fiscal year in which the combination occurs would provide Item 402 disclosure for the named executive officers and directors of the combined entity, complying with Item 402(a)(4) of Regulation S-K and Instruction 1 to Item 402(c) of Regulation S-K. [Aug. 8, 2007]

3. Determination of NEO Status Related to CIC Payments & Termination Date

Question: A company was acquired earlier this year and the executive officers of the acquired company all had change in control agreements. The compensation paid to the executive officers under the change in control agreements would make their total compensation higher than any of the acquiror's current NEOs listed, including the PEO and PFO. There was a two-day period between the effective date of the change in control and the termination date for certain of the executive officers of the acquired company. Certain other executive officers of the acquired company stayed on for several months to help transition before being terminated pursuant to their change in control. The compensation paid to the individuals that only stayed on for two days would be higher than the compensation for those individuals that stayed on for several months.

I understand based on the executive compensation release that there is no exemption for non-recurring and unlikely-to-continue compensation. Can you please confirm that (1) the people that only stayed on for two days would not be NEOs because they were not serving as executive officers of the acquiror for those two days even though their total compensation would be the highest of all employees; (2) if the remaining executive officers stayed in their old role to help with the transition (and earned more than $100,000 during those months), but they were now just officers of a subsidiary and it may not have had the same decision-making skills during that time, would they still be NEOs and considered to be serving in the capacity of an executive officer?

Answer: The determination of who is a named executive officer is based on the principles set forth in Item 402(a)(3) of Regulation S-K, as applied to the particular facts and circumstances of each situation. Thus, the ultimate determination should be made by the acquiror in consultation with its counsel. With that as a caveat, it appears that, with respect to the executive officers of the acquired company who served for a two-day period between the effective date of the change in control and their termination date, they would not be considered named executive officers of the acquiror (based on Item 402(a)(3)(iv) of Regulation S-K), assuming two facts: (1) they were not either the PEO or PFO of the company during that two-day period and (2) they did not otherwise serve as an executive officer of the registrant at any time during that two day period.

With respect to the executive officers of the acquired company who remained employed for several months to assist with the transition, a similar analysis applies, although it may require a more careful factual analysis. Assuming that none of these individuals served as the PEO or the PFO of the acquiror, then their status as executive officers of the acquiror (and potential named executive officers pursuant to Item 402(a)(3)(iv) of Regulation S-K)) will depend on whether, in their capacity as executive officers of a subsidiary to the acquiror, they were exercising a policy-making role for the acquiror (based on current interpretations of status as an "executive officer" under Exchange Act Rule 3b-7).

4. Post-Merger NEOs Include Current & Former "Highest Paid" Executives

Question: A company's CEO and CFO both retired after a merger in 2016. The company now has a new CEO and a new CFO. I know that all 4 of these individuals will be listed as named executive officers pursuant to for 402(a)(3(i) and (ii).

Because of severance payments made in connection with the merger, two of the company's former executive officers would have been part of the three most highly compensated executive officers but for the fact they were not serving as executive officers at the end of 2016 (they would have been the first and second most highly paid after the former CEO and former CFO).

Am I reading the rule correctly in that the company will have 9 NEOs for its 2016 disclosure: the former CEO, the former CFO, the new CEO, the new CFO, the three most highly compensated executive officers serving as executive officers at the end of 2016, and the two additional individuals for whom disclosure would have been provided but for the fact they weren't serving as executive officers at the end of 2016?

Answer: Sorry, but you're correct. It's pretty clear from the rule that everybody who was a CEO or CFO needs to go in the table, and the response to Regulation S-K CDI 117.06 says that you can't use the compensation paid to these folks to bump any other NEO out of the table, so you're left with having to include everybody you suggest.

Also note that there's no prescribed order for listing the people in the table. *See* AIG's 2017 proxy statement and Sangamo's 2017 proxy statement for examples of two different approaches.

ag. Determining NEOs for Purpose of Filing Employment Agreement

Question: Item 601(b)(10)(iii)(A) requires a reporting company to file a management contract or compensatory arrangement in which any director or named executive officer participates as an exhibit to its annual report on Form 10-K. This Item references Item 402(a)(3) in defining "named executive officer," which states that an NEO includes the three most highly compensated executive officers (other than the principal executive officer and principal financial officer) who were serving as executive officers at the end of the last fiscal year.

Does this mean that employment agreements with executive officers who were not NEOs in fiscal 2012, but are going to be NEOs for fiscal 2013, must be filed with the SEC? Does the analysis change if the reporting company is not certain at the time its annual report on Form 10-K is filed that the executive officer will be an NEO for fiscal 2013? Given that a company may incorporate by reference the disclosure from its annual proxy statement to satisfy the executive compensation disclosure requirements under Part III of Form 10-K (because the SEC has recognized that it would be difficult for a company to determine its NEOs by the time the Form 10-K is filed), it would seem to follow that the exhibit requirement would revert back to the NEOs for fiscal 2012. However, a literal reading of the Item makes this conclusion problematic.

In addition, if employment agreements must be filed for the NEOs for fiscal 2013, and one of the NEOs left the company during 2013 but will still be an NEO in its upcoming executive compensation disclosure based on Item 402(a)(3)(iv), is the reporting company still required to file that NEO's employment agreement (if there exists any continuing obligation thereunder—*i.e.,* a non-solicitation agreement)? If the answer to this question is yes, does the analysis change if there are no continuing obligations?

Answer: We agree that Item 601(b)(10)(iii)(A) operates in the manner described as the "literal" reading of the rule. However, once the new fiscal year begins, the Item is referring to the NEOs under Item 402(a)(3) as of the end of the last completed fiscal year. This can potentially create some problems at the time that the annual report on Form 10-K must be filed if the company has not yet identified the executive officers who are named executive officers by virtue of being the most highly compensated executives, but we believe that the SEC Staff would likely take the position that a company should probably have a good idea of who these individuals are likely to be by the time of filing the Form 10-K.

The SEC tried to address the potential for these types of problems in Item 5.02 of Form 8-K by adopting Instruction 4 to Item 5.02, which refers to the last disclosed NEOs, rather than directly to the definition in Item 402.

Question: Based on SEC Staff guidance, it is unclear whether agreements with former named executive officers must be filed as exhibits to an annual report on Form 10-K under the following scenario:

- An executive officer who was an NEO for purposes of the company's fiscal 2012 executive compensation disclosure, and who will be an NEO for purposes of its fiscal 2013 executive compensation disclosure, resigned during fiscal 2012.
- Item 601(b)(10) requires the filing of all contracts entered into outside the ordinary course of business that are material to the company and that either have continuing obligations or were entered into not more than two years prior to filing the report.
- Item 601(b)(10)(iii)(A) deems all contracts with NEOs material, which makes clear that employment and severance agreements with the former NEO will need to be described in the company's fiscal 2013 proxy statement, and all such agreements will need to be filed as exhibits to the annual report on Form 10-K for fiscal 2012. However, must the agreements be filed as part of the annual report on Form 10-K for fiscal 2013?
- Based on a strict reading of the rule, it would appear that, at the time of filing of the Form 10-K for fiscal 2013, the former executive is still an NEO, and agreements with that former executive are therefore *per se* material. Accordingly, agreements would need to be filed as exhibits if there are continuing obligations thereunder or if they were entered into not more than two years prior to the filing of the Form 10-K. In this spirit, I have heard that "common practice" is to include agreements with the former NEO as exhibits in such

a situation because the Form 10-K will cover a period during which the agreement was material (*i.e.,* the Form 10-K will discuss fiscal 2012, at which time the former executive was an NEO).

- Or, in accordance with the last clause of Item 601(b)(10)(iii)(A) and footnote 379 to the 2006 adopting release, is the company allowed to analyze the issue under the rules for non-NEO executive officers, which permits a company to not file as exhibits contracts with those persons if those contracts are immaterial in amount or significance? I believe that it may be argued that agreements with the individual could be immaterial if the individual will not be an NEO, the individual was not employed during the prior fiscal year, and the agreement does not have continuing obligations.

Answer: We believe that the agreement would get filed (presumably for the last time) in the Form 10-K filed in fiscal 2012. Because former executives are picked up under Item 402(a)(3) for the fiscal year in which they resign, then a company cannot fall back to the non-NEO analysis of whether the agreements are immaterial in amount or significance.

ah. Beneficial Ownership Disclosure for NEO Who No Longer Is an Employee

Question: A former employee qualifies as a named executive officer under Item 402(a)(3). While the company has included all of the other required disclosures about this individual in its proxy statement, it is unable to acquire his beneficial ownership information as of the record date. Item 403(b) appears to require the disclosure of such information. Has the SEC provided relief from disclosure in this situation?

Answer: The one area of relief for beneficial ownership disclosure that the SEC Staff has provided relates to a named executive officer who has died since the beginning of the last fiscal year (see Question 129.03 of the SEC Staff's Regulation S-K Compliance and Disclosure Interpretations). We are not aware of this same approach ever being extended to executive officers who have left the company.

If efforts have been made to acquire the information from the former executive officer and it is not possible to obtain it, then the company could seek to rely on rarely used Exchange Act Rule 12b-21. In complying with that provision (which sets a relatively high bar in the Staff's view on what information is not known or not reasonably available), the company would need to disclose everything it does know about the former executive officer's holdings and also include a statement "either showing that unreasonable effort or expense would be involved or indicating the absence of any affiliation with the person within whose knowledge the information rests and stating the result of a request made to such person for the information."

While we don't see Exchange Act Rule 12b-21 (or Securities Act Rule 409) used very often, it is there for situations like this where a third party has information that it is not willing to share despite the company's request. Companies try to avoid relying on these rules because it is a little bit odd to include the required statements about the unavailability of the information when disclosure is made.