S.E.C. to Require More Disclosure on Executive Pay

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By Stephen Labaton
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WASHINGTON, Jan. 17 - The Securities and Exchange Commission voted unanimously on Tuesday to overhaul the way companies report their pay packages for senior executives, a move that is expected to lead to greater disclosure but not to any significant decline in executive compensation.

The proposal - the biggest change in this area in more than a dozen years - is the first major rule suggested by the commission's new chairman, Christopher Cox. S.E.C. officials said it would be adopted in a few months, after a few details were sorted out. It is expected to go into force for the 2007 proxy season.

The move comes after a series of corporate scandals at the New York Stock Exchange and Tyco International, among others, that drew criticism over excessive pay.

In 1992, when the five-member commission first addressed executive pay issues, it sought to require greater disclosure as an antidote to excessive pay. But in the intervening years, many boards have come up with partly or completely hidden benefits for top executives, ranging from paying their taxes to allowing use of corporate jets for personal reasons.

"Simply put, our rules are out of date," Mr. Cox said at a commission meeting. But Mr. Cox emphasized that the agency did not intend to produce rules that forced changes in executive pay scales, but to make them more apparent to investors.

"It's about wage clarity, not wage controls," he said. "By improving the total mix of information available to the marketplace, we can help shareholders and compensation committees of boards of directors to assess the information themselves, and reach their own conclusions."

In recent years the commission has said that several companies, including General Electric and the Walt Disney Company, failed to adequately describe significant payments and benefits to top executives. Just as the accounting scandals prompted Congress and the regulators to adopt rules to invigorate audit committees of directors, the proposal on executive pay is meant to prompt compensation committees to be more exacting.

At the same time, large institutional investors, like pension funds, have been raising more questions about the compensation of executives at companies where they own stock. The pay of the average worker remained almost flat at $27,000 from 1990 to 2004, adjusted for inflation, while average chief executive pay has risen from $2.82 million to $11.8 million, a ratio of more

than 400 to 1, according to the Institute for Policy Studies and a group, United for a Fair Economy, which has been critical of the disparity between the pay of senior executives and lower-ranking employees.

The proposed rules would for the first time require public companies to provide a figure for total compensation, including significant perks, stock options and retirement benefits for the chief executive, the chief financial officer and three other top-paid officers, as well as all directors.

It is intended to prod companies into providing greater justification for pay packages, retirement plans, severance agreements and so-called golden parachutes - large payments to executives when control of a company changes hands. And it would require companies to place a precise dollar value on grants of stock options and restricted stock.

Many companies now do little more than provide legal boilerplate to justify the pay packages.

But the plan fell short of calls by some institutional investors to give a greater voice to shareholders in setting some pay packages. And it proposed to loosen at least one area of disclosure by raising the threshold to $120,000 for reporting a business transaction between a company and an executive or relative. Such disclosures are now required for transactions of $60,000 or more.

Experts hailed the proposal for leading to greater transparency, saying that it would end up showing many hidden benefits given to top executives - particularly the value of stock options, pension plans and a wide assortment of perks - that are now either not disclosed or obscured.

But they acknowledged that the changes, while they may encourage reining in some perks, would not lead to a decline in the rapidly growing pay packages of top executives at many public companies.

"The positive effect will be that on the margin - and it is an important margin - there will be a new so-called outrage constraint," said Lucian A. Bebchuk, the director of the corporate governance program at Harvard Law School, who has documented how executive pay is often hidden and has far outpaced compensation for other employees. "The caveat is that even though there is an outrage constraint, shareholders have very limited power to do anything about it."

Professor Bebchuk said that once what he has called the stealth compensation - pension and retirement plans in particular - became public, the disparities between the top and bottom of a company would be even greater. His research has found, for instance, that at the companies in the Standard & Poor's 500 with pension plans, the median actuarial value for pensions given to chief executives is about $15 million, or about a third of the overall total compensation.

B. Espen Eckbo, director of the corporate governance center at the Tuck School of Business at

Dartmouth, said the new rules would give institutional investors more ammunition to use to scrutinize boards and management.

"There will be criticism; there will be second-guessing," said Professor Eckbo, speaking in part from his experience as an adviser to the Norwegian Petroleum Fund, a large pension fund. Still, he said, "forcing people to explain what they are doing can't be bad."

Once the commission publishes the proposal, it will entertain comments for 60 days before voting on a final rule. Agency officials are preparing for a spirited debate over the best way to value options: some business groups have already complained that the proposal would unfairly overvalue options by giving them a full value at the time they are granted, while some institutional investors have urged the commission not to permit companies to undervalue them.

The Business Roundtable, which represents chief executives from many of the nation's largest companies, issued a statement generally supporting the commission's proposal, although it cautioned that it wanted to examine the details. The statement, by the group's president, John J. Castellani, also asked the agency not to require companies to calculate stock options in a way that overvalues them.

"Our goal is to effectively balance the goal of providing shareholders with timely disclosure of accurate and complete compensation information with the need to prevent strategic company information from being revealed to competitors and damaging a company," he said.

Ira Kay, a compensation consultant at Watson Wyatt Worldwide, a human resources consulting firm, said company directors now found themselves caught between highly marketable executives, who could often command huge packages, and more active institutional investors seeking greater accountability.

"Boards are caught balancing the interests of the executives and the shareholders," he said. "It's a difficult balancing act."