



Navigating new executive compensation disclosure obligations

This is the first part of a client alert series for public companies and their boards and compensation committees, covering key considerations for equity grant practices.

Overview

Additional executive compensation disclosure obligations under Item 402(x) of Regulation S-K will soon become effective for many public company issuers.

For issuers with a calendar year fiscal year, the new disclosure requirements will be in effect for the 2025 proxy season and cover grant practices during the 2024 fiscal year.

Item 402(x) was adopted by the US Securities and Exchange Commission in December 2022, and requires narrative and tabular disclosures of a public company's policies and practices related to the grant of stock options and stock appreciation rights (SARs) in proximity to the release of material nonpublic information (MNPI).

These new disclosure requirements are intended to address concerns regarding potential opportunistic timing of such grants by issuers and apply even to grants that are coincidentally – rather than opportunistically – made in proximity to the release of MNPI. As a result, issuers should be aware of the scope of the new requirements and begin planning for additional disclosure burdens.

Issuers that file annual reports on Form 10-K and proxy information statements are required to comply with the new disclosure requirements starting with their first filings that cover a full fiscal period beginning on or after April 1, 2023 (or October 1, 2023 for smaller reporting companies). The new disclosure requirements do not apply to foreign private issuers.

New disclosure requirements: Narrative and tabular

Item 402(x) requires issuers to provide narrative disclosure about their policies and practices regarding the timing of awards of stock options, SARs, and similar instruments in relation to the disclosure of MNPI.

Specifically, a company must disclose how its board determines when to grant such awards, whether and how its board takes MNPI into account when determining the timing and terms of such awards, and whether the company has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.

This narrative disclosure is required regardless of whether the issuer has actually granted stock options, SARs, and similar instruments close in time to the release of MNPI. Notably, this disclosure is not required with respect to awards of restricted stock or restricted stock units.

The new rule also requires issuers to include new tabular disclosure for certain awards of stock options, SARs, and similar instruments granted to named executive officers (NEOs) during the prior completed fiscal year.

Specifically, tabular disclosure is required with respect to each such award that was granted within the period - referred to in this client alert as the MNPI window - beginning four business days before and ending one business day after the filing of a report on Form 10-Q, Form 10-K, or Form 8-K that discloses material nonpublic information. Notably, Item 402(x) includes an exception, such that no tabular disclosure is required if the MNPI consists of material new option awards disclosed on Form 8-K.

For each such grant made to a NEO, the tabular disclosure must include the:

- Grant date
- Number of securities underlying the award
- Per-share exercise price of the award
- Grant date fair value of the award (using the same methodology as used for the issuer's financial statements under generally accepted accounting principles), and

- Percentage change in the market value of the securities underlying the award measured between one trading day before and one trading day after disclosure of the MNPI.

Again, disclosure is not required for awards of restricted stock or restricted stock units. Smaller reporting companies and emerging growth companies are also required to provide such disclosures, but only for their applicable NEOs as determined under Item 402(m)(2) of Regulation S-K.

For purposes of illustration, consider a calendar year issuer that files a Form 10-Q on August 9, 2024. If the issuer grants stock options to its NEOs prior to August 5, 2024 (more than four business days prior to the filing of the Form 10-Q) or after August 12, 2024 (more than one business day after the filing of the Form 10-Q), no tabular disclosure will be required in the issuer's 2025 proxy statement under the new rule with respect to the stock option grants.

However, if the issuer were to make the grants on August 5, then tabular disclosure would be required in the issuer's 2025 proxy statement. A sample table is provided below which illustrates how the table might look based on the relevant facts related to the grant.

NAME (A)	GRANT DATE (B)	NUMBER OF SECURITIES UNDERLYING THE AWARD (C)	EXERCISE PRICE OF THE AWARD (\$/SH) (D)	GRANT DATE FAIR VALUE OF THE AWARD (E)	PERCENTAGE CHANGE IN THE CLOSING MARKET PRICE (F)*
PEO	8/5/2024	100,000	\$50.00	\$2,000,000	+5%
PFO	8/5/2024	80,000	\$50.00	\$1,600,000	+5%
A	8/5/2024	20,000	\$50.00	\$400,000	+5%
B	8/5/2024	20,000	\$50.00	\$400,000	+5%
C	8/5/2024	200,000	\$50.00	\$400,000	+5%

*Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information.

Next steps: Now is the time to prepare for Item 402(x) disclosure

In light of the upcoming effectiveness of Item 402(x), issuers should consider adopting (or updating) their equity grant policies and guidelines to avoid or limit the need for any tabular Item 402(x) disclosure.

For instance, issuers might consider:

- Generally fixing pre-scheduled equity grant dates so they are scheduled to occur during anticipated open trading windows shortly after an MNPI window is expected to close, and
- Adopting pre-clearance procedures to block or limit grants from being made within a MNPI window and require that such grants be delayed until after the MNPI window closes.

Such changes may help to entirely eliminate or at least minimize the tabular disclosure burdens, streamline the preparation of narrative disclosure regarding grant policies and procedures, and assist issuers with avoiding the impression that any equity grants were made opportunistically with MNPI timing considerations in mind.

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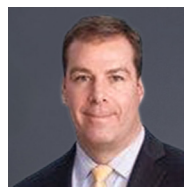


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