Publications

NYSE and NASDAQ Rules on Shareholder Approval of Equity Compensation Plans

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The Securities and Exchange Commission (SEC) recently approved changes to the New York Stock Exchange (NYSE) and NASDAQ rules on shareholder approval of equity compensation plans. 68 Fed. Reg. 39995 (July 3, 2003). The rules were revised as part of a broader effort by the SEC and the markets to enhance corporate governance.

The rules generally require that a companys shareholders approve the adoption or material amendment of an equity compensation plan. The definition of equity compensation plan is quite broad and includes any plan or other arrangement that provides for the issuance of employer equity securities to employees, directors or other service providers. Thus, qualified and nonqualified plans that provide for distributions to participants in the form of company stock may be subject to these rules.

Under the rules, a plan that provides for the deferred delivery of shares will not be considered an equity compensation plan if participants pay the current fair market value for the shares. A deferred compensation plan could thus be exempt from the rules completely if it simply involves executives deferring compensation into a company stock fund and no employer contributions are made into the stock fund and distributed in shares.

The rules also provide that certain equity compensation plans may be approved by a companys independent compensation committee or a majority of the companys independent directors, rather than by shareholders. If plans are approved on this basis, the NYSE or NASDAQ (as applicable) will need to be notified of such approval. Plans subject to this lesser approval requirement include tax-qualified retirement plans (such as 401(k) plans and ESOPs), employee stock purchase plans under Code section 423, and certain parallel nonqualified plans.

A parallel nonqualified plan is defined as a retirement plan that is designed to work in parallel with a qualified retirement plan. The parallel plan must have substantially the same terms as the qualified plan, except that it provides for benefits in excess of the Code limits applicable to the qualified plan (e.g., sections 402(g), 401(a)(17) and 415). A parallel plan also must cover substantially all employees who are participants in the qualified plan and have compensation in excess of the Code section 401(a)(17) limit ($200,000, as adjusted). Finally, a participant may not receive employer equity contributions under the parallel plan in excess of 25% of his cash compensation. Given all these requirements, a large percentage of deferred compensation plans will need to get shareholder approval in any event.

The shareholder approval requirement will clearly apply to option and other omnibus stock award plans, even if no officers or directors are eligible for awards under the plan. The rules also provide examples of the types of amendments to equity compensation plans that will be considered material and, therefore, require shareholder approval. For example, an amendment expanding the types of awards available under a plan or the class of persons eligible to participate in a plan would require shareholder approval. The NYSE rules (but not the NASDAQ rules) provide that, unless a plan specifically permits options to be repriced, a repricing will be deemed a material amendment of the plan requiring shareholder approval.

The rules became effective on June 30, 2003 upon SEC approval. Plans in place before this date are generally exempt from the rules until they are materially amended. However, under the NYSE rules, certain pre-existing plans are exempt from the rules only for a limited transition period, which will end no later than June 30, 2004.