

## NEWSSTAND

### Client Advisory - SEC Proposes Additional Corporate Governance and Compensation Disclosure

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The Securities and Exchange Commission recently proposed additional disclosure requirements<sup>1</sup> for public companies that are expected to apply to next year's proxy season. Companies should consider what new disclosures the proposals would require them to make, particularly if companies are currently contemplating changes to their leadership structure or recruiting new directors. Companies may also want to consider what additional planning and preparation would be required for the expected disclosures, which in some instances may require significant lead times based on director meeting schedules. Further, companies may want to reevaluate certain governance, compensation and risk management arrangements in light of the expected disclosure requirements.

#### ITEMS THAT MAY REQUIRE EARLY ACTION

- Review potential disclosures with Chairman or lead director if there are any contemplated changes in directors or leadership structure
- Review expected disclosure requirements regarding director qualifications with Chair of Nominating Committee
- Review the impact of proposed compensation and risk management disclosures if there are any contemplated changes in compensation models for key business units or managers

The proposals include the following:

#### Additional director information

The following additional disclosures would be required for each director and director nominee:

- **Qualifications.** In light of a company's business, the person's particular experience, qualifications, attributes and skills that qualify that person to serve as a director and, if applicable, as a member of any board committee.
- **Other directorships.** Any directorships at other publicly owned companies held by the person during the last five years. (The existing rule only requires reporting of directorships currently held.)
- **Legal proceedings.** The person's involvement in certain legal proceedings occurring during the last ten years. (The existing rule only requires reporting of involvement in legal proceedings occurring during the last five years.)

Companies may want to consider what additional disclosure would result for directors and director nominees if these proposals are adopted, particularly in light of the longer "look-back" periods. Companies should also consider having their board and/or nominating committee assess and formulate the desired qualifications of company directors and how the current directors and any director nominees meet those qualifications. If these proposals are adopted, companies may need

to incorporate additional board and/or nominating committee meetings into their annual meeting and proxy preparation schedules.

### **Information regarding leadership structure**

The following additional disclosures regarding a company's leadership structure would be required:

- **Rationale for leadership structure.** Description of the company's leadership structure and discussion of why the company believes it is the best structure for the company.
- **Rationale for combined or separate CEO/Chairman, lead independent director.** Discussion of why the CEO and Chairman are separate or combined positions and, if combined, why the company does or does not have a lead independent director and the lead independent director's specific role in the company's leadership structure.
- **Board's role in risk management.** Discussion of the board's role in the company's risk management process and any effect this has on the company's leadership structure.

Companies may want to consider reevaluation of their leadership structure in light of the proposed disclosure requirements, particularly if there are any changes contemplated or pending as to who will fill the leadership positions. If these proposals are adopted, companies will need to plan accordingly to make the necessary assessments and articulate the required disclosures, which may require additional attention at upcoming board or committee meetings.

### **Change in how stock and option awards are reported in compensation tables**

Companies would be required to disclose in the Summary Compensation Table and Director Compensation Table the aggregate grant date fair value of stock and option awards computed in accordance with Statement of Financial Accounting Standards (FAS) No. 123R. Currently, these awards are required to be presented in the tables based on the dollar amount recognized for financial statement reporting purposes for the fiscal year in accordance with FAS 123R, which provides that the value of awards be allocated and reported over the related service or performance periods. As a result, if this proposal is adopted, companies would no longer have to include for any particular year the value of any awards that were granted in prior years. Companies would need to recalculate the list of their most highly-paid executives as the value of awards granted to each recipient could vary considerably from year to year, particularly for newly hired executives, and could even change which executive officers will be included in the tables from year to year. While the Commission is considering requiring companies to recalculate prior year's awards included in the tables, it will not require the inclusion of different executive officers in the table for prior periods based on any changes to total compensation resulting from the recalculation of those prior awards.

### **Additional information regarding compensation consultants**

If a compensation consultant or any of its affiliates provides consulting services related to executive or director compensation and provides any additional services to the company, the company would need to describe (i) the additional services; (ii) the aggregate fees paid for the additional services and the aggregate fees paid for the consulting services related to executive or director compensation; (iii) whether the engagement of the consultant for the additional services was made, recommended, subject to screening or reviewed by management; and (iv) whether the board or the compensation committee approved the additional services.

### **Additional discussion of compensation and company risks**

The current Compensation Discussion and Analysis requirements would be expanded to require discussion and analysis of compensation policies and practices for employees generally (i.e., not just named executive officers (NEOs), as is now the

case), if those policies and practices influence employee behavior in ways that create or increase risks and may have a material effect on the company. Examples of situations that could trigger additional disclosure and analysis of compensation policies and practices may include, among others, (i) a business unit that carries a significant portion of the company's risk; (ii) a unit with incentive compensation that is structured significantly differently from other units, or in a way that varies significantly from the overall risk and reward structure of the company; (iii) units that are significantly more profitable than others; and (iv) units where compensation expense is a significant percentage of unit revenues. Companies would also be required to identify the risks and discuss how they are managed. While the Commission has indicated that it believes that this information, if relevant, is currently required disclosure regarding a company's compensation policies and practices for NEOs, this proposal would require analysis of whether discussion is required regarding the compensation and risks relating to non-NEO employees.

### **More timely reporting of shareholder voting results on Form 8-K**

A new item would be added to Form 8-K to require disclosure of shareholder voting results within four business days after the adjournment of a shareholder meeting. In the case of a contested election of directors, companies would be required to file a Form 8-K reporting the preliminary results and then an amendment to the Form 8-K to report the final results. Currently, companies are required to report voting results in the next periodic report, on either Form 10-Q or Form 10-K, covering the quarter in which the meeting occurred.

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In addition to soliciting comments on the proposals, the Commission has also invited comments on other ways to improve proxy statement disclosure, which many interpret as an opportunity for the business community to suggest ways to simplify and reduce required disclosure, especially the detailed compensation disclosure. All comments must be submitted by September 15, 2009.<sup>2</sup>

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<sup>1</sup>The proposals are set forth in SEC Release No. 33-9052, which was issued on July 10, 2009 and is available at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>. The disclosure-related proposals apply primarily to annual meeting proxy statements, but would also apply to registration statements and, in some cases, to Annual Reports on Form 10-K.

<sup>2</sup>Instructions for submitting comments are included in the proposing release.

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This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If you would like further information, please contact the Edwards Angell Palmer & Dodge LLP attorney responsible for your affairs or one of the following members of the firm's Securities and Public Company Practice Group:

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