



## SEC Adopts Enhanced Executive Compensation and Corporate Governance Disclosures

By Vincent A. Vietti

On December 16, 2009, the Securities and Exchange Commission (SEC) adopted amendments to the disclosure requirements relating to executive compensation and other corporate governance matters. The rules will require:

- Enhanced disclosure regarding risk assessment to the extent an issuer's compensation policies are reasonably likely to have a material adverse effect on the issuer;
- Reporting of grant date fair value of equity awards in the summary compensation tables for executive officers and directors;
- Additional disclosure regarding qualification and background of directors and nominees including all public company directorships during the prior five years, and involvement in an expanded list of certain legal proceedings during the prior 10 years, if material (this provision also applies to executive officers);
- New disclosure regarding corporate governance structure;
- New disclosure of fees paid to compensation consultants under certain circumstances; and
- Reporting results of shareholder votes on Form 8-K within four days after the meeting.

The new rules are effective February 28, 2010, and apply to fiscal years ending on or after December 20, 2009.

In subsequent guidance, the SEC confirmed that for issuers with fiscal years ending on or after December 20, 2009:

- The Form 10-K and proxy statement for such issuers must be in compliance with the rules if filed on or after February 28, 2010;
- If such an issuer is required to file a preliminary proxy statement and expects to file its definitive proxy statement on or after February 28, 2010, then the preliminary proxy statement must be in compliance with the rules even if filed before February 28, 2010; and
- If such an issuer files its 2009 Form 10-K before February 28, 2010, and its proxy statement on or after February 28, 2010, the proxy statement must be in compliance with the new proxy disclosure requirements.

For issuers with fiscal years ending before December 20, 2009, the SEC confirmed that:

- The 2009 Form 10-K and related proxy statement for such issuers are not required to be in compliance with the new rules, even if filed on or after February 28, 2010;
- Such issuers will not be required to comply with the new rules until the filing of their Form 10-K for fiscal year 2010. As a result, any

registration statements filed by such issuers before the 2010 Form 10-K is required to be filed would not be subject to the new rules; and

- Such issuers may voluntarily comply. However, if an issuer complies with the revised Summary Compensation Table provisions, it must comply with all of the other new provisions. Such issuers may comply with the other new disclosures without having to comply with all of the new requirements.

### Disclosure of Compensation Policies as They Relate to Risk Management

To address concerns that compensation policies may have become disconnected from long-term financial goals and that incentive compensation policies applicable to non-executives may be important to this assessment, the SEC proposed to require additional disclosure to the Compensation Discussion and Analysis (CD&A) required under S-K Item 402. The new rules require issuers to discuss how their overall compensation policies for employees in general, including non-executive officers, create incentives that can affect such issuer's risk profile and management of that risk, if such policies create risks that are reasonably likely to have a material adverse effect on the issuer. Disclosure will not be part of the CD&A as originally proposed, but

rather included in a separate section of Regulation S-K. The final rules include a non-exclusive list of situations where compensation policies may potentially trigger disclosure. These include compensation policies and practices:

- At business units that are significantly more profitable than others in the company;
- At business units that carry a significant portion of the issuer's risk profile;
- At business units that have compensation policies and practices that are structured in a significantly different manner than other units;
- At business units where compensation expense is a significant percentage of the revenues of such business unit; or
- That vary significantly from the overall risk and reward structure of the issuer, such as where bonuses are awarded based on the accomplishment of a particular task, where the income and risk related to that task extends over a significantly longer time.

The final rules also include illustrative examples of the matters that would potentially be appropriate for an issuer to address if such issuer determines disclosure is required. These include:

- General design of policies and practices for employees whose behavior would be most affected by the incentives established by such policies and practices;
- An issuer's risk assessment or incentive considerations in structuring compensation policies or in awarding and paying compensation;
- How policies relate to the realization of risks resulting from actions of employees in both the short and long term, such as

clawbacks or holding periods;

- Policy regarding adjustments to address changes in risk profiles and material adjustments that have been made as a result of changes in risk profiles; and
- The extent to which the issuer monitors its policies and practices to determine whether its risk management objectives are being met with respect to incentive compensation.

Smaller Reporting Companies. The narrative disclosure regarding risk will not apply to smaller reporting companies. After receipt of comments, the SEC concluded that such issuers are less likely to have the types of policies that have been addressed by the new rules.

### Revised Compensation Tables

The Summary Compensation and Director Compensation Tables have been revised to require issuers to report as compensation the aggregate grant date fair value—computed in accordance with FASB ASC Topic 718 (formerly FAS 123R) of stock and option awards issued during the fiscal year to named executive officers (NEO) and directors, rather than the dollar amount recognized for financial statement reporting purposes for that fiscal year. The full grant date fair value of each award will continue to be included in the Grants of Plan-Based Awards and Director Compensation Tables. With respect to awards, subject to performance conditions, the value of such awards reported in the Summary Compensation, Grants of Plan-Based Awards, and Director Compensation Tables will be computed based upon the probable outcome of the performance condition as of the grant date with footnote disclosure of the maximum value of such awards.

For fiscal years ending on or after December 20, 2009, issuers will be

required to include the full grant date fair value of stock and option awards for each fiscal year required to be included in the table. This will require issuers to recompute the stock awards, option awards and total compensation columns of the Summary Compensation Table to include the full grant date fair value of stock and option awards issued during 2008 and 2007 (2008 in the case of smaller reporting companies). Issuers will not be required to include different NEOs for any preceding fiscal year based on such recomputation or to amend any prior year's disclosure in previously filed reports.

Smaller Reporting Companies. The new rules will be of particular interest to smaller reporting companies as current rules do not require these issuers to disclose the grant date fair value of equity awards. Accordingly, smaller reporting companies will, for the first time, be required to disclose the grant date fair value of equity awards in their compensation tables.

### Director and Nominee Disclosure

The new rules expand the current narrative disclosure requirements regarding directors and nominees to include:

- The specific experience, qualifications or skills that qualify each individual director or nominee to serve as a board member;
- All directorships held at public companies by the individual at any time during the past five years, even if not currently serving on such board; and
- Involvement in certain legal proceedings that occurred during the past 10 years (this provision also applies to executive officers).

Consistent with the current rules, disclosure of involvement in certain

legal proceedings is only required if such involvement is material to an evaluation of the ability or the integrity of such director, nominee or officer. The list of proceedings has been expanded to include:

- Any judicial or administrative proceeding resulting from involvement in mail or wire fraud or fraud in connection with any business activity;
- Any judicial or administrative proceeding based on violations of federal or state securities, commodities, banking or insurance laws and regulations or any settlement to such actions; and
- Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self regulatory organization.

The instructions clarify that settlements of civil proceedings among private parties are not included within the enumerated proceedings.

The new rules also require additional disclosure of whether, and if so, how, a nominating committee considers diversity in identifying director nominees. The SEC did not define diversity, concluding that issuers should be permitted to define diversity in ways they consider appropriate.

Smaller Reporting Companies. Although the proposing release sought comment as to whether any special accommodations should be made for smaller reporting companies, the final rules do not provide any such accommodation. As a result, the foregoing rules will apply to smaller reporting companies.

### **New Disclosure Regarding Board Structure and Role in Risk Oversight**

The new rules require disclosure of whether and why an issuer has chosen

to combine or separate the principal executive officer and board chairman positions, and the reasons why the issuer believes this structure is the most appropriate for such issuer at the time of the filing. If one person serves as both the principal executive officer and chair of the board, issuers must disclose whether and why it has a lead independent director and such director's specific role in the leadership of the board. Issuers must also disclose the extent of the board's role in risk oversight.

### **Use of Compensation Consultants**

In response to investor concerns regarding ancillary services by compensation consultants, the SEC proposed additional disclosure if a compensation consultant plays a role in determining or recommending the amount or form of executive or director compensation and such consultant or any of its affiliates perform additional services for the company. After reviewing numerous comment letters, the SEC adopted a modified version of the proposal designed to enable investors to better assess any potential conflicts. Under the final rule, in addition to the current requirement to disclose the role of compensation consultants in determining or recommending compensation, the following additional disclosure will be required:

- If the board has engaged its own compensation consultant and such consultant or its affiliates provide other non-executive compensation consulting services to the company and the fees for the non-executive compensation consulting services exceed \$120,000 during the issuer's fiscal year, disclosure of the amount of such fees, whether the decision to engage the consultant for non-executive compensation

consulting was made or recommended by management, and whether the board approved such services;

- If the board has not engaged its own consultant, fee disclosure is required if a consultant provides executive compensation consulting services and non-executive compensation consulting services to the issuer and fees exceed \$120,000 during the last completed fiscal year; and
- Fee and related disclosure for consultants who work with management is not required if the board has its own consultant.

The rule does not require disclosure of the nature and extent of additional services provided by compensation consultants and their affiliates as proposed. The SEC concluded that disclosure could cause competitive harm, for example, by revealing confidential and sensitive pricing information, and that critical information about any potential conflict is adequately conveyed through the disclosure of the amount of fees.

### **Prompt Disclosure of Voting Results**

Finally, the new rules accelerate the disclosure of voting results of shareholders meetings by requiring issuers to disclose the results on a Form 8-K under new Item 5.07 within four business days after the meeting at which the vote was held. If the voting results are not definitively determined within such four-day period, issuers are required to disclose the preliminary voting results on a Form 8-K within four business days after the meeting. The issuer would then file an amended Form 8-K within four business days after certification of the final voting results to disclose such final results.

## SMALL CAP SECURITIES UPDATE

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