

Alerts and Updates

SEC FINALIZES PROXY DISCLOSURE ENHANCEMENTS

December 28, 2009

On December 16, 2009, the U.S. Securities and Exchange Commission (SEC) adopted in [Release Nos. 33-9089, 34-61175](#) amendments to its regulations in connection with proxy solicitations and other reports filed with the SEC. By these amendments, the SEC intends to improve the disclosure public companies provide investors regarding compensation and corporate governance. The additional disclosures include information about the relationship of a company's overall compensation policies to risk, director and nominee qualifications, company leadership structure and the potential conflicts of interests of compensation consultants. In addition, the amendments add a new Form 8-K disclosure item for real-time reporting of shareholder voting results.

Effectiveness of Amendments

When the new requirements first become applicable to an issuer's Form 10-Ks and proxy statements depends on the date its fiscal year ends and, in the case of a fiscal year ending on or after December 20, 2009, the date the Form 10-K or proxy statement is filed.

Issuers with Fiscal Years Ending before December 20, 2009. According to [guidance](#) provided by the SEC staff on December 22, 2009, for an issuer with a fiscal year ending before December 20, 2009, the new disclosure requirements will *not* be applicable to its 2009 Form 10-K and related proxy statement, even if those filings are made on or after February 28, 2010, which is the effective date of the amendments. In other words, an issuer with a fiscal year ending before December 20, 2009 will not be required to comply with the new requirements until the filing of its Form 10-K for fiscal 2010.

Issuers with Fiscal Years Ending on or after December 20, 2009. For an issuer with a fiscal year ending on or after December 20, 2009, its 2009 Form 10-K and proxy statement must comply with the new requirements 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 comply with the new requirements, even if filed before February 28, 2010. If such an issuer files its 2009 Form 10-K before February 28, 2010 and its definitive proxy statement on or after February 28, 2010, the proxy statement must comply with the new requirements.

Enhanced Compensation Disclosure

The new regulations add a new paragraph "(s)" to Item 402 of Regulation S-K to require a company (other than a smaller reporting company) to discuss and analyze its compensation policies for all employees, if those compensation policies and practices create risks that are *reasonably likely* to have a material *adverse* effect on the company.¹ The SEC staff indicated that the nature and extent of the specific additional required disclosures will vary, depending on the particular company and its compensation policies.² However, the adopting release provides a non-exhaustive list of situations that could potentially trigger the enhanced disclosure, including the following situations:

- A particular business unit accounts for a significant portion of the company's risk profile;
- The compensation of a particular business unit is structured significantly differently from that of other units;
- A particular business unit is significantly more profitable than other units;
- The compensation expense of a particular business unit represents a significant percentage of the company's revenues; or
- Compensation policies or practices vary significantly from the company's overall risk and reward structure, such as when the timing for performance-based bonuses or incentive awards occurs significantly before receipt of anticipated income or expiration of associated risk to the company.

Unlike the proposed rule, the disclosure and analysis required by the amendments will not be included in the Compensation Discussion and Analysis. Rather, companies affected will make their appropriate disclosures in the compensation section of the proxy statement and Form 10-K.

Under the new requirements, disclosure regarding stock and option awards in the Summary Compensation Table and Director Compensation Table must be based on the aggregate grant date fair value of the awards under FASB ASC Topic 718 (formerly referred to as FAS 123(r)). This replaces currently mandated disclosure of the annual accounting expense of such equity awards. The value of performance awards must be calculated based on the probable outcome of the performance condition(s) determined as of the grant date. The Summary Compensation Table and Director Compensation Table must each include a footnote, if applicable, reporting the maximum value that can be earned under a performance award, assuming the highest level of the performance condition(s) is probable. Companies will also be required to recalculate amounts included in each table for the prior fiscal years presented in the table based on the new standard.

Enhanced Director and Nominee Disclosure

Item 401 of Regulation S-K, as amended, requires disclosure for each director and any nominee for director of the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company.³ The amendment also requires disclosure of any directorships at public companies and registered investment companies held by each director or nominee at any time during the past five years (including any directorships no longer held), lengthens from five to ten years the period of time for which disclosure of legal proceedings is required, and expands the types of legal proceedings that must be disclosed. Item 407, as amended, regarding corporate governance, requires a discussion of whether, and, if so, how, the nominating committee or board considered "diversity" in identifying director nominees. However, the SEC does not define "diversity" and, instead, recognizing that companies may define diversity in various ways, reflecting different perspectives, allows companies to define diversity "in ways that they consider appropriate."

New Disclosure about Board Leadership Structure and Risk Oversight

Item 407 of Regulation S-K (and corresponding Item 7 of Schedule 14A under the proxy rules), as amended, requires a company to include disclosure of its board's leadership structure and the reasoning behind that structure. Specifically, a company is required to disclose whether it has chosen to combine or separate the positions of principal executive officer and board chairman, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company. If a company has combined the roles of principal executive officer and board chairman, and a lead independent director is designated to chair meetings of the independent directors, the company must disclose whether and why it has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. The final rule also requires discussion of the extent of the board's role in the oversight of risk, including how the board administers its risk oversight function, such as through the entire board or through a designated committee, and the effect the board's role has on the board's leadership structure. The SEC also suggests that companies, where relevant, may want to address whether the individuals who supervise day-to-day risk management responsibilities report directly to the board as a whole or to a board committee or how the board or committee otherwise receives information from such individuals.⁴

New Disclosure Regarding Compensation Consultants

Currently, Item 407 of Regulation S-K requires disclosure of the role of a compensation consultant in determining or recommending the amount or form of executive and director compensation. In order to provide investors with information to enable them to better assess the potential conflicts of interest that a compensation consultant may have in recommending executive compensation, and the compensation decision made by the board, amended Item 407 will now require companies to disclose whether the board's compensation consultant provides other non-executive compensation consulting services to the company and, if the fees paid for the additional services exceed \$120,000 during the company's fiscal year, to disclose the compensation to the consultant or its affiliates for executive and director compensation services and the fees paid for the other services.⁵ The company must also disclose whether the decision to engage the compensation consultant for non-executive compensation consulting services was made or recommended by management, and whether the board has approved these non-executive compensation consulting services. If the board has not engaged its own consultant, fee disclosures are required if there is a consultant providing executive compensation consulting services and non-executive compensation consulting services to the company, provided that the fees for the non-compensation consulting services exceed \$120,000 during the company's fiscal year.⁶ Disclosure is not required regarding fees for non-executive compensation consulting services paid to compensation consultants who provide services only with respect to broad-based plans that do not discriminate in favor of executive officers or directors of the company or additional limited information-providing services.⁷

Reporting of Voting Results on Form 8-K

To expedite the timely reporting of shareholder voting results, the amendments transfer the requirement to disclose voting results from Forms 10-Q or 10-K to Form 8-K. New Item 5.07 in Form 8-K requires the preliminary or final shareholder voting results to be filed within four business days following the end of the meeting at which the vote was held. If the final results cannot be reported in the original Form 8-K, the final results must be reported in an amendment to the original report within four business days after the final voting results are known.

Proxy Solicitation Enhancements

Consideration of certain amendments governing the proxy solicitation process, which were included in the proposed rule, were deferred until a later time.

Looking Ahead

The enhanced disclosure requirements discussed above continue the SEC's recent trend of reforming executive compensation policies while increasing board accountability to shareholders. Publicly held companies should consider examining existing compensation/risk management processes and practices, as well as D&O questionnaires and board committee charters and organizational structure, to be prepared to timely respond to the new disclosure requirements. In view of the SEC's increased expectations regarding executive compensation practices, some compensation committees may wish to consider retaining independent legal counsel.

For Further Information

If you have any questions regarding the foregoing enhanced disclosure requirements, including how they may affect your company, please contact one of the [members](#) of the [Securities Law Practice Group](#) or the lawyer in the firm with whom you are regularly in contact.

Notes

1. The SEC states that "by focusing on risks that are 'reasonably likely to have a material adverse effect' on the company, the amendments are intended to elicit disclosure about incentives in the company's compensation policies and practices that would be most relevant to investors." However, a company is not required to affirmatively disclose that the risks arising from its broader compensation policies are not reasonably expected to have a material adverse effect on the company.
2. If a company determines that disclosure is required, the SEC suggests that disclosure should include the general design philosophy of the company's policies and practices, as such policies and practices relate to or affect risk taking by those employees who are so incentivized; the company's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices; and the extent to which the company monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.
3. The SEC states that the amendments will provide investors with more meaningful disclosure "that will help them to determine whether and why a director or nominee is an appropriate choice for a particular company." Nevertheless, the SEC did not adopt in the final regulations a proposed amendment for disclosure of a director's or

nominee's "risk assessment skills," although the SEC notes that if particular skills, such as risk assessment expertise, were part of the specific experience, qualifications, attributes or skills that led the board or proponent to conclude that the person should serve as a director, this should be disclosed.

4. The SEC states that disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company.
5. The SEC states that the extent of the fees and provision of additional services by a compensation consultant or its affiliate may create the risk of a conflict of interest that may call into question the objectivity of the consultant's advice and recommendations of executive compensation.
6. The SEC states that disclosure of consultant fees is not required if the board and management have different compensation consultants, even if management's consultant provides additional services to the company (so long as the board's consultant does not provide additional services to the company). According to the SEC, this exception would be available without regard to whether the management's consultant participates in board meetings.
7. According to the SEC, its amendments as adopted are intended to facilitate investors' consideration of whether, in providing advice, a compensation consultant may have been influenced by a desire to retain other engagements from the company. The SEC further states that "this does not reflect a conclusion that we believe that a conflict of interest is present when disclosure is required under our new rule, or that a compensation committee or a company could not reasonably conclude that it is appropriate to engage a consultant that provides other services to the company requiring disclosure under our new rule. It also does not mean that we have concluded that there are no other circumstances that might present a conflict of interest for a compensation consultant retained by a compensation committee or company." Rather, the new disclosure is intended to provide context to investors for their evaluation purposes.