



Securities Briefing Vol. 8, No. 1

January 5, 2010

New SEC Disclosure Requirements for the 2010 Proxy Season and New Reporting of Voting Results

On December 16, 2009, the Securities and Exchange Commission (the "**SEC**") published final rules (the "**Amendments**")¹ that considerably expand the required disclosures public companies must make in their proxy statements. The adopted Amendments make new or revised disclosures about compensation policies and practices that present material risks to the company, stock and option awards of executives and directors, director and nominee qualifications and legal proceedings, board leadership structure, the board's role in risk oversight, and potential conflicts of interest of compensation consultants that advise companies and their boards of directors. The Amendments apply to proxy statements, information statements, annual reports, and registration statements under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. The Amendments also transfer the requirement to disclose shareholder vote results from Forms 10-Q and 10-K to Form 8-K.

The Amendments are effective February 28, 2010 and it is believed that this effective date applies to the filing of proxies after February 28, 2010. The purpose of the Amendments are to improve disclosures regarding compensation and corporate governance and to provide a "more transparent view of these key risk, governance, and compensation matters [to] help shareholders make more informed voting and investment decisions."

Overview of the Proxy Disclosure Enhancements

Primary Areas Affected by the Amendments

- **Risk.** The Amendments require disclosure regarding the board's role in risk oversight and "to the extent that risks arising from a company's compensation policies and practices for employees are reasonably likely to have a material adverse effect on the company, disclosure about such policies and practices as they relate to risk management." The Amendments involve discussion of a company's compensation policies or practices related to "risk management and risk-taking incentives that can affect the company's risk and management of that risk."
- **Governance and Director Qualifications.** The Amendments require more disclosure of directors and director nominees' background and qualifications and new disclosure about a company's board leadership structure. The Amendments call for:

- More information on directors and nominees' qualifications and experience, including any directorships held by each director and nominee during the past five years at a public company.
- New disclosure on the nominating committee's consideration of diversity when considering director candidates.
- Discussion on board leadership and its role in oversight of risk.
- More disclosure of legal actions involving the executive officers, directors, and nominees for directors for the past 10 years.
- Compensation. The Amendments modify the reporting of stock and option awards in the Summary Compensation Table and Director Compensation Table and require disclosure of possible conflicts of interest of compensation consultants in certain situations. The Amendments require:
 - Reporting of the aggregate grant date fair value of stock awards and option awards granted in the fiscal year, computed pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 718 (rather than the dollar amount recognized for financial statement purposes).
 - New disclosure of the fees paid to compensation consultants in certain situations.
- Reporting of Voting Results on Form 8-K. New Item 5.07 to Form 8-K requires companies to disclose the results of a shareholder vote and to file that information within four business days of the meeting at which the vote was held.

Compensation Programs and Risk Management—New Disclosures

- The Amendments require a company to "address its compensation policies and practices for all employees, including non-executive officers, if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company." The disclosure is focused on material adverse effects.
- The new disclosures cover all employees, not just named executive officers.
- The new disclosures are limited to risks arising from compensation programs that are reasonably likely to have a material adverse effect.
- The disclosures will vary depending on the particular facts and a company's specific compensation program.
- Under appropriate circumstances, a company may conclude that its compensation policies and practices are not reasonably likely to have a material adverse effect on the company; however, there is no requirement to make an affirmative statement to that effect.
- Investors would benefit from disclosure of material information related to how the company "compensates and incentivizes its employees that may create risks that are reasonably likely to have a material adverse effect on the company."
- Although the new requirements are not a part of CD&A but are included as a separate paragraph of Item 402 of Regulation S-K, these requirements regarding compensation policies do not apply to smaller reporting companies.

Examples of situations that could trigger discussion and analysis disclosure

- Business unit that carries a significant portion of the company's risk profile
- Business unit with a significantly different compensation structure from other units
- Business units that are significantly more profitable than others or where compensation expense is a material percentage of the unit's revenues
- Compensation policies which vary significantly from overall risk and reward structure of the company

Examples of issues a company may need to address

- General design philosophy of compensation policies for employees whose behavior would be most affected
- Risk assessment or incentive considerations used in structuring, rewarding, and paying compensation
- Policies which address short-term and long-term compensation risks
- Any material adjustments made to compensation policies/practices due to changes in the company's risk profile
- The extent to which the company monitors its compensation policies to determine whether its risk management objectives are being met

Revisions to the Summary Compensation Table and Reporting of Equity Awards

- The Amendments modify the manner in which stock and option awards are disclosed in the Summary Compensation Table and Director Compensation Table.
 - The Amendments require disclosure of the aggregate grant fair value of awards computed pursuant to FASB ASC Topic 718.
 - Previous disclosure required companies to disclose the dollar amount recognized for financial statement reporting purposes for the fiscal year in accordance with FASB ASC Topic 718.
- Disclosure of full grant date fair value provides investors with useful information. Investors may consider compensation decisions made throughout the fiscal year to be material to their voting and investment decisions.
- The aggregate grant date fair value disclosure is a better reflection of the compensation committee's decisions concerning stock and option awards.
- The value of the performance awards disclosed in the Summary Compensation Table, Grants of Plan-Based Awards Table, and Director Compensation Table should be computed based upon the "probable outcome of the performance condition(s) as of the grant date because that value better reflects how compensation committees take performance-contingent vesting conditions into account in granting such awards."
- The Summary Compensation Table and Director Compensation Table require footnote disclosure of the maximum value assuming the highest level of performance conditions is probable. Such disclosure provides investors with "additional information about an award's potential maximum value subject to

changes in performance outcome."

- The Amendments require disclosure of awards granted during the year as opposed to awards granted for services in a prior year.
- Contrary to the proposed rules, the requirement to report the full grant date fair value of each equity award in the Grants of Plan-Based Awards Table and Director Compensation Table has been retained.
- Companies must continue analyzing in CD&A their choice to grant post-fiscal year end equity awards where such decisions could impact a reasonable understanding of named executive officers' compensation for the prior fiscal year.
- Companies with fiscal years ending on or after December 20, 2009 which provide 402 disclosure must "present recomputed disclosure for each preceding fiscal year required to be included in the table, so that the stock and option awards columns present the applicable full grant date fair values, and the total compensation column is correspondingly recomputed."

Additional Disclosures: Compensation Consultants' Fees and Services

- Consultants engaged by the board or compensation committee. Fees and related disclosures are required if the compensation consultant provided recommendations on the amount or form of executive and director compensation and provided other consulting services for a fee in excess of \$120,000 for the last completed fiscal year. Disclosure related to whether the decision to engage the consultant was made by management and whether the board approved the non-executive compensation services is also required.
- Consultants not engaged by the board. If a consultant provides both executive compensation services and non-compensation services, and the fees for the non-executive compensation services exceed \$120,000 for the fiscal year, disclosure is required.
- If the board and management have different consultants, fee disclosure is not required for those consultants who work with management, even if management's consultant provides other services to the company.
- For purposes of the compensation consultant disclosures, services relating only to broad-based nondiscriminatory plans or providing information (i.e., surveys) that are not company-customized, or if customized, are based on parameters determined by another (other than the consultant), are not treated as executive compensation consulting services.
- Required new disclosures include:
 - Aggregate fees for determining executive compensation and other services
 - Whether decision to engage consultant was made or recommended by management
 - Whether compensation committee or the board approved such other services in addition to executive compensation services
 - Disclosure of the nature and extent of additional services is not required

Board Governance Proposals: Director and Nominee Disclosures

- The Amendments provide investors with more information to better enable them to determine whether and why a director or nominee is an appropriate choice for the company.
- The Amendments expand the current disclosures regarding directors and nominee experience by requiring, on an annual basis, specific disclosure of particular "experience, qualifications, attributes, or skills" that qualify that person to serve as a director.
- The Amendments do not indicate the particular information to be disclosed.
- Any directorship held by each director and nominee at any time during the past five years at public companies must be disclosed.
- Required disclosure of certain legal proceedings occurring in the prior ten years, including:
 - any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity;
 - any judicial or administrative proceedings based on violations of federal or state securities, commodities, banking or insurance laws, and regulations or any settlement to such actions; or
 - any disciplinary sanctions or doers imposed by a stock, commodities or derivatives exchanges or other self-regulatory organization.
- Required disclosure of whether and how the nominating committee considered diversity in identifying nominees for director.

Board Governance Proposals: Company Leadership Structure and Board's Role in Risk Management

To provide investors with more transparency and significant information regarding a company's corporate governance practices, the Amendments require or encourage disclosure regarding:

- Board leadership structure and why the company has determined that its board leadership structure is appropriate for the company
- The board's role in the company's risk oversight (such as credit risk, liquidity risk, and operational risk)
- 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"
- Whether and why a company has combined or separated the principal executive officer and board chair positions
- Why the company feels its particular leadership structure is the most suitable for the company
- Whether and why the company has a lead independent director and the role such director has in the leadership of the company, in certain situations
- The vote results from a meeting of shareholders on Form 8-K generally within four business days of the meeting

Copy of SEC Final Rules Regarding Proxy Disclosure



A copy of the final SEC proxy disclosure enhancements is available on the SEC's Web site at www.sec.gov.

[1] All quotes in this publication are from SEC Release Nos. 33-9089, Proxy Disclosure Enhancements.

This article is provided for general informational purposes only and should not be construed as legal advice or legal opinion on any specific facts or circumstances. You are urged to consult a lawyer concerning any specific legal questions you may have.