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## SEC Proposes Enhanced Executive Compensation and Corporate Governance Proxy Disclosure

On July 10, 2009, the Securities and Exchange Commission released proposed amendments to enhance the executive compensation and corporate governance disclosures that companies are required to include in their proxy statements and other reports filed with the SEC. The proposed rules would:

- require certain companies to discuss how their compensation policies affect risk management and the role the board of directors plays in the risk management process;
- require discussion of a company's leadership structure, e.g., why it has decided to combine (or separate) the roles of board chair and CEO;
- require companies to disclose additional information about qualifications of directors and nominees and potential conflicts with compensation consultants; and
- require companies to include the aggregate grant date fair value of equity awards in the Summary Compensation Table and Director Compensation Table rather than the amount recognized for financial statement reporting purposes.

The SEC also proposed requiring disclosure of shareholder voting results within four business days on a Form 8-K and amending proxy rules to address technical issues that have arisen in the proxy solicitation process.

### Compensation Policies and Risk Management

The SEC noted that current executive compensation disclosure may not provide

sufficient information about the risks produced by a company's compensation programs. The proposed rules would require a company to disclose in its CD&A how its compensation policies or practices create incentives that can affect risks and to disclose how the company manages those risks. Unlike the CD&A generally, this disclosure is not limited to policies or practices affecting executive officers, but this disclosure would only be required if the company's policies or practices may have a material effect on the company. Consequently, the requirement to provide this disclosure will vary depending on the company and its compensation policies and practices. Several situations that may trigger disclosure are identified in the proposed rules, including compensation policies and practices:

- at a business unit that carries a significant portion of the company's risk profile or is significantly more profitable than others within the company;
- at a business unit with compensation structured significantly differently than other units or where the compensation expense is a significant percentage of the unit's revenues; or
- that vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time.

For companies whose compensation policies or practices may give rise to risks that have a material effect on the company, the proposed rules identify several examples of issues that, depending on the

particular company, may need to be addressed, including:

- the general design philosophy of the compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk taking by those employees, and the manner of its implementation;
- the company's risk assessment or incentive considerations, if any, in structuring its compensation policies or in awarding and paying compensation;
- how the company's compensation policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring clawbacks or imposing holding periods;
- policies regarding adjustments to its compensation policies to address changes in its risk profile;
- material adjustments made to compensation policies or practices as a result of changes in risk profile; and
- the extent to which the company monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

The SEC believes that investors will benefit from disclosure about how a company rewards and incentivizes its employees to the extent it creates risk to the company and that investors will be able to identify more easily whether a company has implemented compensation policies or practices that can lead to excessive or inappropriate risk taking by employees.

### **Company Leadership Structure and Board Role in Risk Management**

The proposed rules would require a company to describe its leadership structure in its proxy statement and also discuss why the company

believes it is the best structure for it at the time of the filing. In connection with this disclosure, companies would be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. A company that combines the principal executive officer and board chair roles would be required to disclose whether the company has a lead independent director and the reasons, as well as the specific role the lead independent director plays in the leadership of the company. The proposed rule is intended to provide investors with additional information about how the company's board functions.

The role of the board in the risk management process would also need to be disclosed. The SEC believes that investors will benefit from an understanding of how a company's senior management and board manage the risks that the company faces, particularly in light of the role that risk and the adequacy of risk oversight have played during the recent market crisis.

### **Directors and Nominees**

The proposed rules would require a company to disclose, for each director or nominee, the specific experience, qualifications, attributes or skills that qualify that person to serve as a director, and as a member of any committee, at the time that the disclosure is made. Companies may, for example, describe a director's or nominee's risk assessment skills or other area of expertise and any specific past experience that would be useful to the company and why the director's or nominee's experience and skills would benefit the company. The SEC believes that providing investors with more meaningful disclosure about directors and nominees will help investors to choose board members that are good fits for a particular company.

In addition, the SEC is proposing to require disclosure of any directorships at other public companies held by a director or nominee at any time during the past five years (companies are

now only required to disclose current director positions at other public companies). It is also proposed that legal proceedings involving directors or nominees be disclosed for the past 10 years rather than for five years as under the current rules. The changes are intended to allow investors to better evaluate the relevance of a director's or nominee's past board memberships and, with respect to disclosure of legal proceedings, an individual's competence and character.

### Compensation Consultants

Companies are currently required to describe any role played by compensation consultants in determining or recommending the amount or form of executive and director compensation and identify any such consultant and, among other things, the nature and scope of its assignment. In addition to providing recommendations on executive compensation, many compensation consultants provide additional services to companies, such as benefits administration, human resources consulting and actuarial services. These additional services can generate fees for compensation consultants that are in excess of the fees earned from their executive compensation services. This has raised concerns among the SEC and investors that the independence of these compensation consultants may be compromised by the fees generated from the provision of additional services. The proposed rules would thus require a company to disclose the fees it pays to a compensation consultant (or its affiliates) if the compensation consultant provides services to the company in addition to executive compensation services. A company would also be required to disclose whether the decision to engage the compensation consultant for non-executive compensation services was approved by the board of directors or the compensation committee.

### Equity Awards

The proposed amendments would require that the aggregate grant date fair value (computed in accordance with FAS 123R) of stock and option

awards be reported in the Summary Compensation Table (and corresponding table for directors) included in proxy statements, rather than the currently required dollar amount recognized for financial statement reporting purposes during the fiscal year.

Under the SEC's originally announced executive compensation disclosure format in 2006, companies would have been required to disclose the aggregate grant date fair value of equity awards. Shortly before those executive compensation disclosure rules became effective, the SEC adopted the current disclosure requirement for reporting the financial statement charge for equity awards.

Since the adoption of the current rule, the SEC has received comments from investors that the disclosure that investors find most useful is the full grant date fair value of equity awards made during the covered fiscal year because it allows them to better evaluate the amount of equity compensation awarded during such fiscal year and the decisions of a company's compensation committee. The SEC believes that disclosure of the full grant date fair value measure will indicate which executives the company intends to compensate most highly and will also facilitate a CD&A that clearly explains a company's compensation policies and decisions.

The amendments would also:

- rescind the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table (and corresponding disclosure with respect to directors) in order to avoid duplication of information with the revised Summary Compensation Table (and corresponding table for directors); and
- amend the Summary Compensation Table to provide that companies will not be required to report in the salary and bonus columns the amount of salary or bonus forgone at a named executive officer's election, and that non-cash awards received instead are reportable in the

column applicable to the form of award elected, so that the disclosure in the table reflects the form of compensation ultimately received by the named executive officer.

### Shareholder Voting Results

The SEC also proposes to require a company to disclose on Form 8-K the results of any shareholder vote, which would generally require such results to be filed within four business days after the end of the meeting at which the vote was held. If definitive vote results are not available within that time frame for a contested election of directors, companies would be required to disclose on Form 8-K the preliminary voting results within four business days after such preliminary voting results are determined, and file an amended report on Form 8-K within four business days after the final voting results are certified. A company is currently required to report the results of a shareholder vote in its Form 10-Q / 10-K.

### Proxy Solicitation Process

The SEC is also proposing to adopt certain technical amendments to the proxy solicitation rules in order to provide greater certainty to soliciting parties, help shareholders receive timely and complete information and facilitate shareholder voting. The amendments would:

- clarify that, when a person provides to a shareholder an unmarked copy of management's proxy card (in connection with, for example, a "just vote no" campaign) with a request that it be returned directly to management, this is not a "form of revocation" disqualifying the person from relying on an exemption from certain proxy soliciting rules even if the solicited shareholder uses the duplicate proxy card to revoke the shareholder's prior vote;
- clarify that a soliciting person with a substantial interest in the subject matter of a solicitation must comply with proxy disclosure obligations

even if the soliciting person's interest is not related to security holdings in the company;

- permit a person soliciting in support of nominees who, if elected, would constitute a minority of the board (i.e., a short slate) to round out its short slate with another soliciting person's nominees or management's nominees;
- require that conditions under which shares represented by a proxy will not be voted be objectively determinable; and
- clarify that information about the identity and interests of participants in a proxy solicitation must be filed with Schedule 14A or other soliciting materials no later than the time the first soliciting communication is made.

Comments on the proposed rule changes may be submitted to the SEC until September 15, 2009. A complete copy of SEC Release No. 33-9052 can be found at

<http://sec.gov/rules/proposed/2009/33-9052.pdf>.

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