



New SEC Proxy Disclosure Rules

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Introduction

- On December 16, 2009, the SEC adopted new rules that substantially revise disclosure rules relating to executive compensation programs and modify current disclosure rules relating to corporate governance matters
 - Improve the disclosures shareholders receive regarding compensation and corporate governance in response to shareholders' increasing focus on corporate accountability and desire for additional information to make more informed voting and investment decisions
 - Provide investors with meaningful disclosure in order for an investor to evaluate how effectively a company is managing risk and compensation generally

Overview

- New rules require:
 - Disclosure of how compensation policies and practices affect risk management
 - Inclusion of the aggregate grant date fair value of equity awards in the Summary Compensation Table and Director Compensation Table
 - Disclosure of additional information about payments to and potential conflicts with compensation consultants
 - Discussion of board leadership structure
 - Discussion of the role the board plays in the risk oversight process
 - Disclosure of additional information about the background and qualifications of directors and nominees and legal proceedings involving executive officers, directors and nominees
 - Disclosure of consideration by the nominating committee of diversity in the director nomination process
 - Disclosure of shareholder voting results within four business days on a Form 8-K

Overview

- Final rules are substantially similar to the rules proposed in July 2009
- The SEC deferred consideration of proposed amendments to the proxy solicitation process included in the proposing release pending its continuing consideration of its separate proxy access proposal
- Other legislative developments relating to corporate governance and executive compensation
 - Mandatory “Say on Pay”
 - Mandatory Majority Voting
 - Separate Chair and CEO positions

Effective Date and Transition Rules

- Effective date: 2/28/2010
- Issuers with fiscal years ending before 12/20/2009
 - 2009 10-K and proxy statement are not required to comply with the new rules even if filed on or after 2/28/2010
 - Not required to comply with the new rules in their Securities Act or Exchange Act registration statements until the filing of their 2010 Form 10-K

Effective Date and Transition Rules

- Issuers with fiscal years ending on or after 12/20/2009
 - Form 10-K and proxy statement must be in compliance with the new rules if filed on or after 2/28/2010
 - If required to file a preliminary proxy statement and expect to file definitive proxy statement on or after 2/28/2010, then the preliminary proxy statement must comply with the new rules even if filed before the effective date
 - If file 2009 Form 10-K before 2/28/2010 and proxy statement on or after 2/28/2010, the proxy statement must comply with the new rules
 - If file a Securities Act or Exchange Act registration statement on or after 12/20/2009, must comply with the new rules for the registration statement to be declared effective on or after 2/28/2010
 - If the registration statement is on Form S-3, which incorporates by reference the issuer's 2009 Form 10-K, compliance with the new rules is not required if 10-K filed before 2/28/2010

Effective Date and Transition Rules

- New Registrants
 - If a new registrant first files its registration statement on or after 12/20/2009, compliance with the new rules would be required for the registration statement to be declared effective on or after 2/28/2010
- Voluntary Compliance
 - An issuer that is not required to comply with the new rules may voluntarily comply with the new rules in its 2009 Form 10-K and proxy statement
 - May voluntarily comply with the new rules on a selective basis (i.e., include some, but not all, of the disclosures required by the new rules)
 - If an issuer voluntarily complies with the new rules relating to the SCT and DCT, it must comply with all of the new Regulation S-K rules

Effective Date and Transition Rules

- If a shareholder meeting takes place on or after 2/28/2010, an issuer must report shareholder voting results within four business days
 - If the meeting takes place before that date, no Form 8-K is required and disclosure of shareholder voting results should be included in next Form 10-K or Form 10-Q
 - If the Form 10-K or Form 10-Q is due on or after 2/28/2010, the results of the meeting should be reported in the “Other Information” Item, rather than in the “Submission of Matters to a Vote of Security Holders” Item, which will be deleted from Form 10-K and Form 10-Q on 2/28/2010

Enhanced Compensation Disclosure

- A company must disclose in its proxy statement (1) how its compensation policies or practices create incentives that can affect risks and (2) how the company manages those risks ***if*** the company's policies or practices create risks that are reasonably likely to have a material adverse effect on the company (when viewed as a whole)
 - Enable investors to evaluate whether a company's compensation policies or practices create incentives that could lead to excessive risk taking
 - Disclosure, if required, will vary depending on the company and its compensation policies and practices
 - Disclosure is not limited to policies or practices affecting executive officers — it relates to all employees
 - Smaller reporting companies are exempt from providing the new disclosure

Enhanced Compensation Disclosure

- Situations that may trigger disclosure include 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
 - Has a significantly different compensation structure than other units or has compensation expense that is a significant percentage of the unit's revenues
 - 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

Enhanced Compensation Disclosure

- If disclosure is required, issues that companies may need to address include:
 - The general design philosophy of the compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as they relate to or affect risk taking by those employees on behalf of the company, and the manner of their implementation
 - Risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation
 - How the compensation policies and practices 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 and practices to address changes in its risk profile
 - Material adjustments the company has made to its compensation policies and practices as a result of changes in its risk profile
 - 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

Enhanced Compensation Disclosure

- Changes from the proposing release:
 - The SEC imposed a higher disclosure threshold (“reasonably likely to have a material adverse effect”) from the threshold proposed (“may have a material effect”)
 - Higher threshold is similar to the MD&A disclosure threshold and is intended to elicit only those disclosures that would be most relevant to investors
 - Focus on adverse effects also allows companies to consider mitigating factors (e.g., clawbacks) designed to limit risks of certain compensation arrangements in its assessment
 - No requirement to make an affirmative statement to the effect that risks arising from compensation practices are not reasonably likely to have a material adverse effect

Enhanced Compensation Disclosure

- Changes from the proposing release (cont.):
 - Disclosure separate from CD&A — avoid the confusion that may have arisen if the CD&A were to be expanded beyond a company's NEOs to include a discussion of compensation policies applicable to all employees
 - New disclosure will be outside the scope of the Compensation Committee report required by S-K 407(e)(v)
 - SEC recommends presenting the new disclosure with a company's other Item 402 disclosures — SEC would have concerns if the disclosure is “difficult to locate” or is “presented in a fashion that obscures it”
 - To the extent that risk considerations are a material aspect of the company's compensation policies or decisions for NEOs, companies are required to discuss them as part of their CD&A under the current rules

Enhanced Compensation Disclosure

- Practical Considerations:
 - Conduct a risk assessment of compensation policies and practices to determine whether disclosure is required
 - Review performance-based compensation plans and arrangements to determine whether these plans and arrangements could lead to excessive risk taking, and the company's ability to identify and manage those risks
 - Review any mitigating elements of those plans and arrangements (e.g., clawbacks, hold-through-retirement policies, etc.)
 - Analyze controls and risk management system in connection with the assessment
 - Companies may decide to include some form of this new disclosure voluntarily
 - Such disclosures may focus on the risk assessment undertaken by management and/or the board and any mitigating factors in compensation plans and arrangements

Enhanced Compensation Disclosure

- RiskMetrics has added “excessive risk-taking” to its list of problematic pay practices and will assess a company’s compensation policies and practices that could encourage excessive risk-taking
- Assessment will also consider mitigating factors (e.g., clawbacks, stock ownership and holding requirements, etc.)

“Excessive Risk Taking” Practices

- Guaranteed bonuses
- Single performance metric for short-term or long-term incentive pay plans
- Lucrative severance packages
- High pay opportunities relative to industry peers
- Disproportionately large supplemental pensions
- “Mega annual” equity awards that provide unlimited upside with no downside risk

Enhanced Compensation Disclosure

- RiskMetrics’ “Problematic Pay Practices”

Most Problematic Pay Practices	
Type	Examples
Egregious Contracts	<ul style="list-style-type: none"> • Contracts containing multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation
New CEO with Overly Generous New-Hire Package	<ul style="list-style-type: none"> • Excessive “make whole” provisions without sufficient rationale • Any of the problematic pay practices listed in the policy
Abnormally Large Bonus Payouts Without Justifiable Performance Linkage or Proper Disclosure	<ul style="list-style-type: none"> • Includes performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance
Egregious Pension/Supplemental Executive Retirement Plan Payouts	<ul style="list-style-type: none"> • Inclusion of additional years of service not worked that result in significant benefits provided in new arrangements • Inclusion of performance-based equity awards in the pension calculation
Excessive Perquisites	<ul style="list-style-type: none"> • Perquisites for former and/or retired executives, such as lifetime benefits, car allowances, personal use of corporate aircraft or other inappropriate arrangements • Extraordinary relocation benefits (including home buyouts)

Enhanced Compensation Disclosure

Most Problematic Pay Practices	
Type	Examples
Excessive Severance and/or Change-in-Control Provisions	<ul style="list-style-type: none"> • Change-in-control payments exceeding three times base salary and bonus • Single-trigger change-in-control payments without a second step loss of job or substantial diminution of job duties • New or materially amended employment or severance agreements that provide for modified single triggers, under which an executive may voluntarily leave for any reason and still receive the change-in-control severance package • New or materially amended employment or severance agreements that provide for an excise tax gross-up • Modified gross-ups would be treated in the same manner as full gross-ups
Tax Reimbursements	<ul style="list-style-type: none"> • Reimbursement of income taxes on certain executive perquisites or other payments (for example, personal use of corporate aircraft, executive life insurance, bonus, etc; see also excise tax gross-ups above)
Dividends or Dividend Equivalents	<ul style="list-style-type: none"> • Dividends or dividend equivalents paid on unvested performance shares or units
Company Stock Hedging Activities	<ul style="list-style-type: none"> • Executives using company stock in hedging activities, such as “cashless” collars, forward sales, equity swaps or other similar arrangements
Underwater Stock Options	<ul style="list-style-type: none"> • Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts)

Enhanced Compensation Disclosure

Other Problematic Pay Practices	
Type	Examples
Excessive Severance and/or Change-in-Control Provisions	<ul style="list-style-type: none"> • Payments upon an executive's termination in connection with performance failure • Liberal change-in-control definition in individual contracts or equity plans which could result in payments to executives without an actual change-in-control occurring
Overly Generous Perquisites	<ul style="list-style-type: none"> • Perquisites such as: <ul style="list-style-type: none"> • personal use of corporate aircraft • executive life insurance • personal security systems maintenance and/or installation • car allowances
Internal Pay Disparity	<ul style="list-style-type: none"> • Excessive differential between CEO total pay and that of next highest-paid named executive officer
Voluntary Surrender of Underwater Options by Executive Officers	<ul style="list-style-type: none"> • May be viewed as an indirect option repricing/exchange program especially if canceled options are returned to the equity plan, as they can be regranted to executive officers at a lower exercise price, and/or the executives subsequently receive unscheduled grants in the future

Reporting Equity Awards

- The aggregate grant date fair value of stock and option awards, computed in accordance with FASB ASC Topic 718 (the codification of SFAS 123(R)) must be reported in the SCT and DCT, rather than the dollar amount recognized for financial statement reporting purposes during the fiscal year
- Value of performance awards reported in the SCT, DCT and the Grants of Plan-Based Awards Table computed based upon the probable (generally, target) outcome of the performance condition(s) as of the grant date and not the amount payable for maximum performance
 - Include a footnote to the table disclosing the maximum value of the performance award assuming the highest level of performance conditions is achieved
- Report in SCT and DCT incremental fair value of equity awards, computed in accordance with FASB ASC Topic 718, that are repriced or materially modified during the fiscal year

Reporting Equity Awards

- Present recomputed disclosure of the value of equity awards and total compensation for each prior fiscal year required to be included in the SCT for the NEOs included based on the determination of NEOs for the most recently completed year
 - Stock awards and option awards columns should present the applicable full grant date fair values
 - The total compensation column for those years should be correspondingly adjusted
 - Companies are not required to include different NEOs for any prior fiscal year based on recomputing total compensation for those years, or to amend the SCT in prior years' filings
 - If an individual is a NEO for 2009 and that individual was also a NEO in 2007, but not 2008, compensation for all three years is required in the SCT

Reporting Equity Awards

- Changes from the proposing release:
 - SEC had proposed dropping requirement to report in the salary and bonus columns the amount of salary or bonus forgone at a NEO's election, and providing that non-cash awards received instead would be reportable in the column applicable to the form of award elected
 - SEC retained requirement — disclosure of amounts of salary and bonus awarded better enables investors to understand the relative weights the company applied to annual incentives and salary
 - SEC had also proposed dropping 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 SCT and DCT
 - SEC retained requirement based on comments that investors would be better served by retaining disclosure of the value associated with each type of equity award granted on a grant-by-grant basis, which would help investors better evaluate the decisions of the compensation committee

Reporting Equity Awards

- Practical Considerations:
 - Under new rule may have volatility in NEOs from year to year
 - A newly-hired executive officer that is granted an equity award in connection with his/her commencement of employment or an executive officer receiving a sizable refresh award may become a NEO even where the executive officer would not normally qualify as a NEO
 - In this situation, a company may consider voluntarily including disclosure about an executive officer who would normally be a NEO in the absence of the grant of a sizable equity award to a new officer or another executive officer

Compensation Consultants

- Compensation consultant disclosure is required if company's compensation committee (or board):
 - engages a compensation consultant to provide executive compensation consulting services; **and**
 - the consultant provides additional non-executive compensation consulting services (e.g., benefits administration, HR consulting or actuarial services) to the company for which the consultant (including affiliates) is paid fees > \$120,000.

Required Disclosure

- Aggregate fees for executive compensation consulting services and aggregate fees for additional services
- Whether the decision to engage compensation consultant for additional services was made, or recommended, by management
- Whether the compensation committee or the board approved the additional services provided by the compensation consultant

Compensation Consultants

- Compensation consultant disclosure is also required if a company's compensation committee (or board) has not engaged a compensation consultant:
 - but management has engaged a compensation consultant to provide services to the company in addition to executive compensation consulting services; **and**
 - the consultant is paid fees > \$120,000 for the additional services.

Required Disclosure

- Aggregate fees for the executive compensation consulting services
- Aggregate fees for the additional services

Compensation Consultants

- Exceptions: No disclosure is required where:
 - Compensation committee (or board) and management have each engaged separate compensation consultants; or
 - Executive compensation services provided by the compensation consultant are limited to either:
 - consulting on non-discriminatory broad-based plans generally available to all employees (e.g., 401(k) and health insurance plans)
 - providing information that either is not customized for a particular company (e.g., industry surveys) or that is customized based on parameters that are not developed by the consultant, so long as the consultant does not provide advice or recommendations with respect to the information

If the consultant's role extends beyond these two types of services, then fees paid for these services will need to be disclosed

Compensation Consultants

- Changes from the proposing release:
 - No disclosure is required where the annual fees for the non-executive compensation consulting services are \$120,000 or less
 - Companies will not be required to also disclose the nature and extent of non-executive compensation services provided by the compensation consultant
 - SEC noted the potential competitive harm from companies being required to disclose confidential and sensitive pricing information and opted not to require a description of the non-executive compensation services
 - Companies must still disclose the nature and scope of executive compensation services provided by the compensation consultant

Compensation Consultants

- Practical Considerations:
 - Companies and consultants may not have historically tracked fees paid for executive compensation consulting services and fees paid for additional services separately, but will now need to do so
 - For 2009, may need to go back and separate
 - Companies should consider adopting pre-approval policies similar to those in place for outside auditor engagements, in order to provide the compensation committee an opportunity to review and approve all services rendered by its consultant

Board Leadership Structure

- A company must describe the leadership structure of its board of directors and discuss why the company believes it is the best structure for its board
 - 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 must disclose whether the company has a lead independent director and the reasons, and the specific role the lead independent director plays in the leadership of the company
 - It is the leadership structure of the board that should be described, not the structure of the company's management

Board Leadership Structure

- Practical Considerations:
 - SEC's intent was not to influence a company's decision regarding its board leadership structure
 - Reasons to combine board chair and CEO roles may include:
 - Establish a single voice for the company
 - CEO leads board discussion on company performance because of responsibility for day-to-day operations and strategy implementation
 - Complexity of company
 - Relationships with customers, employees or stockholders
 - Mandated by by-laws
 - Companies should emphasize importance of independent board leadership regardless of board leadership structure
 - Companies may want to review RiskMetrics' guidelines for voting on shareholder proposals relating to independent board chairs
 - If a company's lead independent director assumes certain responsibilities, RiskMetrics will generally recommend against shareholder proposal

Board's Role in Risk Oversight

- Disclose board's role in the oversight of risk and the effect that this has on the board's leadership structure
 - Companies will have flexibility to describe how the board administers its risk oversight function (e.g., through the whole board or through a separate committee)
 - NYSE Rule 303A.07: Duties and responsibilities of audit committee must include discussing "policies with respect to risk assessment and risk management"
 - Companies may want to disclose whether individuals with day-to-day risk management responsibilities report directly to the board (or a committee) or how the board otherwise receives information from such individuals
 - Companies are required to disclose board's role in the oversight of risk — rather than board's role in the risk management process — SEC acknowledged that board's role is to oversee management, which is responsible for day-to-day risk management processes

Directors and Nominees

- A company (or other proponent soliciting proxies) must disclose, for each director or nominee, the specific experience, qualifications, attributes or skills that qualify that person to serve as a director at the time of disclosure
 - Disclosure required annually, even if a director is not up for re-election in a particular year, and must be provided on an individual basis
- Changes from proposing release:
 - The final rules do not specify any particular qualifications (e.g., risk assessment skills) that a director or nominee should possess or that a company should describe in its proxy statement and are intended to give companies flexibility in determining the information relating to their directors that should be disclosed to investors
 - SEC did not adopt proposed rule that a company must disclose annually, for each director or nominee, the specific experience or attributes that qualify that person to serve as a committee member, given that many companies rotate their directors among different committee positions
 - If an individual is appointed or nominated as a director because of a particular attribute related to a board committee (e.g., the audit committee), that fact should be disclosed when discussing the individual's qualifications to be a director

Directors and Nominees

- A company must disclose any directorships at other public companies held by a director or nominee at any time during the past five years, rather than just current director positions at other public companies as currently required
- Legal proceedings involving executive officers, directors or nominees are now required to be disclosed for the past 10 years rather than for five years as under the current rules
- Expanded list of legal proceedings involving directors or nominees requiring disclosure:
 - 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
 - Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization

Directors and Nominees

- Companies must disclose:
 - whether, and if so how, its nominating committee considers diversity in identifying nominees for director
 - how any policy relating to consideration of diversity in identifying board nominees, if any, is implemented, as well as how the nominating committee assesses the effectiveness of the policy
- Companies may have varying conceptions of the term diversity — for some, diversity may refer to differences in viewpoint or experience, while for others, it may focus on race, gender or national origin
 - Diversity is not defined in the final rules and companies are permitted to define diversity as they deem appropriate

Directors and Nominees

- Practical considerations:
 - Companies should begin drafting new disclosures regarding specific experience, qualifications, attributes or skills of directors early in the process and should seek input from directors and nominees
 - Additional disclosure controls and procedures may need to be implemented to ensure that information about directors who are not up for re-election at the upcoming shareholders' meeting is recorded, processed, summarized and reported
 - Companies should consider whether and how to discuss “hard” and “soft” skills
 - D&O questionnaires will need to be updated to account for the disclosures required by the new rules
 - Review corporate governance guidelines and determine whether or not a company has a diversity policy

Shareholder Voting Results

- A company must disclose on Form 8-K (rather than on Form 10-Q or 10-K) the results of any shareholder vote 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, 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
 - To avoid any potential confusion when reporting preliminary voting results, companies may include additional disclosure that helps put preliminary voting disclosure in a proper context

Resources

- Chadbourne & Parke's Client Alert
 - <http://www.chadbourne.com/files/Publication/0ff17072-755b-485d-8112-0591d0d984ba/Presentation/PublicationAttachment/9782d134-31c3-4d6d-8a9b-01cd5b1c52a2/ProxyEnhancement.pdf>
- Final Rule Release
 - <http://sec.gov/rules/final/2009/33-9089.pdf>
- Proxy Disclosure Enhancements Transition C&DIs
 - <http://sec.gov/divisions/corpfin/guidance/pdetinterp.htm>
- Regulation S-K C&DIs
 - <http://sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>