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## **SEC Proposes Proxy Disclosure and Corporate Governance Revisions**

On July 10<sup>th</sup>, the Securities and Exchange Commission (“SEC” or “Commission”) issued a proposed set of rule revisions intended to improve the disclosure provided to shareholders of public companies regarding compensation and corporate governance matters. New disclosures under the revisions are designed to enhance the information included in proxy and information statements and would include information about: 1) the relationship of a company’s overall compensation policies to risk; 2) company leadership structure; 3) the qualifications of directors and nominees; and 4) potential conflicts of interests of compensation consultants. In addition, the revisions would change the reporting of annual stock and option awards to company executives and directors, as well as require quicker reporting of voting results. Importantly, the proposed rules are subject to a 60-day comment period and may change based on comments received during this period.

Partially in reaction to the turmoil that has occurred in the financial markets during the past 18 months, the SEC set out to re-examine the type of information that is being provided to shareholders and the timeliness of this disclosure. The proposed amendments are designed to enhance the information that is currently available in four key areas:

- 1) Executive Compensation – (a) disclosure change as it relates to the value reported for annual stock and option awards, (b) new disclosure about the relationship between a company's overall compensation policies and its risk profile and (c) additional disclosure about compensation consultant conflicts of interests.
- 2) Board Governance – new disclosure about why a board has chosen its particular leadership structure, and a description of the board's risk management role.
- 3) Director and Nominee Qualifications - better disclosure about each candidate's particular experience, qualifications, attributes or skills that qualify that person to be a board member.
- 4) Voting Results – more timely disclosure of annual and special meeting voting results.

This alert letter summarizes the major aspects of the proposed rules.

## **Enhanced Compensation Disclosure**

The Commission proposes to revise compensation disclosure in two ways: (i) by changing the Summary Compensation Table (“SCT”) reporting of stock and option awards and (ii) by broadening the scope of the Compensation Discussion and Analysis (“CD&A”) to include a new section that analyzes the link between a company’s overall compensation policies and the company’s risk and management of that risk.

### *Summary Compensation Table*

The proposed amendments would require disclosure in the SCT and Director Compensation Table to include the aggregate grant date fair value of stock and option awards computed in accordance with FAS123R instead of the dollar amount recognized for financial statement reporting purposes during the covered year.<sup>1</sup> The SEC believes that the aggregate grant date fair value approach will permit investors to better evaluate the amount of equity compensation awarded and that this approach is more consistent with how companies and compensation committees make compensation decisions. Given that the aggregate fair value of stock and option awards would now be shown in the SCT, the rules also would 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 footnote disclosure to the Director Compensation Table as these disclosures would be considered duplicative.

One final amendment to the SCT disclosure relates to the salary and bonus columns. Registrants would no longer be required to report in these columns the amount of salary or bonus forgone at the named executive officer’s (“NEO”) election. Instead, the non-cash awards received would be reportable in the column applicable to the form of award elected. Thus, the SCT disclosure would reflect the form of compensation ultimately received by the NEO.

Regarding transition, the SEC stated that its goal is to facilitate year-to-year comparisons in a cost-effective way. Given the significant changes made in 2006, the SEC, at that time, did not require companies to conform prior years to the new rules. Here however, the SEC is considering an approach that would require 2009 values under the new rules and recomputed disclosure for each of the two preceding years for NEOs that appear in the 2009 SCT<sup>2</sup>.

### *Compensation Discussion & Analysis*

The current CD&A disclosure must address the material elements of a company’s compensation program and design for NEOs. The proposed amendments would broaden the scope of the CD&A to include discussions on a company’s compensation policies and practices for employees generally if risks arising from these policies or practices may have a material effect on the company. The situations that would require disclosure will vary depending on the particular company and its compensation programs.

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<sup>1</sup> Readers may recall that the initially adopted 2006 disclosure amendments used an aggregate grant date fair value approach (same approach as proposed in the rule revisions) but were modified to the current approach pursuant to the Interim Final Rules released in December 2006 shortly before the effective date of the 2006 disclosure amendments.

<sup>2</sup> There is no requirement to amend prior year filings or to include different NEOs for any preceding year based on the recomputed total compensation for those years.

Some situations the SEC identified as potential triggers for discussion and analysis include compensation policies and practices:

- At a business unit of a company that carries a significant portion of the company's risk profile;
- At a business unit with compensation structured in a significantly different manner than other units;
- At business units that are significantly more profitable than others in the company;
- At business units where compensation expense is a significant percentage of a 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.

Importantly, disclosure under the proposed rule amendment would only be required if the materiality threshold is triggered.

### **Enhanced Director and Nominee Disclosure**

The Commission seeks to expand disclosure regarding the qualifications of directors and nominees, past directorships held by directors and nominees, and the time frame for disclosure of legal proceedings involving directors, nominees and executive officers. The amendments are designed to provide investors with more meaningful information to assist them in their voting decisions by better enabling them to determine whether and why a director or nominee is an appropriate fit for a particular company.

Specifically, the amendments would expand the current narrative disclosure requirements to include discussions of specific experience, qualifications or skills that qualify the individual to serve as a board and committee member. This expanded disclosure would apply to incumbent directors and nominees regardless of who has nominated the director. The rules also propose two additional changes to the biographical disclosure requirements of directors and nominees. The first item is a proposal to expand the disclosure of any directorships held by directors or nominees *currently* to any directorships held *at any time during the past five years* at public companies (even if the individual no longer serves on that board). Secondly, in an effort to enhance the ability to evaluate the competence and integrity of a director or nominee, the SEC seeks to lengthen the time during which disclosure of specific legal proceedings involving directors and nominees is required from *five to ten* years.

## **New Disclosure about Company Leadership Structure and the Board's Role in the Risk Management Process**

The proposed rules would require disclosure in the proxy of the company's leadership structure and a discussion of why the company believes it is the best structure for it at the time of the filing. In particular, the company would be required to disclose whether and why the company has chosen to combine or separate the CEO and board chair positions. In cases where the two roles are combined, the company would also have to disclose whether and why the company has a lead independent director as well as the specific role the lead independent director plays in the leadership of the company.

In addition, the proposed rules require additional disclosure about the board's role in the company's risk management process. This information is intended to provide investors with valuable insight into how a company's board perceives and manages a company's risk. For example, the disclosure may address how the board implements and manages its risk management function - through the board as a whole or through a committee, such as the audit committee.

## **New Disclosure Regarding Compensation Consultants**

In an effort to shed further light on compensation consultant independence, the proposed rules would expand the current rules to require disclosure of the aggregate fees paid to compensation consultants and their affiliates when they play a role in determining or recommending the amount or form of executive and director compensation, but only if they provide additional services to the company. The proposed amendments would require a description of any additional services provided to the company within the last year by the compensation consultants and any affiliates of the consultants and the aggregate fees for these additional services. The company must also disclose whether the decision to engage the compensation consultant for the additional services was made, recommended, subject to screening or reviewed by management and whether the board or compensation committee approved the additional services.

## **Reporting of Voting Results on Form 8-K**

The Commission proposes to accelerate the filing of voting results of annual or special meetings by transferring this disclosure from Forms 10-Q and 10-K to Form 8-K. New Item 5.07 of Form 8-K would require companies to disclose the results of shareholder votes within four business days after the end of the meeting at which the vote was held. In cases where the matter relates to a contested director election and the voting results are not definitively determined at the end of the meeting, companies must file a preliminary voting result within the four-day time period and then file an amended report within four business days after the final voting results are certified.

## **Proxy Solicitation Process**

The SEC also proposed revisions to its rules governing the proxy solicitation process to provide clarity to soliciting parties and to assist shareholders in receiving timely and complete information.

## **Comment Period**

There will be a 60-day comment period for submission of comments on the proposed rule revisions to the SEC from the date that the revisions are published in the Federal Register. The Commission highlighted the concern it shares with investors and companies that proxy statements are in danger of becoming unreadable due to the sheer volume of information contained within them. The Commission stressed that comment submissions should focus on whether the rules are achieving their intended purpose of providing clear and concise information to investors rather than adding to the already considerable disclosure requirements. In this regard, the SEC solicited comments on whether any current disclosures are unnecessary in light of the proposed amendments.

Specifically, the SEC has requested comments on eliminating the instruction that permits companies to avoid disclosing performance targets due to the potential adverse competitive effect on the company. Among other things, the Commission also asked whether new or expanded disclosures should be provided regarding “hold to retirement” and clawback provisions, internal pay equity (ratio of total compensation among the NEOs or each NEO to the average non-executive employee) and tax gross-up arrangements for NEOs (including a requirement to disclose and quantify the savings to each executive).

Issuance of final rules is expected later this year with the anticipation that compliance with the amendments would begin in the 2010 proxy season following their publication in the Federal Register.

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This letter is intended to alert compensation professionals about developments that may affect their companies, and should not be considered or relied upon as legal advice. Specific questions about the applicability of the proposed rules to proxy disclosure of compensation of executives and directors should be discussed with appropriate counsel. General questions about this letter may be directed to Lou Taormina in our New York office at (212) 299-3717 or by email at [ltaormina@fwcook.com](mailto:ltaormina@fwcook.com). This letter and other published materials are available on our website, [www.fwcook.com](http://www.fwcook.com).