

## CORPORATE ALERT

### SEC PROPOSES CHANGES TO EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE DISCLOSURE RULES

On July 10, 2009, the Securities and Exchange Commission (SEC) published proposed amendments to its disclosure rules that would require public companies to provide enhanced proxy and information statement disclosure about certain executive compensation and corporate governance matters.<sup>1</sup> Specifically, the proposed rule changes would—

- require that stock awards and option awards granted to executives and directors be reported at grant date fair value, rather than the value recognized for the fiscal year for financial reporting purposes
- add a new section to Compensation Discussion & Analysis (CD&A), explaining how a company's overall compensation policies affect the company's risk and management of risk if the risks arising from such policies may have a material effect on the company
- require discussion of the board of directors' role in risk management
- require disclosure of the company's leadership structure (such as whether it separates or combines the CEO and chairman of the board positions) and why the company has chosen its particular leadership format
- require disclosure of the specific qualifications and attributes of directors and nominees that qualify them to serve on the board and board committees, and expand the disclosure about such persons to include any directorships held by them in the past five years, not just those currently held
- lengthen the time period for disclosing certain legal proceedings involving directors, nominees and executive officers from the past five years to the past 10 years

---

<sup>1</sup> SEC Rel. Nos. 33-9052, 34-60280, Proxy Disclosure and Solicitation Enhancements (July 10, 2009).

- require disclosure of fees paid to, and services provided by, compensation consultants if they played a role in determining or recommending the amount or form of executive or director compensation and also provided additional services to the company.

The proposed rule changes would also require that results of shareholder votes be reported within four business days on Form 8-K (rather than quarterly on Form 10-Q) and codify certain SEC staff positions concerning proxy solicitations.

The proposed rule changes are subject to a 60-day comment period upon publication in the *Federal Register*. If the proposed amendments are adopted, the SEC expects that the amendments would be effective in time for the 2010 proxy season. Adoption of the proposed rule changes in one form or another is expected, since the proposals were approved by a unanimous vote of the commissioners. Each of the proposed rule changes is discussed in more detail below.

#### CHANGES TO EXECUTIVE COMPENSATION DISCLOSURE

**Stock and Option Awards.** The SEC is proposing to amend Item 402 of Regulation S-K to require that the value of stock and option awards be reported in the Summary Compensation Table and the Director Compensation Table, based on the aggregate grant date fair value of such awards as computed in accordance with FAS 123R. Currently, the value of these awards is reported as the dollar amount recognized for financial reporting purposes for the fiscal year. The SEC believes that the reporting of the full grant date fair value will provide clearer, more meaningful disclosure of the compensation awarded to executives, in contrast to the current method that can result in fluctuations of the amount reported and even negative adjustments to reported compensation.<sup>2</sup>

The proposed rule change would require reporting of the aggregate grant date fair value of stock and option awards granted *during* the relevant fiscal year. The SEC is soliciting comment on whether the rule should be amended to require the reporting of the aggregate grant date fair value of such awards granted for services performed during the relevant fiscal year, even if the awards were granted *after* fiscal year end.

The proposed change in the method of reporting the value of stock and option awards could significantly alter the total compensation reported for executive officers and, therefore, could result in a change in the composition of a company's named executive officers for 2009. For transitioning to the amended rule, the SEC is considering whether to require companies to present in their 2010 proxy statements recomputed disclosure for 2008 and 2007 reflecting full grant date fair values of stock and option awards and corresponding adjustments to total

---

<sup>2</sup> In connection with the proposed amendment, the SEC would also—

(i) 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 because these disclosures would be duplicative of the aggregate grant date fair value disclosure to be provided in the Summary Compensation Table and Director Compensation Table; and

(ii) amend Instruction 2 to the salary and bonus columns of the Summary Compensation Table to provide that companies will not be required to report in those columns the amount of salary or bonus forgone at a named executive officer's election pursuant to company programs under which stock, equity-based or other forms of non-cash consideration may be received at the officer's election instead of a portion of annual compensation earned in a covered year, and that non-cash awards received instead are reportable in the column applicable to the form of award elected.

compensation. If a person who would be a named executive officer for 2009 was also disclosed as a named executive officer for 2007 but not for 2008, the officer's compensation would be reported for each of the three years, but the SEC would not require companies to include different named executive officers for any preceding fiscal year based on the recomputation.

**Risk Management Disclosure in CD&A.** The SEC is proposing to expand CD&A to include a discussion and analysis of how a company's compensation policies and overall actual compensation practices for employees generally create incentives that can affect the company's risk and management of risk, if risks arising from such policies and practices may have a material effect on the company. To the extent the risks arising from such compensation policies and practices would not have a material effect on the company, no disclosure is required.

Companies are currently required to discuss in CD&A material information that is necessary to an understanding of the company's compensation policies and decisions regarding named executive officers. Consequently, to the extent risk considerations are a material aspect of the company's compensation policies or decisions for named executive officers, the company is required to discuss them in CD&A under the current rules. The SEC is proposing to add an additional disclosure requirement regarding risk-taking incentives and risk management that would apply to a company's broader compensation policies and practices for employees generally if risks arising from such policies and practices may have a material effect on the company. While the SEC acknowledges that the situations requiring disclosure will vary, the SEC lists several situations that could trigger the new disclosure, including compensation policies and practices—

- at a business unit of the company that carries a significant portion of the company's risk profile
- at a business unit with compensation structured significantly differently than other units within the company
- at business units that are significantly more profitable than others within the company
- at business units 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.

Emphasizing that the purpose of the new disclosure requirement is to provide investors with material information concerning how a company compensates and incentivizes its employees that may create risk, the SEC provides the following examples of issues that a company may need to address—

- the general design philosophy of the company's 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 on the company's behalf, 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 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 claw backs or imposing holding periods
- the company's policies regarding adjustments to its compensation policies to address changes in its risk profile
- material adjustments the company has made to its compensation policies or practices as a result of changes in its risk profile
- 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.

**Compensation Consultants.** The SEC is proposing to amend Item 407 of Regulation S-K to require additional disclosure about compensation consultants who provide services to their clients in addition to their executive and director compensation consulting services. Specifically, if a compensation consultant or its affiliates played a role in determining or recommending the amount or form of executive or director compensation and also provided additional services, then the company would be required to disclose the following—

- the nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant and its affiliates
- the aggregate fees paid for all additional services and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation
- whether the decision to engage the compensation consultant or its affiliates for non-executive compensation services was made, subject to screening, or recommended, by management
- whether the board of directors or the compensation committee has approved the additional services.

The proposed amendments, as well as the existing disclosure requirements of Item 407 regarding compensation consultants, would not apply to those situations in which the compensation consultant's only role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors of the company and that are available generally to all salaried employees, such as 401(k) plans or health insurance plans.

## CHANGES TO CORPORATE GOVERNANCE DISCLOSURES

**Director and Nominee Qualifications.** The SEC is proposing to amend Item 401 of Regulation S-K to expand the disclosure requirements regarding directors and nominees. Specifically, the SEC is proposing to require disclosure detailing for each director and nominee for director the particular experience, qualifications, attributes

or skills that qualify that person to serve as a director of the company as of the time that a filing containing such disclosure is made with the SEC, and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the company's business and structure. These revisions are aimed at helping investors determine whether a particular director and the entire board composition are appropriate choices for a given company. The types of information that may be disclosed include, for example, information about a director's or nominee's risk assessment skills and any specific past experience that would be useful to the company, as well as information about a director's or nominee's particular area of expertise and why the director's or nominee's service as a director would benefit the company at the time at which the filing with the SEC is made.

The SEC is also proposing to require disclosure of any public company directorships<sup>3</sup> held by each director and nominee at any time within the past five years. Item 401 of Regulation S-K currently requires disclosure only of presently held directorships.

**Legal Proceedings.** Item 401 requires disclosure of specified legal proceedings over the past five years involving any director, executive officer or nominee for director. The SEC is proposing to lengthen this period from five to 10 years.

**Board Leadership Structure.** The SEC proposes to amend Item 407 of Regulation S-K to require disclosure of a company's leadership structure. Companies would be required to disclose whether the company separates the positions of principal executive officer and chairman of the board or whether the same person holds both positions. If one person serves as both principal executive officer and chairman of the board, the company must disclose whether it has a lead independent director and the specific role the lead independent director plays in the company's leadership. The company must also explain why it has determined that its leadership structure is appropriate given the company's specific characteristics or circumstances.

**Board's Role in Risk Management.** Item 407 of Regulation S-K would also be amended to require disclosure of the extent of the board's role in the company's risk management and the effect that this has on the company's leadership structure. In view of the role that risk and the adequacy of risk oversight played in the recent market crisis, the SEC believes it is important for investors to understand the board's role in this area. Companies would be expected to discuss how the board implements and manages its risk management function, such as through the board as a whole or through a committee. The disclosure might address questions such as whether the persons who oversee risk management report directly to the board as a whole, to a committee, such as the audit committee,<sup>4</sup> or to one of the other standing committees of the board; and whether and how the board, or board committee, monitors risk.

**Shareholder Voting Results.** The SEC is proposing that shareholder voting results be reported under a new Item 5.07 to Form 8-K, which would have to be filed within four business days after the meeting at which the vote was

---

<sup>3</sup> Specifically, any directorship held at any company with a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 or subject to the requirements of Section 15(d) of that act, or any company registered as an investment company under the Investment Company Act.

<sup>4</sup> Section 303A of the NYSE's Listed Company Manual provides that the audit committee of companies listed on the exchange must "discuss guidelines and policies to govern the process by which risk assessment and management is undertaken."

taken.<sup>5</sup> The current requirement of reporting shareholder voting results on the Form 10-Q or Form 10-K (for the fourth quarter) for the quarterly period in which the shareholder meeting took place, would be deleted. If the matter voted upon at the meeting relates to a contested election of directors and the voting results are not definitively determined at the end of the meeting, the company would be required to file a Form 8-K disclosing the preliminary voting results within four business days after the 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.

## PROXY SOLICITATION MATTERS

In addition to proposed changes to the disclosure rules relating to executive compensation and corporate governance, the SEC is proposing to amend its proxy solicitation rules to codify several SEC staff positions:

- *“Form of Revocation” under Rule 14a-2(b)(1)*. This rule exempts solicitations by shareholders who are not seeking proxy authority and who do not have a substantial interest in the subject matter of the solicitation. A shareholder is deemed to be seeking proxy authority—and, therefore, is ineligible for the exemption—if the shareholder furnishes a “form of revocation.” The introductory text to the Rule would be amended to clarify that a person providing an unmarked copy of management’s proxy card requested to be returned directly to management is not providing a form of revocation. The SEC explains that the amendment would facilitate voting by shareholders sharing their views on matters submitted for shareholder approval (such as “just vote no” campaigns) without having to conduct a fully regulated proxy solicitation and would allow shareholders a convenient way to vote after hearing those views without having to request another proxy card from management.
- *“Substantial Interest” under Rule 14a-2(b)(1)*. The Rule 14a-2(b)(1) exemption is not available to “[a]ny person who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation that would not be shared pro rata by all other holders of the same class of securities....” The SEC has received questions as to whether this limitation applies only when the person is a security holder of the class being solicited and the benefit relates to, or is derived from, such holdings or is generally applicable to any person with a substantial interest in the subject matter. Consistent with its intent to limit the exemption to disinterested persons, the SEC proposes to amend the rule to clarify that a person need not be a security holder of the class of securities being solicited, and a benefit need not be related to, or derived from, any security holdings for a person to be disqualified from relying on the exemption.
- *Rounding Out Short Slates*. Rule 14a-4(d)(1) requires that, in order to solicit authority to vote for the election of a person to office, the person must be a bona fide nominee who consents to being named in the soliciting person’s proxy statement and to serving if elected. Rule 14a-4(d)(4) contains an exemption to the bona fide nominee requirement that allows a person soliciting support for nominees who, if elected, would constitute a minority of the board of directors (commonly referred to as a “short slate”), to round out its short slate of nominees up to the total number of director positions then subject to election,

<sup>5</sup> The four business day period would begin to run on the day on which the meeting ended.

by seeking authority to vote for nominees named in the company's proxy statement. The SEC proposes to amend the rule, so the short slate rounding exception is also available when a non-management soliciting person attempts to round out its short slate by seeking authority to vote for nominees named in any other persons' proxy statement. Thus, in an election contest, one insurgent group could round out its short slate with nominees proposed by another insurgent group. The proposed exception would be available only when non-management parties are not acting together, and a non-management person would be required to represent in its proxy statement that (1) it has not agreed and will not agree to act, directly or indirectly, as a group or otherwise engage in any activities that would be deemed to cause the formation of a group with the other non-management person, as determined under Regulation 13D-G, and (2) it is not a "participant" in the other non-management person's solicitation.

- *Objectively Identifiable Conditions to Voting Proxies.* The SEC is proposing to amend Rule 14a-4(e) to clarify that any condition specified by a party soliciting proxies as to circumstances in which it may vote the shares for which it has received proxies must be objectively determinable.
- *Time of Filing of Participant Information.* Rule 14a-12 permits a written proxy solicitation to be made before furnishing a proxy statement if, among other things, the solicitation contains certain specified information about the participants or contains a legend advising security holders where they can obtain the information. This rule would be amended to clarify that the legend may be used only if the required participant information has been previously filed under cover of Schedule 14A as part of a proxy statement or other soliciting materials.

## CONSIDERATIONS FOR COMPANIES

The proposed rule changes are subject to a 60-day comment period upon publication in the *Federal Register*, and it is possible that the final form of the rules may differ from those proposed. Whatever form the final rules take, however, there are several matters that companies should be considering at this time because the SEC has indicated that it intends to implement the rule changes in time for the 2010 proxy season. Items that companies should be considering include—

- *Potential Changes to Named Executive Officers.* The proposed change in the method of reporting the value of stock and option awards could significantly alter the total compensation reported for executive officers and, therefore, could affect which officers are identified as named executive officers in a company's proxy statement.
- *Risk Management and the Board.* In light of the additional disclosures that will be required concerning the board's role in risk management, the board of directors should be evaluating the adequacy of its risk management oversight procedures. For a more detailed discussion of this topic, see the second topic discussed in our alert, "Top 10 Topics for Directors in 2009," which is available here.
- *Risk Management and Executive Compensation.* The compensation committee should review the company's compensation policies for employees generally to determine whether the risks arising from

those policies may have a material effect on the company, and if so, whether any actions should be taken to mitigate or manage those risks.

- *Board Composition.* In light of the proposed disclosure requirements regarding leadership structure and director qualifications, the board of directors should review its composition to determine whether it has the appropriate mix of experience and skills to address the company’s business needs and challenges. The board should also reassess the company’s leadership structure to determine whether the structure is appropriate for the company. Approximately one-third of S&P 500 companies have separated the positions of chief executive officer and chairman of the board. In companies where the chairman of the board and the chief executive officer roles are combined, the board should assess whether it would be advisable to appoint a lead independent director if the board has not already done so.
- *Compensation Consultants.* In light of the additional disclosures concerning compensation consultants when they provide additional services to a company, the board or compensation committee should review the manner in which the company uses compensation consultants. Over the past few years, the use by compensation committees of pay consultants who perform other work for the company has drawn increasing fire from institutional investors and shareholder activists concerned about the potential conflicts of interest.

## CONTACT INFORMATION

If you have questions regarding this alert, please contact—

Jessica Cherry .....	212.872.7437 .....	jcherry@akingump.com .....	New York
Gemma L. Descoteaux .....	214.969.4783 .....	gdescoteaux@akingump.com .....	Dallas
N. Kathleen Friday .....	214.969.2827 .....	kfriday@akingump.com .....	Dallas
Julie M. Kaufer .....	310.728.3313 .....	jkaufer@akingump.com .....	Los Angeles
C.N. Franklin Reddick III .....	310.728.3204 .....	freddick@akingump.com .....	Los Angeles
Terry M. Schpok .....	214.969.2870 .....	tschpok@akingump.com .....	Dallas
Rosa A. Testani .....	212.872.8115 .....	rtestani@akingump.com .....	New York
Zachary N. Wittenberg .....	202.887.4592 .....	zwittenberg@akingump.com .....	Washington, D.C.