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SEC Adopts Enhanced Proxy Disclosure Rules for the 2010 Proxy Season

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As companies begin preparing their 2010 proxy statements and other periodic reports, they should be aware that the SEC has recently adopted amendments that significantly enhance the disclosure reporting companies are required to include in these filings. These rules focus primarily on a company's disclosure of compensation and governance policies and practices. The revised rules became effective on February 28, 2010. A summary of these amendments is provided below.

Compensation Policies and Practices

The new rules require reporting companies to disclose whether their compensation policies and practices create risks that are reasonably likely to have a material, adverse effect on the company. A crucial point for companies to note is that this requirement covers the compensation policies and practices relating to all employees of a company, not just its executive officers. If the company determines that its policies could have such an effect, the company must discuss its compensation policies and practices as they may relate to risk management and risk taking incentives that can affect the company's risk and management of that risk. The SEC has determined that such disclosure will be separate from the CD&A disclosure. The SEC has provided a non-exclusive list in the new rule of situations in which compensation policies or programs may have the potential to raise material risks to companies. An example of a potential situation in which a compensation policy may trigger disclosure provided by the SEC is the following: "Compensation policies and procedures that vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon the accomplishment of a task, while the income and risk to the registrant for the task extend over a significantly larger period of time." If disclosure is triggered, the SEC has provided a non-exclusive list of examples of the types of issues that a company should address in its disclosure.

Under the new rules, smaller reporting companies are not required to provide the new disclosure. The SEC believes that it is less likely for such companies to have the types of compensation policies and practices that these amendments are intended to address.

Revisions to the Summary Compensation Table

The amendments also affect the disclosure of stock awards and option awards in the Summary Compensation Table and Director Compensation Table by requiring disclosure of the aggregate grant date fair value of awards computed in accordance with FASB ASC Topic 718 (formerly referred to as FAS 123(r)), instead of the dollar amount recognized for financial statement reporting purposes. In making this change, the SEC noted that the disclosure of the aggregate grant date fair value provides a better picture of a compensation committee's decision in connection with stock and option awards.

For performance awards, the amended rules require that the estimated grant values be calculated based on the probable outcome of the performance conditions determined as of the grant date. A footnote to the compensation tables must provide the maximum value that can be earned under a performance award assuming that the individual achieved the highest level of the performance conditions.

In an effort to facilitate year-to-year comparisons, the SEC is requiring companies who are providing the new disclosure to recompute their disclosure in the Summary Compensation Table for all prior fiscal years required to be included in that table. This is required so that the applicable full grant date fair values are presented for the stock and option awards and so that the total compensation column is correspondingly recomputed.

Enhanced Director and Nominee Disclosure

The new rules also amend the director biography disclosure requirements. The new disclosure requirements were geared at providing investors with more meaningful disclosure and to better enable investors to determine whether and why a director or director nominee is an appropriate choice for a particular company.

Under the amended disclosure rules, companies are required to provide disclosure for each director and any nominee for director regarding the experience, qualifications, attributes or skills that led the board to conclude that such person should serve as a director. This disclosure is required for all director nominees and for all directors, including those directors not up for reelection in a particular year. Because the SEC views the composition of the entire board as important information for investors to have when making their voting decisions, this new disclosure is required to be made annually.

Disclosure is not required for any specific experience, qualifications or skills that qualify a person to serve on a committee of the board. But if the board considers, when choosing a director or director nominee to serve on the board, certain qualifications, attributes or experience related to an individual's service on a committee, then the company must disclose these as part of the individual's qualifications to serve on the board.

The amended rules also require disclosure of any directorships held by each director and director nominee at any time during the past five years (instead of just current directorships) at public companies and registered investment companies, even if the individual no longer serves on such board. The SEC believes that this will allow investors to better evaluate the relevance of past board experience of a director or director nominee, and provide insight into any professional or financial relationships that could pose potential conflicts of interest.

The length of time during which disclosure of legal proceedings involving directors, director nominees and executive officers is required has been increased from five years to ten years. This change is meant to provide investors with a better insight into an individual's competence and character. In addition, Item 401(f) of Regulation S-K has been amended to require disclosure for the following additional legal proceedings:

- 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; and

- Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization.

Under the amended Item 407(c) of Regulation S-K, companies are now required to disclose whether a nominating committee, or the board if its serves in place of a nominating committee, considers diversity in identifying nominees for director. In addition, if there is a policy with regard to the consideration of diversity in identifying director nominees, the company must disclose how this policy is implemented and how the effectiveness of this policy is assessed by the nominating committee or the board. In its release, the SEC recognized that companies may define diversity in a variety of ways. Certain companies may define diversity to include differences in professional experience, education or skill, while others define diversity in terms of race, gender and national origin. In this particular instance, the SEC has chosen not to provide a definition and will allow companies to define diversity in the manner that they consider appropriate. Nominating committees will have to incorporate these new and expanded disclosure obligations into their deliberations as they consider the nominees for the 2010 annual meeting.

New Disclosure about Board Leadership Structure and the Board's Role in Risk Oversight

Under the amended rules, companies must disclose their board leadership structure and the board's role in risk oversight. Under the new rules, companies must disclose whether and why they have chosen to combine or separate the principal executive officer and board chairman positions, and the reasons that the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. Also, in companies where these roles are combined and a lead independent director is designated to chair meetings of the independent directors, the companies must disclose whether and why the company has a lead independent director and the specific role the lead independent director plays in the leadership of the company.

Companies must also disclose the board's role in the oversight of risk and its involvement in the company's risk management practices. Within this disclosure, a company should include its perception of the role of the board, and the relationship between the board and senior management, in managing the company's material risks. The disclosure should address how the board administers the oversight function (i.e. through the audit committee, a separate risk committee, or the full board). Companies may also disclose, when relevant, whether and how the individuals who supervise the day-to-day risk management responsibilities directly report or otherwise communicate to the board or to a board committee. The final rules also require funds to provide disclosure about the board's role in risk oversight.

New Disclosure Regarding Compensation Consultants

In addition to the current requirement to disclose the role of a compensation consultant in determining the amount or form of executive and director compensation, the disclosure of fees paid to a compensation consultant will now be required in certain circumstances. If the board or compensation committee has retained its own consultant to provide advice or recommendations on the amount or form of executive and director compensation and such consultant or its affiliates provide other non-executive compensation consulting services to the company, then the company must disclose the aggregate fees paid for such services. This disclosure is only required if the fees for the non-executive compensation consulting services exceed $120,000 during the company's fiscal year. Disclosure is also required regarding whether management made or recommended the decision to engage the consultant or its affiliates for these services, and whether the board approved such services.

In the event that the board has not retained its own consultant, but there is a consultant (including its affiliates) providing executive and non-executive compensation consulting services to the company, then disclosure of the aggregate fees paid to the consultant is required. Again, this disclosure is only required if the fees for the non-executive compensation consulting services exceed $120,000 during the company's fiscal year.

If the board has retained its own consultant, then disclosure of the fees paid to consultants that work with management is not required (whether they provide only executive compensation consulting services or both executive and other non-executive compensation consulting services).

Certain services are not treated as executive compensation consulting services for purposes of the compensation consultant disclosure rules if they involve only broad-based non-discriminatory plans or the provision of information, such as surveys, that the consultant has not customized for the company, or are customized based on parameters that are not developed by the consultant. Also, the new disclosure rules provide that disclosure of the nature and extent of additional services is not required.

Reporting of Voting Results on Form 8-K

In addition to the amended proxy rules noted above, the new disclosure rules also include the new Item 5.07 to Form 8-K that requires companies to disclose the results of a shareholder vote on a Form 8-K and to file it within four business days after the end of the meeting at which the vote was held. The instructions to Item 5.07 of Form 8-K has also been amended to require companies to disclose any preliminary voting results within four business days after the end of the meeting where the vote was held. The company must then disclose the final voting results on an amended Form 8-K within four business days after such results are known. It is important to keep in mind that the timely filing of the Form 8-K is necessary to maintain Form S-3 eligibility.

The SEC's Compliance & Disclosure Interpretations

Since the release of the final rules, the SEC has already provided a number of updates to its Compensation & Disclosure Interpretations. Companies should review these CD&I's for additional insight into the SEC's view of how these new rules should be implemented and should keep an eye out for additional CD&I's the SEC may release on these rules in the near future. Summaries of just a few of the CD&I's regarding these new rules are set forth below:

- A company should provide disclosure of each director or director nominee's experience, qualifications, attributes and skills on an individual basis. This disclosure should not be given on a group basis, even if more than one director or nominee shares similar attributes or characteristics. (CD&I for Regulation S-K, Question 116.05)

- If a company grants an equity award to an executive officer in one year and that same award is forfeited in the same year due to the executive officer leaving the company, then the grant date fair value disclosure for that award is still required to be included for purposes of determining the total compensation for such year and for identifying the named executive officers for such year. (CD&I for Regulation S-K, Question 117.04)

- The rules do not specify where the disclosure under new Item 402(s) regarding narrative disclosure of a company's compensation policies should be presented within a company's filings with the SEC. The SEC recommends, however, that such disclosure be presented along with any other disclosure provided under Item 402 in such filing by the company. (CD&I for Regulation S-K, Question 128A.01)
- The disclosure required under Items 407(e)(3)(iii)(A) and (B) regarding the additional services provided by compensation consultants is not limited to services for non-executives. (CD&I for Regulation S-K, Question 133.10)
- The SEC also offers insight into how the fees for certain types of services provided by compensation consultants should be considered either for "determining or recommending the amount or form of executive and director compensation" or for "additional services". (CD&I for Regulation S-K, Question 133.11)

Recommended Action for Companies in Advance of the 2010 Proxy Season

In light of the enhanced disclosure required of companies under the new rules, companies should take certain steps geared towards identifying and assessing areas in their corporate documents and their practices and procedures that will enable them to adequately respond to the required disclosure under the new rules.

The Nominating and Governance Committee should review the leadership structure and operation of the board, review current director qualifications, review criteria for director nominees, and revise corporate governance guidelines as necessary to reflect such assessment. Boards should take note that even directors who are not up for reelection need to have the required disclosure under Item 401(e)(1) of Regulation S-K as of the time of the filing in which the disclosure is made. Therefore, boards who have classified board structures need to ensure that the proper information on such directors is obtained and disclosed within the time periods specified by the SEC and should consider implementing additional disclosure controls and procedures to assist with that function. Boards should also consider implementing of or reviewing their existing diversity policies regarding director nominations in light of the new requirement.

Compensation Committees should undertake a comprehensive risk analysis of the company's compensation structure throughout its entire organization so that it is well versed not only in compensation policies, programs and arrangements applicable to the named executive officers, but also to any other employees where there could be perceived risks arising out of the compensation structure. The Compensation Committee should also consider how the company's policies relate to its risk management practices and to pay attention to whether its compensation policies appropriately align risk and award. The compensation committee charter should be revised as necessary to reflect this assessment. Also companies should identify the board's practices and responsibilities with regard to risk management oversight and its interaction and communication with management with regard to risk management.

Director & Officer Questionnaires of companies should be updated to capture all relevant information required by the amended rules, including legal proceedings during the past 10 years and other directorships held during the past 5 years. Companies should also take note if they have any minimum standards required of individuals to serve on their board and determine whether and how all directors and director nominees are assessed against such standards.

A review of all services provided by compensation consultants, and fees paid to such consultants, would also be a wise decision on the part of companies as they prepare for the upcoming proxy season.