

## SEC Adopts New Compensation and Corporate Governance Disclosure Requirements

December 21, 2009

On December 16, 2009, the Securities and Exchange Commission adopted amendments (the "New Rules") to the compensation and corporate governance disclosure rules to expand or revise disclosure on:

- companies' overall compensation policies and their impact on risk taking;
- stock and option awards to executives and directors;
- director and nominee qualifications and legal proceedings;
- board leadership structure;
- the board's role in the risk oversight process; and
- potential conflicts of interest of compensation consultants that advise companies.<sup>1</sup>

In addition, the SEC transferred the requirement to disclose shareholder voting results to Form 8-K from Forms 10-Q and 10-K.

While the new rules largely follow the rule changes proposed this past July (the "Proposed Amendments"), some important modifications were made. The new rules are effective February 28, 2010, which for most companies means they will be applicable for the upcoming proxy season.

### **Disclosure about Risks Resulting from Compensation Policies and Practices**

While current SEC rules require disclosure about the material elements of compensation for a company's named executive officers, the Proposed Amendments would have expanded the required disclosure in the compensation discussion and analysis (CD&A) to require a discussion and analysis of a company's broader compensation policies and practices applicable to all employees to the extent that risks arising from those compensation policies or practices might have a material effect on the company. The Proposed Amendments would have required disclosure of those risks and the management of those risks.

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<sup>1</sup> See SEC Release No. 33-9089; 34-61175 (Proxy Disclosure Enhancements) (December 16, 2009) (the "Adopting Release"), available at <http://sec.gov/rules/final/2009/33-9089.pdf>. See also our Client Alert of July 20, 2009 entitled "Securities and Exchange Commission Proposes New Compensation and Corporate Governance Disclosure Requirements and Revisions to Proxy Solicitation Rules," available [here](#).

As adopted, the New Rules are in many ways similar to the Proposed Amendments but differ significantly from the Proposed Amendments in several respects. First, the disclosure is not part of the CD&A but instead is a new separate section in the proxy compensation disclosure (Reg. S-K, Item 402(s)). Moving the discussion out of the CD&A was a response to comments that it would potentially be confusing to include in the CD&A a discussion of compensation policies beyond the named executive officer group.

Second, disclosure will be required only if risks arising from the company's compensation policies and practices are reasonably likely to have a material adverse effect on the company. The reasonably likely standard is the same disclosure threshold used for purposes of the management discussion and analysis (MD&A) rules in a company's Form 10-K. The revised disclosure threshold will allow companies to take into account policies and procedures that might mitigate the probability of a material adverse effect.

Situations that could trigger the disclosure requirement include compensation policies and practices:

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

The New Rules provide an illustrative, non-exclusive list of issues that companies may need to address for the employees or business units discussed. These include:

- what general design philosophy, and the manner of its implementation, drives the company's compensation policies for employees whose actions would be most influenced by those incentives;
- what risk assessment and incentive considerations were factored into structuring the company's compensation policies or into making compensation decisions;

- how the company's compensation policies, such as claw-backs or stock retention policies, relate to the realization of risks resulting from employees' actions;
- what the company's policies are regarding amendments to its compensation policies due to changes in its risk profile and what amendments have been made as a result of such changes; and
- the extent to which the company monitors its compensation policies to determine whether risk management goals are being met with respect to providing incentives to employees.

The New Rules do not require that a company make an affirmative statement that it has determined that the risks arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company.

### **Revisions to the Summary Compensation Table and Director Compensation Table**

The New Rules revise the Summary Compensation Table and the Director Compensation Table to require disclosure of the aggregate grant date fair value of stock and option awards made during the year computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation – Stock Compensation (FASB ASC Topic 718)<sup>2</sup> rather than disclosure of the amount recognized for financial statement reporting purposes for the fiscal year for all outstanding awards in accordance with FASB ASC Topic 718, as is currently required. Performance awards will be computed based on the probable outcome as of the grant date of the performance conditions, with footnote disclosure of the maximum value if the highest level of performance conditions is attained. Also, the New Rules retain the requirement that the full grant date fair value of each equity award be reported in the Grants of Plan-Based Awards Table and the Director Compensation Table.

Companies with a fiscal year ending on or after December 20, 2009 will be required to present recomputed disclosure for each preceding fiscal year required to be included in the tables.

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<sup>2</sup> Formerly known as FAS 123R (Share-Based Payments). The FASB Accounting Standards Codification has superseded all references to previous FASB standards for interim or annual periods ending on or after September 15, 2009.

## Enhanced Director and Nominee Disclosure

The New Rules expand the director and nominee disclosure in the following areas:

- *Qualifications of Directors and Nominees:* Disclosure will be required about each director's and nominee's particular experience, qualifications, attributes or skills that qualify that person, in light of the company's business and structure, to serve, at the time the disclosure is made, as a director. To the extent material, the disclosure will need to cover more than the past five years and include information about the person's particular area of expertise and other relevant qualifications. As adopted, the New Rules do not require disclosure of specific experience, qualifications and skills that qualify a person to serve on a board committee.
- *Past Directorships Held by Directors and Nominees:* Disclosure will be required about any directorships at public companies that a director or nominee held at any time during the past five years even if the director or nominee no longer serves on that board.
- *Legal Proceedings:* The reporting period about specific material legal proceedings that involve directors, nominees and executive officers is extended from five to ten years. In addition, the New Rules require disclosure about additional types of legal proceedings, including: (i) judicial or administrative proceedings resulting from an involvement in: (a) mail or wire fraud; (b) fraud in connection with any business entity; (c) violations of federal or state securities, commodities, banking or insurance laws and regulations (including any settlement of such actions, but excluding settlements of civil proceedings among private parties); and (ii) any disciplinary sanctions or orders imposed by self-regulatory organizations such as stock, commodities or derivatives exchanges.
- *Board Diversity:* The New Rules require disclosure as to whether and how a nominating committee considers diversity in identifying director nominees. If the nominating committee (or the board) has a policy on considering diversity, a company would be required to disclose how the policy is implemented and how the nominating committee assesses its effectiveness. The New Rules do not define the term "diversity."

These expanded disclosure requirements also apply to management investment companies that are registered under the Investment Company Act of 1940.

### **Disclosure about Board Leadership Structure and the Board's Role in the Risk Oversight Process**

The New Rules require disclosure about a board's leadership structure and the reasons why the company believes its leadership structure is appropriate given its specific characteristics or circumstances. As part of this disclosure, companies must indicate whether they have combined or separated the CEO and chairman of the board positions. Companies that have combined the role of the CEO and chairman of the board must disclose whether they have a lead independent director and what specific role the lead independent director plays in the leadership of the company. This disclosure will appear in proxy and information statements.

The New Rules also require disclosure about the board's role in the oversight of risk. Disclosure might address questions such as:

- the structure of the board's risk oversight function – whether it is done through the board as a whole or through a committee, such as the audit committee; and
- the reporting relationships between the persons who oversee the day-to-day risk management and the board and board committees.

The New Rules also require registered investment companies to disclose in proxy and information statements information about their leadership structure and their board's role in the risk oversight process.

### **Disclosure regarding Compensation Consultants**

The New Rules require disclosure about the fees paid to compensation consultants and their affiliates under certain circumstances. The New Rules have been modified from the Proposed Amendments to narrow the scope of the required disclosure.

If the board or compensation committee has engaged its own compensation consultant and the consultant (or its affiliates) also provides other services not involving the amount or form of executive compensation to the company (or its affiliates) that exceed \$120,000 during the fiscal year, then disclosure is required of:

- the aggregate fees relating to advice on the amount or form of executive and director compensation and the aggregate fees paid for other services;

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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- whether the decision to engage the compensation consultant (or its affiliates) for such other services was made or recommended by management; and
- whether the compensation committee or the board approved such other services.

If the board has not engaged its own compensation consultant, but management has engaged a compensation consultant and such compensation consultant (or its affiliates) also provides other services to the company (or its affiliates) in excess of \$120,000 during the fiscal year, then disclosure is required of the aggregate fees relating to advice on the amount or form of executive and director compensation and the aggregate fees paid for other services.

The Adopting Release provides that disclosure is not required where the board and management have retained different compensation consultants and management's consultant also provides other services.

For purposes of the New Rules, services involving only broad-based non-discriminatory plans or non-customized surveys are not treated as executive compensation consulting services, unless the consultant provides advice or recommendations in connection with the information provided in the survey.

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

The New Rules require the disclosure of shareholder voting results on a Form 8-K within four business days of the shareholder meeting, rather than in the next Form 10-Q or Form 10-K.

The New Rules recognize that there may be situations (for example, contested elections) where definitive voting results may not be available within four business days. In those situations, companies will be required to disclose preliminary voting results within four business days. An amended Form 8-K will need to be filed within four business days after the final voting results are known.

*This client alert was prepared by Martha N. Steinman and K. Oliver Rust. For more information, please contact your Dewey & LeBoeuf relationship partner or:*

*Howard Adler at + 1 212 259 7115 or [hadler@dl.com](mailto:hadler@dl.com);  
Domnick Bozzetti at + 1 212 259 7829 or [dbozzetti@dl.com](mailto:dbozzetti@dl.com);  
Mitchel C. Pahl at + 1 212 259 6720 or [mpahl@dl.com](mailto:mpahl@dl.com);  
Elizabeth W. Powers at +1 212 259 8662 or [epowers@dl.com](mailto:epowers@dl.com);  
K. Oliver Rust at +1 212 259 8571 or [krust@dl.com](mailto:krust@dl.com); or  
Martha N. Steinman at + 1 212 259 8093 or [msteinman@dl.com](mailto:msteinman@dl.com).*