

SEC Adopts Disclosure Enhancements in Time for 2010 Proxy Season

The Securities and Exchange Commission has adopted several changes to its proxy disclosure rules that will be effective for the 2010 proxy season. These changes, which were originally proposed in July, fulfill commitments made earlier this year by Chairman Mary L. Schapiro to update the SEC's proxy disclosure rules to ensure that investors receive relevant information about public companies' leadership structures and compensation practices.

Effective Date

The new rules apply to filings (such as proxy and registration statements) with SEC made on or after February 28, 2010. Consequently, many companies with fiscal years ending on November 30, 2009 and all companies with calendar-year fiscal year-ends will be required to comply with the new rules when they file their next proxy statement.

Compensation Matters

Risk Disclosure

The original risk disclosure proposal has been modified in several significant respects. Under the new rules, a com-

pany must discuss its compensation policies and practices for all employees, including non-executive officers, if those policies and practices create risks that are "reasonably likely" to have a material "adverse" effect on the company – the same standard that applies in the MD&A context. This reflects a higher disclosure standard than the original proposal, which would have required disclosure where a risk "may have a material effect" on the company.

The new rules also make clear that the presence of risk mitigators, such as compensation recovery policies and stock holding requirements, can be taken into consideration when determining when compensation-related risks are likely to have a material adverse effect on a company. As a result, while companies will still need to conduct a risk assessment to determine whether disclosure must be made, the instances where disclosure will be required are likely to decrease.

Interestingly, the disclosure is no longer required to be part of the Compensation Discussion and Analysis. Instead, this information will now be a separate item in a company's executive compensation disclosure. This avoids the expan-

Four Things Companies Should Know about the SEC's New Proxy Disclosure Rules

- The new rules apply to proxy statements and other filings with the SEC made on or after February 28, 2010. Consequently, companies with calendar year-end fiscal years will need to include the new disclosure in their upcoming proxy statement.
- Companies must discuss their compensation policies and practices for their employees (including, but not limited to, executive officers) if those policies and practices create risks that are reasonably likely to have a material adverse effect on the company. This disclosure does not need to be part of the Compensation Discussion and Analysis.
- Companies must report the full grant date fair value (not just the amount that accrued during the fiscal year) of stock and option awards in their Summary Compensation Tables and Director Compensation Tables. In the case of performance-based awards, this amount is to be based on the probable outcome of the performance conditions.
- Companies must disclose the fees for both compensation-related services and non-compensation-related services provided by a compensation consultant that advises the board of directors, the board compensation committee, or management on compensation matters and provides other services for the company (either directly or through an affiliate) to the extent that the amount of these other services exceeds \$120,000 during the last fiscal year.

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sion of the CD&A to cover non-executive officer compensation matters.

Finally, the risk assessment (and any attendant disclosure) must cover compensation policies and practices for all employees, not just executive officers. Consequently, companies will need to identify the types of non-executive pay plans and arrangements that require detailed scrutiny. To facilitate this review, the new rules contain five illustrative examples of the type of policies or practices that could trigger disclosure.

Equity Award Reporting

Under the new rules, companies must report stock and option awards in the Summary Compensation Table (as well as the Director Compensation Table) using the aggregate grant date fair value of the award, as computed under SFAS 123(R), instead of just the annual accounting charge for each outstanding award. The SEC has also simplified the reporting of performance-based awards by requiring that they be reported on the basis of the probable outcome of the performance condition, rather than the amount payable for maximum performance. This harmonizes the proxy reporting treatment with the awards' accounting treatment.

The SEC has retained the requirement that stock and option awards be reported in the fiscal year granted - rather than with respect to the fiscal year in which the relevant services that led to the award were performed.

Finally, the SEC has rescinded its proposal to eliminate the reporting of the grant date fair value of stock and option awards in the Grants of Plan-Based Awards Table. Under the new rules, aggregate grant date fair value amounts must be reported in the Summary Compensation Table (and Director Compensation Table) and individual grant date fair value amounts must be reported in the Grants of Plan-Based Awards Table.

Compensation Consultant Conflicts

To highlight potential conflicts of interest, companies must provide certain information, as well as the fees paid to a compensation consultant (and its affiliates), in the following situations:

- If the board or compensation committee has engaged its own compensation consultant, and this consultant (including its affiliates) also provides additional

services to the company in an amount in excess of \$120,000 during the fiscal year; and

- If the board or compensation committee has not engaged its own compensation consultant, but a compensation consultant (including its affiliates) provides executive compensation consulting services and additional services to the company in an amount in excess of \$120,000 during the fiscal year.

Disclosure is not required for consultants that work with management (without regard to the nature of the engagement) if the board of directors has its own (different) consultant.

Under the new rules, services that involve only broad-based non-discriminatory plans or the provision of information, such as a survey, that is not customized for the company, or is customized based on parameters that are not developed by the consultant, are not considered "executive compensation consulting services."

The disclosure threshold of \$120,000, which is drawn from the related person disclosure rules, is intended to minimize the compliance burden for companies in situations where the SEC deems the potential for a conflict of interest to be minimal.

In addition to quantifying the compensation-related and non-compensation-related fees paid to the compensation consultant, where disclosure is triggered companies will be required, in situations where the board or compensation committee's consultant is also providing additional services to the company, to disclose whether the decision to engage the consultant to conduct the non-compensation-related work was made, or recommended, by management and whether the board approved the additional services.

Corporate Governance Matters

Director Qualifications

Under the new rules, companies must disclose the particular experience, qualifications, attributes, and skills that led their boards of directors to conclude that each individual board member (and each board nominee) should serve as a director. In an unexpected move, however, the SEC dropped the proposal that would have required companies

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to explain why individual directors were selected to serve on specific board committees.

In addition, companies must disclose all directorships at public companies and registered investment companies that each director held at any time during the past five years (even if no longer serving on that board), as well as any legal proceedings, such as SEC securities fraud enforcement actions against the director, going back 10 (instead of five) years.

Board Diversity

Under the new rules, companies must disclose whether, and if so how, a nominating committee considers diversity in identifying director nominees. Among other things, companies will be required to disclose whether they have a policy for considering diversity in identifying director nominees, and, if so, how this policy is implemented and how the company assesses the effectiveness of this policy. The SEC does not define the term “diversity.” Instead, it will be up to each company to define what this concept means within the context of its own organization.

Board Leadership Structure

Under the new rules, companies must disclose their board leadership structure, including whether the company has combined or separated the CEO and chairman positions. In addition, they must explain why they believe their structure is the most appropriate for them at the time of the filing. In certain circumstances, companies will also need to disclose whether and why a company has a lead independent director and the specific role of such director.

Risk Oversight

Under the new rules, companies must disclose the extent of the board of directors’ role in the risk oversight of the company. This requirement has been modified to require a discussion of a board’s oversight, rather than its management, of company risk. As the SEC noted, this change better reflects the board’s actual role in this area.

Reporting Voting Results

As proposed, the SEC has accelerated the reporting of the voting results from annual shareholder meetings. Under the new rules, these results must be disclosed within four business days after the end of the meeting at which the vote

was held. This replaces the requirement to disclose voting results in either annual or quarterly reports, which can be filed well after the relevant meeting.

Need Assistance?

Compensia has had significant experience in helping companies to prepare their executive compensation disclosure. If you have any questions on the subjects addressed in this Thoughtful Pay Alert or would like assistance in assessing how the SEC’s new rules are likely to affect your executive compensation disclosure, please feel free to contact us. ■

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