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SEC Proposes Rules to Enhance Compensation and Corporate Governance Disclosures

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On July 1, 2009, the Securities and Exchange Commission (the "SEC") unanimously approved proposed changes to the proxy rules designed to enhance disclosure of:

- the relationship of the company's overall compensation policies to risk;
- the qualifications of directors, director nominees, and executive officers;
- the company's leadership structure; and
- the role and potential conflicts of compensation consultants.

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- Corporate
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The SEC also proposed accelerating the reporting of results of shareholder votes by requiring such disclosures under a new Form 8-K item.[1]

This legal update is based on information provided at an SEC open meeting and in the SEC's press release announcing the proposal.[2] We will provide a more detailed discussion of the proposals when the text of the rule proposals is available.

Highlights of the SEC's Proposals

Compensation Proposals

The SEC's latest rule proposals regarding compensation seek to provide investors with additional information regarding how a company's overall compensation policies may impact its risk profile. The relationship between compensation policies and risk taking has been highlighted by the financial crisis, and the SEC's proposals build on requirements already applicable to institutions participating in the Treasury Department's Troubled Asset Relief Program. The proposed amendments to the Compensation Discussion and Analysis ("CD&A") disclosure requirements would require a public company to discuss and analyze how the company's compensation policies, as a whole, can affect the company's risk and its management of risk. This proposed requirement would expand the CD&A to include discussion and analysis of a company's policies with respect to the compensation of non-executive officer employees; however, the proposal would not require the disclosure of specific salaries paid to employees beyond the principal executive officer, the principal financial officer, and the three most highly compensated executive officers. As proposed, a company would only be required to include this additional CD&A disclosure regarding its overall compensation policies or practices if a determination is made that the risks arising from those compensation policies or practices may have a material effect on the company.

The proposals also would require companies to include additional disclosures regarding compensation consultants hired by the company or its compensation committee. If a compensation consultant or its affiliates (1) plays a role in determining the amount or form of compensation for the company's executives or directors, and (2) also provides other services to the company, then the company must disclose the nature of the other services, the aggregate fees received by the consultant and its affiliates, whether the decision to engage the compensation consultant for any other services was recommended or made by management, and whether the company's compensation committee or board approved such other services.

The proposals also would amend the reporting of stock and option awards in the Summary Compensation Table and the Director Compensation Table. The proposals would require disclosure, in the Stock Awards and Option Awards columns of those tables, of the fair value of such awards on the grant date, as opposed to the current disclosure requirement that is based on the expense recorded in the financial statements in accordance with FAS 123R. This proposal would reverse a last-minute decision that the SEC made in December 2006, when it adopted interim final rules without public comment that changed the way in which equity awards are reported. The requirement to include amounts expensed in accordance with FAS 123R, as opposed to the grant date fair value of awards, has drawn criticism for making the executive compensation disclosure too complex and not reflective of the way in which companies and their compensation committees approach compensation decisions.

Corporate Governance Proposals

Among the more significant corporate governance proposals included in the proposed new rules is a requirement that companies disclose additional information about directors' and director nominees' specific qualifications, including experience, attributes, and skills, to serve on the board and on any committees to which they are appointed. These disclosures would enhance the five-year biographical disclosure required under the current rules. In addition, the proposals would require companies to disclose, for each director and each nominee, other directorships held at public companies in the past five years (as opposed to only current directorships under the existing rules); and legal proceedings involving directors, director nominees, and executive officers would need to be disclosed if occurring in the past 10 years (as opposed to five years under the current rules). Although not mentioned in the SEC's press release, at least one commissioner noted at the open meeting that the proposals would also seek comment on whether the new rules should require disclosures on board diversity and whether diversity is a factor considered by the nominating committee in the nominating process.

The proposals also would require a company to disclose the company's current leadership structure and why the board believes that structure is best for the company. Included in this additional disclosure would be a discussion as to whether and why (or why not) the company has chosen to separate the principal executive officer and chairperson of the board roles. The new rules also would require disclosure of the board's role in the company's risk management process.

The SEC also proposes to move the disclosure of the results of shareholder votes from a Form 10-Q or Form 10-K item to a new Form 8-K item, thereby accelerating the reporting of such results. Under the new rules, a company would be required to disclose the results of such shareholder votes on Form 8-K within four business days of the conclusion of the meeting.

Next Steps – SEC Comment Period

The SEC has requested that all interested parties provide comments on the proposals. Comments on the proposals will be accepted by the SEC for 60 days following the publication of the proposed rules in the Federal Register. Anyone wishing to comment on the proposals should follow the instructions provided by the SEC at: http://www.sec.gov/rules/submitcomments.htm.

Conclusions

In presenting the new proxy rules proposals, the SEC Staff indicated that they expect some incremental increase to the overall length of proxy statements as a result of the amendments, and they expect that most of the proposals can be effective for the 2010 proxy season if approved. During the open meeting, Chairman Shapiro stated that the goal of the new rules proposals was not merely additional disclosure, but better overall disclosure of the topics addressed by the proposals. Other commissioners noted in their comments that the proposals do not attempt to set standards or best practices for compensation or corporate governance, but rather are intended to enhance the information available to shareholders.

Footnotes

[1] The proxy enhancements proposed by the SEC also included changes intended to clarify proxy solicitation rules regarding communications during the solicitation process, short slates, conditional proxies, and participant information. At the same meeting, the SEC also proposed rules to implement the requirement that companies participating in the Treasury Department's Troubled Asset Relief Program include a proposal in their proxy statements seeking an advisory vote on executive compensation, and the SEC approved the NYSE's proposed rule change to eliminate broker discretionary voting in the election of directors. For our discussion of the NYSE rule change, see "Divided SEC Approves NYSE Amendment to Eliminate Discretionary Broker Voting in Uncontested Director Elections."

[2]The SEC's press release, "SEC Proposes Measures to Improve Corporate Governance and Enhance Investor Confidence," dated July 1, 2009, is available at http://www.sec.gov/news/press/2009/2009-147.htm.