

## Client Alert

# SEC Adopts Modifications to the Proxy Disclosure Rules for 2010 Proxy Season

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## EXEQUITY

Independent Board and  
Management Advisors

On December 16, 2009, the Securities and Exchange Commission (SEC) adopted modifications<sup>1</sup> to the rules regarding proxy disclosure and solicitation, largely as proposed on July 10, 2009.<sup>2</sup> The rules are effective February 28, 2010 and will impact proxy and information statements, Form 10-Ks, and Form 8-Ks filed on or after that date.

**Exequity Comment:** *Most calendar year fiscal year companies are currently in the early stages of preparing their proxy disclosures, and the new rules will significantly impact these disclosures. The rules require some entirely new items (e.g., compensation risk disclosure), some changes to historic ways in which pay arrangements have been quantified (e.g., disclosure of the value of equity awards made during the covered year), and are likely to result in many companies changing their compensation consultant relationships (due to the new disclosures pertaining to consultant independence).*

*One hotly debated issue in this arena—Say on Pay—has not yet been passed. Thus, noticeably absent from 2010 proxies will be a shareholder vote on executive pay (except for TARP companies and voluntary adopters). However, it is likely that one of the several proposed legislative initiatives will ultimately require some form of Say on Pay for the 2011 proxy season.*

### Summary of Key Disclosure Changes

- **Risk Assessment**—The final rules require companies to include a discussion of compensation policies and practices for *all employees* if the policies and practices create risks that are *reasonably likely to have a material adverse effect on a company*, i.e., the same standard applicable to the Management Discussion and Analysis (MD&A) disclosures. The final rules provide examples of situations in which disclosure may be required, such as situations where a business unit carries a significant portion of the company's risk profile, where a business unit has a significantly different compensation structure, or where a business unit is significantly more profitable than others. Note, this disclosure would not be part of the Compensation Discussion and Analysis (CD&A), but rather would fall under a separate paragraph. Importantly, if a company determines that its compensation policies and practices are not reasonably likely to have a material adverse effect, it will not be required to affirmatively disclose this conclusion.

<sup>1</sup> SEC Release No. 33-9089, *Proxy Disclosure Enhancements* (December 16, 2009), available at: <http://www.sec.gov/rules/final/2009/33-9089.pdf>

<sup>2</sup> SEC Release No. 33-9052, *Proxy Disclosure and Solicitation Enhancements* (July 10, 2009), available at: <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>

**Exequity Comment:** *In raising the standard of disclosure to requiring a determination that the compensation policies and practices are **reasonably likely** to have a material adverse effect, we expect that very few companies will be required to include a disclosure in this area. However, all companies will need to establish a process for determining that such a risk does not exist, including determining which committee or committees of the Board will make the assessment, particularly in light of the requirement that all companies will be required to describe the Board's role in overseeing risk generally.*

- **New Disclosure Regarding Compensation Consultants**—Under certain circumstances, the final rules require the disclosure of the fees of compensation consultants in determining or recommending the amount or form of executive and director compensation, as well as the fees associated with non-executive compensation consulting. In addition, if the fees are required to be disclosed, other disclosure requirements will apply, including (i) whether the decision to engage the consultant was made or recommended by management and (ii) whether the Board approved the non-executive compensation services provided. The items below summarize the circumstances where disclosure is required.

— If the Board retains its own consultant separate from management's consultant, only the fees of the Board's consultant will be subject to potential disclosure.

— If the Board's advisor (or management's advisor if the Board does not retain an advisor) provides non-executive compensation services, fee disclosure will be required if the fees associated with non-executive compensation services exceed \$120,000. For this purpose, the rules clarify that the following services are not considered executive compensation services: (i) fees associated with consulting on any broad-based plan that does not discriminate in scope, terms, or operation, in favor of executive officers or directors, and that is available generally to all salaried employees, or (ii) fees associated with survey or other information that either was not customized for a particular company or was customized based on parameters that were not developed by the consultant, and about which the consultant does not provide advice.

**Exequity Comment:** *The rules are intended to provide disclosure of conflicts of interests that a compensation consultant may have. Because fee disclosure can be easily avoided in settings in which the Compensation Committee retains its own independent advisor, the final rules could cause a significant movement toward a two-consultant model, with an independent firm advising the Board while a multi-service firm represents management.*

- **Summary Compensation Table (SCT)**—The final rules require disclosure of the full grant date fair value of stock awards and option awards made during the year in the Summary Compensation and Director Compensation Tables (with the fair value being determined according to the dictates of FASB ASC Topic 718 (formerly FAS 123(R))). This is a reversal of the 11th hour changes made in 2006 which required the disclosure to reflect the expense accrued during the year (covering all awards expensed during the year, regardless of whether they were granted in the covered year) shown in the table. The rules require that disclosures of award values for prior years be restated to reflect this change in new filings but do not require amendments to prior filings.

The final rules retained the requirement that compensation be disclosed in the form in which it was granted. Thus, if salary is deferred at the executive's election into a non-cash form such as stock, the amount will be reflected in the salary column of the SCT. However, footnote disclosure of the deferral into stock would be required, along with a reference to the Grant of Plan-Based Awards Table where the stock award is reported.

Under a new instruction, any stock awards or option awards that are subject to performance conditions will be included in the appropriate column of the SCT based on the probable outcome of such performance conditions. Companies must disclose in a footnote to the SCT the value of such awards at grant assuming the highest level of performance is achieved if an amount less than the maximum is included in the SCT. These requirements also apply to equity awards disclosed in the Director Compensation Table.

**Exequity Comment:** *These rules will impact the individuals who will be required to be disclosed in the proxy for fiscal 2009. Though the individuals included as named executive officers (NEOs) in the disclosures may change from year to year based on one-year awards (e.g., sign-on grants or retention awards), the SEC believes that the new approach to valuing equity awards more accurately reflects the Compensation Committee's deliberation process on top executive pay for the covered year. Note that the prior method for disclosing equity award values was similarly subject to year-over-year changes in the NEO group, as the individuals disclosed could be significantly impacted by the retirement eligibility of senior officers where equity awards accelerated vesting upon retirement.*

- **Grants of Plan-Based Awards Table (GPBAT)**—The final rules do not eliminate the grant date fair value column for equity awards in the GPBAT and Director Compensation Table.

Performance-based awards should be disclosed in the GPBAT based upon the probable outcome of such performance conditions, which should be consistent with the company's estimate of aggregate compensation cost to be recognized over the service period determined as of the grant date under FASB ASC Topic 718, excluding the effect of estimated forfeitures.

- **New Disclosure About Company Leadership and the Board's Role in the Risk Management Process**—The final rules require companies to disclose the company's leadership structure and why the company believes it is an appropriate structure. Companies will also be required to disclose whether the same person serves as both Principal Executive Officer (i.e., CEO) and Chairman of the Board and, if so, whether and why a lead independent director role exists, and the specific role played by the lead independent director in the leadership of the company. The proposed rules would also require disclosure of the Board's role in the company's risk management process.

**Exequity Comment:** *This rule is likely to continue the trend toward a splitting of the roles of CEO and Board Chair, and where these roles remain combined, toward designation of a lead director. In addition, given the dramatically heightened focus on risk, we expect many companies to formally designate the Audit Committee as the identified overseer of risk, while some companies will establish a separate committee of the Board to specifically oversee risk.*

- **Director and Nominee Changes**—The final rules expand the disclosure requirements regarding the qualifications of directors and nominees, past directorships held by directors and nominees, and the time frame for disclosure of legal proceedings involving directors, nominees, and executive officers. The proposals would require companies to disclose details of each director's and nominee's particular experience, qualifications, attributes, or skills that qualify that person to serve as a director as of the time of the filing, but not as a member of any committee that the person serves on or is chosen to serve on in light of the company's business and structure as was proposed. The final rules also introduce a new rule not in the proposed rules that requires companies to explain if and how their Nominating Committee takes diversity into account in the selection of director nominees, although the rules do not define diversity.
- **Reporting of Voting Results on Form 8-K**—The final rules require companies to report the results of a shareholder vote within four business days after the end of the meeting at which the vote was held on a Form 8-K.
- **Transition to New Rules**—The final rules simply indicate that their effective date is February 28, 2010. However, the SEC issued several Compliance and Disclosure Interpretations (C&DIs) concerning the transition to the new proxy enhancement disclosures on December 22, 2009.<sup>3</sup> These C&DIs make clear that:
  - Companies with fiscal years ending on or after December 20, 2009 will have to file their Form 10-K and proxy statement in compliance with the new rules.
  - If a company is not required to comply with the new rules, it can do so voluntarily so long as it complies with all the other requirements applicable to the form it files.
  - If a company is becoming subject to the securities disclosure rules and files a registration statement on or after December 20, 2009, it will have to comply with the new Regulation S-K amendments for such registration statement to be declared effective on or after February 28, 2010.
  - As to the Form 8-K requirements applicable to the reporting of shareholder voting results, these will apply to any meeting that takes place on or after February 28, 2010.

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<sup>3</sup> SEC's Proxy Disclosure Enhancements Transition, Compliance and Disclosure Interpretations (December 22, 2009), available at: <http://www.sec.gov/divisions/corpfin/guidance/pdetinterp.htm>



If you have any questions about this **Client Alert**, please contact Ed Hauder ((847) 996-3990 or [Edward.Hauder@exqty.com](mailto:Edward.Hauder@exqty.com)) or any of the following:

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PUB/CA/SEC Pxy Rule Amends\_20100105

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