

August 7, 2009

SEC Proposes Rule Amendments to Executive Compensation and Corporate Governance Disclosure

On July 10, 2009, the U.S. Securities and Exchange Commission (the "SEC") proposed a series of amendments to its executive compensation and corporate governance disclosure rules in Regulation S-K. See [Release Nos. 33-9052, 34-60280, and IC-28817](#).¹

Comments on the proposed rules are due September 15, 2009. If the proposed amendments are adopted, the SEC anticipates that they will be effective for the 2010 proxy season.

Executive Summary

The proposed amendments would:

- add a new section to Compensation Discussion & Analysis ("CD&A") requiring disclosure about a company's overall compensation policies and their impact on risk taking;
- require the reporting of stock and option awards at grant date fair value, rather than the dollar amount recognized for financial reporting purposes for the fiscal year;
- require disclosure about the fees paid to, and additional services provided by, compensation consultants and their affiliates when they play any role in determining or recommending the amount or form of executive and director compensation, if they also provide other services to the company;
- expand the required disclosure regarding the qualifications of directors and nominees, past directorships held by directors and nominees, and lengthen from five to ten years the time frame for disclosure of legal proceedings involving directors, nominees and executive officers;
- require disclosure of a company's leadership structure and why the company believes it is the best structure for it;
- require disclosure about the board's role in the company's risk management process; and
- require that results of shareholder votes be reported within four business days on Form 8-K, rather than in the next Form 10-Q or Form 10-K filing.

¹ This alert discusses the proposed amendments as presently described in the SEC's release, though the amendments are still subject to change.

The proposing release also includes certain proposed amendments to the SEC's proxy rules promulgated under the Securities Exchange Act of 1934 (the "Exchange Act"), which are not discussed in this Corporate/Securities Alert.

Executive Compensation

Risk Management Disclosure

The SEC notes that compensation policies at some companies have become disconnected from long-term company performance because incentive compensation arrangements do not sufficiently align the interests of management and some employees with the long-term well-being of the company. Critics have argued that the structure and particular application of incentive compensation policies can, without adequate recognition of the risks to the company, inadvertently create incentives for management and employees to make decisions that significantly, and inappropriately, increase the company's risk. The misalignment of compensation policies at large financial institutions with their long-term well-being has been cited as a contributing factor for the current market turmoil.

In light of these concerns, the SEC is proposing to amend its CD&A requirements in Item 402 of Regulation S-K to add a section describing how a company's overall compensation policies for employees create incentives that can affect the company's risk and risk management. The proposed amendments would require a company to discuss and analyze its broader compensation policies and overall actual compensation practices for employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a material effect on the company. Disclosure would be required only if the materiality threshold is triggered.

The situations that would require disclosure under the proposed amendments would vary depending on the particular company and its compensation programs. However, the SEC provides a non-exhaustive list of situations that potentially could trigger the disclosure requirement:

- a business unit carries a significant portion of the company's risk profile;
- compensation at a business unit is structured significantly differently than compensation at other business units;
- a business unit is significantly more profitable than other business units;
- compensation expense is a significant percentage of a business unit's revenues; or
- the company has in place compensation policies or practices that vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer time.

The SEC also provides examples of the issues that companies may need to address if disclosure is required:

- the general design philosophy of, and manner of implementing, the company's compensation policies for employees whose risk taking on behalf of the company would be most incentivized by those policies;

- the company's risk assessment or incentive considerations, if any, in structuring its compensation policies or in awarding and paying compensation;
- how the company's compensation policies relate to the realization of risks resulting from the actions of employees in both the short-term and long-term, such as through policies requiring claw backs or imposing holding periods;
- the company's policies regarding adjustments to its compensation policies to address changes in its risk profile;
- material adjustments the company has made to its compensation policies or practices as a result of changes in its risk profile; and
- the extent to which the company monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

Stock and Option Awards

The SEC adopted broad amendments to its executive compensation disclosure rules in 2006 and added a requirement to provide a dollar amount for stock and option awards in the Summary Compensation Table and the Director Compensation Table and to include the dollar amounts as a component of the total compensation calculation. Currently, the value of stock and option awards is reported as the dollar amount recognized for financial reporting purposes for the fiscal year. The SEC is proposing to require that the value of these awards instead be reported based on the aggregate grant date fair value computed in accordance with FAS 123R.

The SEC believes that this change to Item 402 of Regulation S-K will better allow investors to consider compensation decisions made during the fiscal year, evaluate the amount of equity compensation awarded and understand which executives a company intends to compensate most highly. The current method of reporting the value of stock and option awards sometimes results in the disclosure of a negative number. The negative number reduces the amount reported in the total compensation column, which can confuse investors. Also, the SEC believes the effect of option repricings on total compensation will be clearer if the proposed changes are adopted, because aggregate grant date fair value under FAS 123R would include the incremental fair value of repriced options.

Because total compensation is the basis for determining which executive officers, in addition to the principal executive officer and principal financial officer, are the named executive officers whose compensation must be reported and discussed in the CD&A and compensation tables, the proposed amendment may affect the identification of such named executive officers.

The SEC's proposed amendments also would:

- rescind the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table and corresponding footnote disclosure to the Director Compensation Table, because those disclosures may duplicate the new aggregate grant date fair value disclosure in the Summary Compensation Table and Director Compensation Table; and

- provide that registrants would not be required to report in the salary and bonus columns of the Summary Compensation Table the amount of salary or bonus forgone at a named executive officer's election, and that non-cash awards received instead are reportable in the column applicable to the form of award elected.

In its request for comments on the proposal, the SEC notes that, as proposed, the Summary Compensation Table would require reporting the aggregate grant date fair value of stock and option awards granted during the relevant fiscal year, but asks whether the Summary Compensation Table should instead require reporting of the value of awards granted for services performed in the relevant fiscal year, even if the awards were granted in a later fiscal year.

The SEC is also considering whether to require companies providing executive compensation disclosure for a fiscal year ending on or after December 15, 2009 to present recomputed stock and option awards disclosure for each preceding fiscal year required to be included in the Summary Compensation Table. If a person who would be a named executive officer for the most recent fiscal year (2009) also was disclosed as a named executive officer for 2007, but not for 2008, the SEC proposes to require the named executive officer's compensation to be reported for each of those three fiscal years with recomputed stock and option award values. The SEC would not, however, require companies to include different named executive officers for any preceding fiscal year based on recomputing total compensation for those years pursuant to the proposed amendments or to amend previously filed executive compensation disclosure.

Compensation Consultants

Compensation consultants often provide services in addition to recommending executive compensation plans or policies. Many compensation consultants, or their affiliates, provide a broad range of additional services, such as benefits administration, human resources consulting and actuarial services. The fees generated by those additional services may be more significant than the fees earned by the consultants for their executive compensation services. The SEC believes that providing these additional services may create the appearance or risk of a conflict of interest that may call into question the objectivity of the consultants' executive pay recommendations.

The SEC is proposing to amend Item 407 of Regulation S-K to require disclosure about the fees paid to compensation consultants (including affiliates) if they play any role in determining or recommending the amount or form of executive and director compensation and also provide other services to the company (other than consulting on broad-based plans that do not discriminate in favor of executive officers or directors of the company, such as 401(k) plans or health insurance plans). The proposed amendments would also require a description of any additional services provided to the company by the compensation consultants.

Under the proposed amendments, if a compensation consultant or its affiliates played a role in determining or recommending the amount or form of executive or director compensation, and also provided additional services, then the company would be required to disclose the following:

- the nature and extent of all such additional services provided during the last fiscal year;
- the aggregate fees paid for all such additional services, and the aggregate fees paid for work related to determining or recommending executive and director compensation;

- whether the decision to engage the compensation consultant or its affiliates for additional services was made, recommended, subject to screening or reviewed by management; and
- whether the board of directors or the compensation committee approved all of the additional services.

Corporate Governance Disclosure

Enhanced Director and Nominee Disclosure

The SEC is proposing amendments to Item 401 of Regulation S-K to expand the disclosure 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. Specifically, the SEC is proposing to require disclosure detailing for each director and nominee the particular experience, qualifications, attributes or skills that qualify that person to serve as a director, and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the company's business and structure. These revisions are aimed at helping investors determine whether a particular director and the entire board composition is appropriate for a given company.

The SEC notes that the types of information that may be disclosed include information about a director's or nominee's risk assessment skills and any specific past experience that would be useful to the company, as well as information about a director's or nominee's particular area of expertise and why the director's or nominee's service as a director would benefit the company.

The SEC is also proposing two additional changes to its director and nominee biographical disclosure requirements in Item 402 of Regulation S-K. First, the SEC is proposing to require disclosure of any public company directorships held by each director and nominee at any time during the past five years. Existing rules require only disclosure of currently-held director positions. Second, the SEC is proposing to lengthen the time during which disclosure of certain enumerated legal proceedings is required from five to 10 years.

The SEC notes that it is interested in understanding whether investors and other market participants believe that diversity in the boardroom is a significant issue, and is requesting comment on whether additional disclosure in this area should be required.

Company Leadership Structure and the Board's Role in the Risk Management Process

The SEC is proposing a change to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A that would require disclosure of a company's leadership structure and why the company believes it is the best structure for it at the time of the filing. Under the proposed amendments, companies also would be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. If the role of principal executive officer and board chairman are combined, a company would also be required to disclose whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company.

The SEC is also proposing to require additional disclosure in proxy and information statements about the board's role in managing the company's risk, such as credit risk, liquidity risk and operational risk. The disclosure would include information about how the company perceives the board's role in risk management and the relationship

between the board and senior management in managing material risks. The proposing release provides the following examples of topics the disclosure might address:

- whether the board implements and manages its risk management function through the board as a whole or through a committee, such as the audit committee;
- whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and
- whether and how the board, or board committee, monitors risk.

Reporting of Voting Results on Form 8-K

The SEC is proposing to require disclosure of shareholder voting results on Form 8-K within four business days after the end of the meeting at which the vote was held. Current rules require disclosure of shareholder voting results for meetings held during the fiscal quarter covered by either a Form 10-Q or Form 10-K (with respect to the fourth fiscal quarter). Under the proposals, the SEC would add a new Item 5.07 to Form 8-K and delete the requirement from Forms 10-Q and 10-K.

If the matter voted upon at the meeting relates to a contested election of directors and the voting results are not definitively determined at the end of the meeting, companies would be required to disclose on Form 8-K the preliminary voting results within four business days after such preliminary voting results are determined, and file an amended report on Form 8-K within four business days after the final voting results are certified.

Recommendations

The SEC has indicated that if the proposed amendments are adopted, they will likely be effective for the 2010 proxy season. If this is the case, companies will have a relatively short time after adoption of the new rules to incorporate the changes into their drafting process for their 2010 proxy statements. In order to implement the potential changes in a timely manner, companies should consider taking the following steps:

- review whether the company's overall compensation policies and practices for employees create incentives that could affect the company's risk and management of that risk and consider implementing modifications or measures to address the effects of such incentives;
- determine whether the proposed change in the method of reporting the value of stock and option awards will change the identification of the company's named executive officers;
- review the services currently provided to the company by any compensation consultants that play any role in determining or recommending the amount or form of executive or director compensation and if such consultants provide or are expected to provide any additional services to the company, consider implementing or updating written policies regarding compensation consultant independence and approval of the provision of such additional services;
- update director and officer questionnaires and consider whether any additional procedures are necessary in order to provide the proposed additional disclosure regarding the qualifications of

directors and nominees, past directorships held by directors and nominees, and legal proceedings involving directors, nominees and executive officers during the past 10 years;

- review the composition and structure of the board and confirm that it is the best composition and structure for the company, and consider the disclosure that will be made to explain such determination;
- if the chief executive officer is also the chairman of the board, consider appointing a lead independent director;
- consider the role of any lead director and formalizing such role in writing (e.g., in the company's corporate governance guidelines); and
- review the board's (including the audit committee's) role in the company's risk management process and consider whether any changes should be made.

For more information, please contact any of the following members of the [Securities/Capital Markets](#) practice group.

[Brian D. Barnard](#)

(817) 347-6605

brian.barnard@haynesboone.com

[William R. Hays, III](#)

(214) 651-5561

bill.hays@haynesboone.com

[Darrel A. Rice](#)

(214) 651-5969

darrel.rice@haynesboone.com

[Arthur S. Berner](#)

(713) 547-2526

arthur.berner@haynesboone.com

[Bill Kleinman](#)

(972) 680-7565

bill.kleinman@haynesboone.com

[Gregory R. Samuel](#)

(214) 651-5645

greg.samuel@haynesboone.com

[Michael M. Boone](#)

(214) 651-5552

michael.boone@haynesboone.com

[Bryce D. Linsenmayer](#)

(713) 547-2007

bryce.linsenmayer@haynesboone.com

[Janice V. Sharry](#)

(214) 651-5562

janice.sharry@haynesboone.com

[James F. Brashear](#)

(214) 651-5029

jim.brashear@haynesboone.com

[Judithe H. Little](#)

(713) 547-2235

judithe.little@haynesboone.com

[W. Scott Wallace](#)

(214) 651-5587

scott.wallace@haynesboone.com

[Nancy Brenner](#)

(212) 659-4969

nancy.brenner@haynesboone.com

[John W. Menke](#)

(713) 547-2584

john.menke@haynesboone.com

[Rick A. Werner](#)

(212) 659-4974

rick.werner@haynesboone.com

[Brian Daughney](#)

(212) 659-4964

brian.daughney@haynesboone.com

[Amy Christine Moss](#)

(713) 547-2051

amy.moss@haynesboone.com

[Taylor H. Wilson](#)

(214) 651-5615

taylor.wilson@haynesboone.com

[Garrett A. DeVries](#)

(214) 651-5614

garrett.devries@haynesboone.com

[William B. Nelson](#)

(713) 547-2084

bill.nelson@haynesboone.com

[Jennifer Wisinski](#)

(214) 651-5330

jennifer.wisinski@haynesboone.com

[Ricardo Garcia-Moreno](#)

(713) 547-2208

ricardo.garcia-moreno@haynesboone.com

[Bruce Newsome](#)

(214) 651-5119

bruce.newsome@haynesboone.com

[Thomas H. Yang](#)

(214) 651-5545

tom.yang@haynesboone.com

[Debra Gatison Hatter](#)

(713) 547-2615

debra.hatter@haynesboone.com

[George G. Young III](#)

(713) 547-2081

guy.young@haynesboone.com