

Related Practices

Corporate Governance
Public Companies

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The Securities and Exchange Commission recently proposed rule changes intended to increase the transparency of public companies' compensation and governance activities. The proposal focuses on disclosure of compensation and governance policies and practices, with an emphasis on activities that contribute to a company's risk profile. The SEC hopes to have the new rules in place for the 2010 proxy season.

Overall Compensation Policies

Under the proposal, a public company would need to discuss and analyze its compensation policies and actual compensation practices for employees generally— not just for executive officers— if risks arising from these policies or practices could have a material effect on the company. This disclosure, if required, would appear in a separate section of the company's Compensation Discussion and Analysis (CD&A). The proposed rule release specifies that under the SEC's current rules, any material relationship between compensation structure and risk taking for named executive officers should already be disclosed in the CD&A.

Stock and Option Awards of Executives and Directors

The Summary Compensation Table and Director Compensation Table would report the aggregate grant date fair value of stock and stock option awards granted during the fiscal year, computed in accordance with FAS 123R, instead of the dollar amount recognized for financial statement reporting purposes for the fiscal year. Related to this shift, the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table would be rescinded. In addition, the rules regarding disclosure of salary and bonus foregone at the election of a named executive officer in exchange for noncash compensation would be revised to require disclosure of the compensation only under the columns that reflect the form of compensation ultimately received by the named executive officer.

Directors and Nominees

The background information provided about each director and nominee would be expanded to include detailed information on the person's particular experience, qualifications, attributes or skills that qualify him or her to serve as a director and as a member of any committee he or she serves on or will serve on, in light of the company's business and structure. In addition, required disclosure of service on the boards of other public companies would be expanded from current directorships to directorships held within the last five years, and the look-back period for certain legal proceedings that need to be

disclosed would be expanded from five years to 10 years.

Leadership Structure and the Board's Role in Risk Management

A reporting company would need to describe its leadership structure and explain why that structure is appropriate in the company's circumstances. Specifically, the company would need to disclose whether and why the principal executive officer position is combined with the board chair position, and if the positions are combined, whether and why a lead independent director has been designated and what role that position has.

In addition, the proxy statement would include information about the board's role in managing the company's risk. This disclosure would address issues such as whether the board as a whole or a board committee is responsible for the board's risk management function, whether the company personnel responsible for risk management report directly to the board or committee, and whether and how the board or committee monitors risk.

Compensation Consultants

If a consultant has a role in determining or recommending the amount or form of executive officer or director compensation and also provides additional services to the company, the company would need to disclose information that allows investors to evaluate the potential for a conflict of interest. The following information would need to be included in the company's proxy statement: the nature and extent of the additional services, the aggregate fees paid to the consultant for the additional services, the aggregate fees paid to the consultant for the executive officer and director compensation services, the role of management in deciding to engage the consultant to perform the additional services, and whether the board or compensation committee has approved the additional services.

These disclosures are in addition to existing disclosure requirements covering the identity of such compensation consultants, the nature and scope of their assignment, and the instructions or directions given to the consultants.

Other Rule Changes

In addition to these substantive changes designed to enhance disclosure, the SEC also proposes procedural changes to the proxy solicitation rules to clarify their operation. Furthermore, the SEC proposes requiring companies to report voting results from shareholder meetings on Form 8-K, instead of Form 10-Q or Form 10-K. The Form 8-K would need to be filed within four business days after the meeting, subject to limited exceptions for meetings involving contested director elections.

SEC's Next Steps

The comment period for these proposed rules ends on September 15, 2009. The proposed rule release indicates that the SEC is actively considering and welcomes input on a number of additional issues, including whether companies should be required to disclose the extent to which board diversity is a consideration in the nomination process, whether the annual change in value of stock and option awards should be reported in the Summary Compensation Table and Director Compensation Table instead of the aggregate grant date fair value, whether compensation disclosure should be expanded to include all executive officers and whether a company's ability to omit performance targets from CD&A

based on competitive concerns should be eliminated.

Preparing for Changes

Big changes to the proxy disclosure rules are on their way, and these changes could get even bigger by the time the final rules are adopted. Since the SEC hopes to have final rule amendments adopted in time for the 2010 proxy season, it is likely that companies will have limited time to react to the final rules. As a result, companies may want to consider taking the following actions now to prepare for the rule changes:

- n Review compensation policies applicable to broader employee base. Consider how the design of these policies relate to risk management practices and/or risk-taking incentives. For example, consider whether and why policies vary from business unit to business unit, and whether the timing of payment of incentive compensation is aligned with the company's exposure to risk resulting from the events upon which the incentive compensation was earned. Identify other compensation policies, such as broad-based stock ownership guidelines or clawback/forfeiture policies, that may impact risk from employee actions.
- n Engage the nominating and governance committee in discussions regarding the qualifications of all incumbent directors and nominees. Identify the qualifications and skills of each director and nominee. Explain how those qualifications and skills are important to the board in light of the company's business and structure. Compare the qualifications and skills represented by directors and nominees against desirable qualifications for board members as set forth in any company policies. Follow the same procedure for members of each board committee.
- n Revisit the company's position on the desirability of separating the roles of board chair and chief executive officer. If the company has a lead independent director instead of an independent board chair, identify the lead director's responsibilities.
- n Review committee charters and board practices regarding allocation of risk management oversight among the board and board committees. Identify reporting relationships of personnel responsible for risk management, and consider how the board or board committees receive relevant information from risk management personnel.
- n Identify all compensation consultants that play a role in determining or recommending compensation for executive officers and directors. Identify all other services performed by those compensation consultants. Calculate the amount of fees paid, or expected to be paid, for the fiscal year to those compensation consultants for both types of services. Identify who was involved in the decision to engage the compensation consultants to perform each service and whether the board or compensation committee approved the engagement.