

Client Advisory | December 2009

SEC Requires Additional Corporate Governance and Compensation Disclosure for 2010 Annual Meetings

Matthew C. Dallett, Partner

Christopher S. Kiefer, Associate

¹ SEC Release 33-9089 (12/16/09) (the "Adopting Release"), available at www.sec.gov/rules/final/2009/33-9089.pdf. Some of the new requirements are broader than the SEC's July 2009 proposals, which were discussed in our earlier Client Advisory found at www.eapdlaw.com/newsstand/detail.aspx?news=1663. However, the SEC has deferred its proposed changes to the proxy solicitation process.

Most public companies will need to provide new disclosures about corporate governance, director qualifications and compensation matters in proxy statements for their 2010 annual meetings. The SEC has just adopted new rules that apply to filings made on or after February 28, 2010.¹ (The Adopting Release does not explicitly address transition timing questions, so we expect further clarification from the SEC.) The new disclosures will appear primarily in proxy statements but will also apply to some registration statements and Forms 10-K. There is also a new Form 8-K disclosure requirement.

Compliance with the new rules will require companies to gather and describe a significant amount of

information about their policies and practices and their directors, and may require meaningful board or committee involvement. In a number of cases, boards or committees will need to assess whether policies should be adopted or revised in order to support or enhance the new disclosures. The annual D&O Questionnaire will need revising. Given the short time frame for compliance, companies should promptly review their schedules for board and committee meetings, as well as for annual meeting preparation, to accommodate any additional efforts that will be required.

The table below summarizes the new disclosure requirements and suggests actions for companies to take now.

New Disclosure Requirement	Item	Suggested Action
CORPORATE GOVERNANCE		
<p>Board's Leadership Structure</p> <ul style="list-style-type: none"> Describe the "leadership structure" of the board of directors, such as whether the same person serves as the principal executive officer and chairman and, if so, whether there is a lead independent director and his or her role. Explain why the company has determined that this structure is appropriate given the company's specific characteristics or circumstances. 	<p>New Item 407(h), Reg. S-K</p>	<ul style="list-style-type: none"> The governance committee or other appropriate director(s) should assess the board leadership structure and specifically review a draft of the disclosure.
<p>Board's Risk Oversight Role</p> <ul style="list-style-type: none"> Describe the board's role in the "risk oversight" of the company, "such as how the board administers its oversight function, and the effect that this has on the board's leadership structure." A description of the board's role necessitates some description of the larger risk oversight process. 	<p>New Item 407(h), Reg. S-K</p>	<ul style="list-style-type: none"> Corporate risk management personnel should be involved in preparing this disclosure. A review of applicable aspects of the company's internal control over financial reporting may be helpful. The risk management committee or other appropriate director(s) should specifically review a draft of the disclosure. This disclosure should be considered in tandem with the disclosure on "Risk-Related Compensation Policies and Practices" discussed under "Compensation Matters" below.

New Disclosure Requirement	Item	Suggested Action
INFORMATION ABOUT DIRECTORS		
<p>Diversity Considerations in Identifying Director Nominees</p> <ul style="list-style-type: none"> ■ Disclose whether the nominating committee considers diversity in identifying director nominees and, if so, how, including how any policy regarding the consideration of diversity is implemented. ■ If the nominating committee has a diversity policy, discuss how the committee assesses its effectiveness. 	<p>Revised Item 407(c), Reg. S-K</p>	<ul style="list-style-type: none"> ■ Involve the nominating committee and Investor Relations in reviewing the disclosure. ■ If the company has no policy for considering diversity in identifying director nominees, address the pros and cons of adopting one. ■ Note that the SEC does not define “diversity,” leaving it to each company to do so as narrowly or expansively as it considers appropriate (e.g., focusing on concepts such as race, gender and national origin and/or including differences of viewpoint, professional and business experience, education, skill and other individual attributes).
<p>Director Qualifications</p> <ul style="list-style-type: none"> ■ Disclose, for each director nominee <i>and</i> each continuing director, the specific experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director at the time of the disclosure, in light of the company’s business and structure. 	<p>Revised Item 401(e)(1), Reg. S-K</p>	<ul style="list-style-type: none"> ■ The nominating committee should address these considerations when recommending the nominees for the upcoming annual meeting and should communicate them to the board. ■ Unless you wish to disclose that the board did not affirmatively conclude that each continuing director should continue to serve, the nominating committee should also assess these factors for continuing directors and communicate them to the board for its concurrence. ■ The committee should be involved in preparing the disclosure, which will be more meaningful if placed in the context of the desired qualifications of the board as a whole. <ul style="list-style-type: none"> ■ It may be helpful to review the learning from prior board evaluations in this process.
<p>Directorships</p> <ul style="list-style-type: none"> ■ Disclosure of directorships at public companies and registered investment companies must be given for the past five years (instead of only current directorships as at present). 	<p>Revised Item 401(e)(2), Reg. S-K</p>	<ul style="list-style-type: none"> ■ Revise D&O Questionnaire to ask about directorships held during the last five years.
<p>Legal Proceedings</p> <ul style="list-style-type: none"> ■ Companies must disclose for each director, director nominee and executive officer all legal proceedings in the specified categories during the past ten years (instead of five years as at present). ■ The new rule also expands the categories of legal proceedings that must be disclosed to include (i) involvement in mail or wire fraud or fraud in connection with any business entity and proceedings based on violations of federal or state securities, commodities, banking or insurance laws and regulations, excluding settlements of a civil proceeding among private parties, and (ii) disciplinary actions taken by a stock, commodities or derivatives exchange or other self-regulatory organization. 	<p>Revised Item 401(f), Reg. S-K</p>	<ul style="list-style-type: none"> ■ Revise D&O Questionnaire to (i) ask about the newly required categories of legal proceeding and (ii) capture legal proceedings during the last ten years. <ul style="list-style-type: none"> ■ Note that this item also applies to disclosure about executive officers (which typically appears in Form 10-K).

New Disclosure Requirement	Item	Suggested Action
COMPENSATION MATTERS		
<p>Risk-Related Compensation Policies and Practices</p> <ul style="list-style-type: none"> ■ Describe compensation policies and practices (not limited to executives) “as they relate to risk management practices and risk-taking incentives” if they create risks that are reasonably likely to have a material adverse effect on the company. ■ No disclosure is required if you have determined that there are no such risks. <p>{This requirement is not applicable to smaller reporting companies.}</p>	<p>New Item 402(s), Reg. S-K</p>	<ul style="list-style-type: none"> ■ Assess the applicability, in light of the company’s particular circumstances, of the SEC’s list of factors that could trigger disclosure and list of issues that may need to be addressed in any disclosure. (See Appendix A to this Advisory.) ■ You may take into account any policies, controls or other factors that mitigate the chance of a risk coming to pass. <ul style="list-style-type: none"> ■ As with MD&A “trends and uncertainties” disclosure, disclosure of a risk is required if (a) it would have a material adverse effect if it came to pass and (b) you cannot say it is likely that it won’t come to pass. ■ Involve the compensation committee in reviewing the disclosure (or any conclusion that no disclosure is required), even though this does not relate only to executive compensation. ■ Although this disclosure will be provided outside the CD&A, consider whether the CD&A also needs to discuss risk issues applicable to executive compensation.
<p>Stock and Option Awards</p> <ul style="list-style-type: none"> ■ Revise the Summary Compensation Table (“SCT”) and Director Compensation Table (“DCT”) to disclose the aggregate grant date fair value of stock and option awards made to each NEO or director during each year presented (including prior years). ■ Currently, these tables disclose the company’s total compensation expense for all equity awards held by the individual during the respective year, including prior years’ awards. ■ Compute the value of performance-based awards included in the SCT, DCT and Grants of Plan-Based Awards Table based on the probable outcome of the performance conditions at the grant date. ■ Also, if not included in the table, footnote for the SCT and DCT the maximum value of each award assuming that all performance conditions will be met. <p>{This requirement applies only to companies with fiscal years ending after December 20, 2009.}</p>	<p>Revised Items 402(c)(2), 402(d), 402(k), 402(n), Reg. S-K</p>	<ul style="list-style-type: none"> ■ The disclosed grant date values of performance-based awards (based on the “probable outcome”) should be consistent with the financial statement estimates of expense to be recognized over the service period, excluding the effect of estimated forfeitures: most likely the “target” amounts. ■ Calculate Total Compensation for each year shown using the aggregate grant date fair value of stock and option awards made during the respective year. This may affect the determination of NEOs to be included in the compensation tables and CD&A for the current year. ■ If a grant of a large “one-time” (e.g., new hire or retention) award results in one executive displacing from the SCT another whose compensation would otherwise have required him or her to be included, consider including supplemental disclosure to explain the situation.

New Disclosure Requirement	Item	Suggested Action
<p>Compensation Consultant Arrangements</p> <ul style="list-style-type: none"> ■ If a compensation consultant that provides advice or recommendations on executive or director compensation also provides more than \$120,000 of additional services during the company's fiscal year, disclose: <ul style="list-style-type: none"> (i) the aggregate fees for the executive / director compensation services, (ii) the aggregate fees for the additional services, and (iii) who (the compensation committee or management) recommended, made and/or approved the decision to engage the consultant for the respective services. 	<p>Revised Item 407(c)(3), Reg. S-K</p>	<ul style="list-style-type: none"> ■ Identify the services and tabulate the related fees to determine if disclosure is required. If required, obtain the information needed to provide the disclosure. ■ For this purpose, "executive / director compensation services" do not include (i) consulting only on broad-based plans that do not discriminate in favor of executives or directors or (ii) providing surveys and similar information that are not customized for the company or based on parameters developed by the consultant and in connection with which no advice or recommendations are provided. ■ However, such services are apparently included in the fee determination for "additional services" if the consultants provided other executive / director compensation services. ■ Consider having the compensation committee adopt a pre-approval policy for additional services provided by compensation consultants who advise on executive / director compensation.
REPORTING SHAREHOLDER MEETING RESULTS		
<p>Reporting shareholder meeting results</p> <ul style="list-style-type: none"> ■ Report voting results on Form 8-K (instead of Form 10-Q) within four business days after the end of a shareholder meeting. ■ If you only report preliminary results initially, amend the 8-K to report final voting results within four business days after they are known. 	<p>New Form 8-K, Item 5.07</p>	<ul style="list-style-type: none"> ■ Update annual meeting timelines and schedules to include preparation and filing of the voting results on Form 8-K.

Appendix A

[Disclosure Considerations re: Risks Arising from Compensation Policies and Procedures](#)

While the situations requiring disclosure will vary depending on the particular company and compensation policies and practices, situations that may trigger disclosure include, among others, compensation policies and practices:

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

While the information to be disclosed will vary depending upon the nature of the company's business and the compensation approach, the following are examples of the issues that the company may need to address for the business units or employees discussed:

- (1) The general design philosophy of the registrant's compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by employees on behalf of the registrant, and the manner of their implementation;

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

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Stacie S. Aarestad	617.239.0314	saarestad@eapdlaw.com
Barry J. Bendes	212.912.2911	bbendes@eapdlaw.com
Leslie J. Croland	954.667.6129	lcroland@eapdlaw.com
Matthew C. Dallett	617.239.0303	mdallett@eapdlaw.com
Matthew J. Gardella	617.239.0789	mgardella@eapdlaw.com
Nathaniel S. Gardiner	617.239.0293	ngardiner@eapdlaw.com
William C. Hicks	617.239.0435	whicks@eapdlaw.com
Stanley Keller	617.239.0217	stanley.keller@eapdlaw.com
Christopher S. Kiefer	617.239.0643	ckiefer@eapdlaw.com
Leslie J. Levinson	212.912.2772	llevinson@eapdlaw.com
Marc D. Mantell	617.239.0767	mmantell@eapdlaw.com
Eugene W. McDermott, Jr.	401.276.6471	emcdermott@eapdlaw.com
John W. Pickett	617.239.0425	jpickett@eapdlaw.com
Brendan J. Radigan	401.276.6570	bradigan@eapdlaw.com
Laura N. Wilkinson	401.276.6607	lwilkinson@eapdlaw.com

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