

December 2009

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## Enhanced Proxy Disclosures - SEC Proposals & Recommended Actions

This past July, the U.S. Securities and Exchange Commission (the “SEC”) issued a number of proposals to expand the obligations of public companies to disclose certain information to their shareholders through their proxy materials. (*Release Nos. 33-9052; 34-60280; IC-28817; File No. S7-13-09*). The proposals are part of a larger effort by the SEC to enhance transparency of public companies and to “improve the disclosure shareholders of public companies receive regarding compensation and corporate governance and facilitate communications relating to voting decisions.”

Recent statements by Mary Schapiro, Chairman of the SEC, and other members of the SEC staff, have indicated that the SEC will be adopting these proposals in some form before the end of 2009, in time for the beginning of the 2010 proxy season. Although the SEC’s formal proposals are not yet available, there are certain actions that companies should consider in anticipation of the formal adoption of these or substantially similar proposals.

### Enhanced Compensation Disclosure

The SEC proposed amendments to the current Compensation Discussion and Analysis (“CD&A”) requirements. The amendments are designed to address any imbalance in a company’s compensation policies between short-term performance incentives and the long-term well being of the company. The proposed disclosure is designed to help investors identify “whether the company has established a system of incentives that can lead to excessive or inappropriate risk taking by employees.”

The proposed amendments to CD&A would require that a company disclose its overall compensation policies for employees generally, rather than for executives alone. Disclosure would be necessary if it is determined that the risks associated with such compensation policies have a “material effect” on the company. Materiality would be determined on a company-specific basis. The SEC provided the following examples of triggering items/events:

- Compensation related to a business unit of the company that carries the most risk or a unit that is the most profitable of the company;
- A material change to the overall compensation policy of the company; and
- Growing exposure to risk based on incentive practices.

The SEC also proposed to revise the disclosure of stock awards and option awards in both the Summary Compensation Table and Director Compensation Table to require disclosure of such awards based on the aggregate grant date fair value, rather than the amount recognized for financial statement reporting purposes for the fiscal year computed in compliance with FAS 123R. The SEC stated that it believes grant date fair value is “more informative because it better reflects compensation decisions.” However, if a company believes that the full grant date fair value is an inaccurate reflection of an executive officer’s compensation, it may, in the alternative, provide “appropriate explanatory narrative disclosure.”

### Compensation Consultant Disclosure

Currently, public companies are not required to disclose fees paid to compensation consultants for services related to executive compensation or to disclose other services provided by such consultants that are unrelated to the compensation of executives and directors.

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Due to what the SEC believes to be a high potential for conflicts of interest, the SEC proposed amendments to Item 407 of Regulation S-K to require certain disclosures related to compensation consultants where the consultant provides additional services, similar to the required disclosures regarding additional services provided by a company's registered independent public accounting firm. Under the proposal, a company would be required to disclose the following:

- The nature and extent of all additional services provided to the company or its affiliates during the last fiscal year by the compensation consultant and any of the consultant's affiliates;
- The aggregate fees paid for all additional services and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation;
- Whether the decision to engage the compensation consultant or its affiliates for non executive compensation services was made, recommended, reviewed or subject to screening by management; and
- Whether the board of directors or the compensation committee has approved all of these services in addition to executive compensation services.

Notably, disclosure would not be required where the consultant's only role in recommending the amount or form of executive or director compensation is in connection with broad-based plans for the company as a whole, such as 401(k) plans or health insurance plans.

**Director and Nominee Qualifications Disclosure**

The July proposals also included proposed amendments to Item 401 of Regulation S-K to broaden the scope of disclosures regarding the qualifications, past experience and involvement in certain legal proceedings of directors, officers and persons nominated to become a director or officer. Under the proposal, the expanded narrative disclosure required for each director, officer or nominee would include the specific experience, qualifications or skills that qualify the person to serve as a director and committee member.

The SEC also proposed two specific changes to the biographical disclosure requirements: (1) to require that public companies disclose any directorships at a public company held by each director and nominee at any time during the past five years and (2) to lengthen the time from five to ten years for which disclosure of certain legal proceedings involving directors, executive officers and nominees is required.

**Leadership Structure and Risk Management Process**

The SEC also proposed a new requirement under Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A to "increase the transparency for investors into how boards function." The proposal would require disclosure of a company's leadership structure and why the company believes it is the best structure for the company at the time of the filing. Companies would also be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions and whether the company has appointed a lead independent director; if the company has appointed a lead director, it must also disclose his or her role in the leadership of the company.

Additionally, companies would be required to disclose the board's role in the company's risk management practices. In making such a proposal the SEC stated: "[g]iven the role that risk and the adequacy of risk oversight have played in the recent market crisis, we believe it is important for investors to understand the board's [or committee's] role in this area." As an example, the SEC suggested that companies disclose whether the board as a whole implements and manages its risk management functions or whether such duties are delegated to a board committee.

**Conclusion and Recommended Actions**

These proposals have not yet been formally adopted by the SEC and may not be adopted as proposed. However, representatives of the SEC have made public statements indicating that the disclosure contemplated by certain of the proposals will be required in some form for the 2010 proxy season. The proposals reflect an increasing focus by the SEC to enhance the transparency of corporate governance and risk management of public companies so that investors will be able to make more informed decisions. Therefore, public companies are urged to consider their existing practices and whether any changes or new practices are advisable in light of these proposals. We also encourage companies to review their current disclosures to determine what additional information may be required.

Specifically, we encourage public companies to take the following actions:

- Compensation committees and management should review their existing compensation policies (for all employees) in light of the additional CD&A disclosure with respect to:
  - o The company's risk assessment and incentive considerations in the overall structure of a company's compensation policy;
  - o 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 (i.e., the use of clawbacks);
  - o The company's policies regarding material adjustments to its compensation policies to address changes in its risk profile; and
  - o 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.
- Management and counsel should review and amend the company's Director's and Officer's Questionnaires to require the following disclosures:
  - o Principal occupations and employment during the past five years;
  - o Name and principal business of any corporation or other organization in which such occupation and employment were carried on;
  - o Whether such corporation or organization is a parent, subsidiary or other affiliate of the company;
  - o A brief discussion of the specific experience, qualifications, attributes or skills that qualify that person, in light of the company's business and structure, to serve as a director for the company and on any board committees;
  - o A narrative of particular experience in risk assessment and management and how such experience would qualify that person to serve the company;
  - o Any directorships at a public company that he or she has held within the last five years; and
  - o Any legal proceedings he or she has been involved in within the last ten years.
- Nominating committees and counsel should consider the qualifications that would need to be disclosed for each of their directors and nominees.
- Due to the increase in information required to be disclosed under the proposals, companies should deliver their proxy materials to their directors earlier in 2010, so that each director has additional time to review the materials prior to filing.

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