SEC Approves Amendments to Rules Governing Compensation and Corporate Governance Disclosure

On Wednesday, December 16, 2009, the Securities and Exchange Commission approved amendments to the SEC rules governing compensation and corporate governance disclosure. The amendments will be effective for the 2010 proxy season. The amendments will require further disclosure in many areas.

Compensation Disclosure

An amendment to Regulation S-K will now 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. In evaluating their disclosures, companies will need to consider the level of risk that employees might be encouraged to take to meet their incentive compensation elements and whether these risks may have a material effect on the company.

The amendments also revise Summary Compensation Table and Director Compensation Table disclosure of stock awards and option awards to require disclosure of the aggregate grant date fair value of awards computed in accordance with FAS 123R. The revised disclosure will replace currently mandated disclosure of the dollar amount recognized for financial statement reporting purposes for the fiscal year in accordance with FAS 123R. This is a reversal of the SEC’s position in the last days of the Bush administration when it determined that the inclusion of FAS 123R values in the compensation table would result in confusion. However, if a company does not believe that full grant date fair value reflects a named executive officer’s compensation, it can provide appropriate explanatory narrative disclosure. Companies need to be particularly cognizant of the increase in total compensation numbers in their proxy statement disclosure which this change will cause. This change during a period of extreme stockholder sensitivity to any management compensation increase will present a challenge for the company.

Enhanced Director and Nominee Disclosure

The new amendments to Regulation S-K will require disclosure for each director and nominee for director detailing the particular experience, qualifications, attributes or skills that qualify that person to serve as a director of the company as of the time that a filing containing this disclosure is made with the SEC, 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. For example, this information would 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 at the time at which the relevant filing with the SEC is made.

Specifically, the amendments will now require disclosure of any directorships held by each director and nominee at any time during the past five (5) years at public companies and lengthens the time during which disclosure of legal proceedings is required from five (5) to ten (10) years.

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

The new amendments 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. Companies are now required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. In companies where the role of principal executive
officer and board chairman are combined and a lead independent director is chosen, companies must disclose 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. This undoubtedly will influence boards to craft more detailed position descriptions for the lead independent director.

The new amendments also require additional disclosure about the board’s role in the company’s risk management process. For example, how does the board implement and manage its risk management function, through the board as a whole or through a committee, such as the audit committee. This disclosure should address such questions as 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. This provision is consistent with the US Treasury’s guidance on compensation, dated July 16, 2009.

New Disclosure Regarding Compensation Consultants

The new amendments to Regulation S-K will require disclosure about the fees paid to 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. In addition, the amendments require a description of any additional services provided to the company by the compensation consultants and any affiliates of the consultants. These new disclosure requirements apply to all services provided by a compensation consultant and its affiliates if the compensation consultant plays any role in determining or recommending the amount or form of executive or director compensation. The amendments do not apply to those situations in which the compensation consultant’s only role in recommending the amount or form of executive or director compensation is in connection with 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. This change will encourage board compensation committees to consider retaining their own consultants whenever there is even an appearance of a conflict.

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