

**Enhanced Executive Compensation Disclosure:
A Summary of SEC's 2009 Rules**

By Charles C. Shulman

Charles C. Shulman practices employee benefits and executive compensation law in New York and New Jersey. He can be reached at cshulman@EBECLaw.com

The Securities and Exchange Commission finalized amendments to its executive compensation and corporate governance disclosure rules that apply to proxy and information statements. This memo discusses amendments relating to disclosure of a company's compensation policies, director and nominee qualifications, use of consultants, and method of reporting the value of stock awards in the Summary Compensation Table.

On December 23, 2009 the Securities and Exchange Commission published final rules, [Proxy Disclosure and Solicitation Enhancements - Release No. 33-9052](#), 74 Fed. Reg. 68334 (Dec. 23, 2009). The rules were first proposed July 17, 2009. [74 Fed. Reg. 35,076](#) (July 17, 2009). The rules as finalized (i) amend the proxy disclosure (S-K) rules at 17 C.F.R. § 229 and other related rules to provide enhanced proxy disclosure regarding broad-based compensation policies, director qualifications, diversity, leadership structure, and compensation consultant additional fees; (ii) amend the proxy disclosure rules to record the value of stock awards in the Summary Compensation Table based on grant-date fair market value and to describe performance goals based on probable outcome of performance; (iii) require that the shareholder vote results be reported on Form 8-K (within four business days) rather than Form 10-K; and (iv) amend the proxy rules to provide that return of a blank proxy card is not a revocation, a soliciting person can round out its short slate by soliciting persons seeking minority representation on the board and certain other changes regarding proxy solicitation.

This summary discusses the amendments in (i) and (ii) above, which relate to director and executive compensation disclosure.

1. Narrative Disclosure of Company's Compensation Policies and Practices and How They Relate to the Company's Risk Management. Under prior proxy disclosure rules, the Compensation Discussion and Analysis (CD&A) section of the proxy needed to only discuss the compensation of the named executive officers (principal executive officer, principal financial officer, and the three other most highly compensated employees). Under the new 2009 amendments, the CD&A also has to discuss the company's overall compensation policies for its employees in general even for nonexecutives, if the policies are reasonably likely to have a material adverse effect on the company. New Item 402(s).

In particular, discussion and analysis would typically be required for compensation policies and practices at a particular business unit that carries a significant portion of the company's risk profile, or where compensation of a business unit is structured significantly different than other units. *Id.*

Issues that may need to be discussed in the CD&A include: (i) the design philosophy of compensation policies that would have the most effect on risk, (ii) considerations in structuring the compensation policies, (iii) how compensation policies relate to short-term risk, such as through clawbacks or mandatory bonus deferrals, and (iv) adjustments to compensation policies and practices that result from changes in risk profile; and (v) monitoring of compensation policies to determine if risk management objectives are being met with respect to incentivizing employees. *Id.*

Note: Smaller reporting companies that do not need CD&As are also exempt from providing this additional disclosure.

Note: This requirement to discuss the role of risk in compensation plans is intended to make compensation committee to consider how risk may play a role in incentive compensation, and to consider company-wide compensation plans, both of which have until now generally been considered outside the scope of compensation committees.

Note: The above rules are a clear example of how the executive compensation proxy disclosure rules have moved beyond disclosure and into shaping compensation policy.

2. Expanded Disclosure about Directors, Nominees and Executive Officers (Whether or not up for Reelection). The 2009 amendments expand the proxy rules to provide: (i) disclosure for directors, nominees and executive officers of their employment during the past five years, (ii) whether the entity they worked at is affiliated with the company, (iii) the directors and nominees' experience or qualifications that led to the conclusion that the person is fit to serve on the board, (iv) if material, information about the director, nominee or executive's areas of expertise and other relevant qualifications, (v) disclosure of directorships of public companies in the past five years, and (vi) for directors, nominees and officers, any prior business experience and level of responsibility within the past five years. Amendment to Item 401(e).

Disclosure of any legal proceedings involving directors, nominees or executive officers is lengthened by the 2009 amendments from 5 to 10 years. Item 401(f). The amendments also require disclosure of additional legal proceedings, including proceedings resulting from wire or mail fraud or fraud in any business proceeding based on violations of securities, banking or insurance laws, and sanctions or orders imposed by a stock exchange. *Id.*

3. Disclosure Regarding Company Leadership Structure and the Board's Role in Risk Management Process. Under the 2009 Amendments, Item 407 as well as the proxy rules require disclosure of the company leadership structure, such as whether the CEO also serves as chairman of the board, and whether there is a lead independent director, as well as why the company believes this is the best structure. Amendment to S-K Item 407(h) and Item 7 of Schedule 14A. Disclosure would also be required as to the extent of the board's role in the company's risk management, and the effect this has had on the leadership structure. Amendment to Item 407(h).

Note: Companies, as part of their corporate governance focus, have in any event begun to separate the CEO and chairman of the board roles.

4. Disclosure re Diversity. The 2009 amendments require disclosure as to whether and how a nominating committee considers diversity in nominating directors, and whether the committee or the board has a policy on diversity.

5. Disclosure Regarding Compensation Consultants and Fees for Additional Services. The prior rules required disclosure of any role compensation consultants serve with respect to executive or director compensation, who hired the compensation consultants, the nature and scope of their assignment and the material elements of the directions given to the consultants. Item 407 was amended in 2009 to require fee disclosure for compensation consultants retained by the board in certain circumstances. If the board or compensation committee has engaged a consultant to advise regarding executive and director compensation, and the consultant or its affiliates provide other consulting services in excess of \$120,000, fees and related disclosure (such as whether decision to engage consultant for non-executive compensation was made or recommended by management and whether the board has approved the non-

executive compensation consulting services) is required. If management has engaged a consultant for executive compensation and non-executive compensation is in excess of \$120,000 fee disclosure alone is required. Services involving any broad-based nondiscriminatory plans or information not customized for the company, are not executive compensation consulting and no fee disclosure is required. Amendment to Item 407(e)(3)(iii).

Note: The above disclosure will enable investors to assess any incentives the consultants would have in recommending generous executive compensation, as stated in the Preamble.

Note: These disclosure requirements are aimed at avoiding a conflict of interest, and in that respect is similar to restrictions on non-audit services by independent auditors.

6. Reporting of Stock or Stock Option with Full Grant-Date Value in Summary Compensation Table. Under prior December 2006 rules, the disclosure of stock awards and option-awards in the Summary Compensation Table and in the Director Compensation Table were determined based on the dollar amount recognized for financial reporting for the fiscal year. Items 402(c)(2) and 402(v)(2), [71 Fed. Reg. 78,338](#) (Dec. 29, 2006). The 2009 amendments revert to the original method used by the regulations, which is to report stock awards and option awards in the compensation tables based on the full grant-date fair value in accordance with FASB ASC Topic 718 (formerly FAS 123R). 2009 amendment to Items 402(c)(2)(v) & (vi) and 402(k)(2)(iii) and (iv). The amendments also eliminate the requirement of reporting grant-date fair value in the Grants of Plan-Based Awards Table or in the footnote to the Director Compensation Table because such amounts would already be provided for in the compensation tables. Amendments to Items 402(d) and 402(k)(2).

Note: This 2009 amendment is in response to numerous comments received by the SEC that the grant-date fair value is more useful than the amount recognized in the financial statements for the fiscal year because investors consider the compensation decisions made during the fiscal year, (which would be the full grant-date fair values) in making voting and investment decisions. In addition, the prior method of using the dollar amount recognized for financial reporting for the fiscal year can result in an anomaly of reporting a negative number when the stock price drops.

Note: A proposal to rescind the requirement to report the full grant date face value of each equity award in the Grants of Plan-Based Awards and Director Compensation tables was withdrawn in the final 2009 rules.

Note: The final rules adapt the proposal to have the stock and option award to the past years in order to facilitate comparison in years.

Note: Disclosure of awards is made based on awards granted during the year, and not for the year to which the performance is based. See Preamble to Final Rules, 74 Fed. Reg. 68339.

7. Salary or Bonus Foregone. There had been a proposal for salary and bonus columns in the Summary Compensation Table to not require reporting salary or bonus foregone at the election of the executive but the cash awards received instead or of salary or bonus would be reported in the column applicable to that form of award. However, as noted in the Preamble to the final 2009 rules the SEC decided not to adopt this change.

Note: The Preamble to the 2009 rules notes that disclosing the amounts or salary or bonus that the Compensation Committee awarded better enables investors to understand salary and bonus. See Instruction 2 to Item 402(c)(2)(iii) & (iv).

11. **Disclosure of Target Performance Goals.** The final 2009 rules require that grant date fair value of performance awards be reported in the Summary Compensation, Grants of Plan-Based Awards and Director Compensation tables based on the *probable outcome* of the performance conditions, consistent with the recognition criteria in FASB ASC Topic 718. The final 2009 rules do require footnote disclosure of the maximum value assuming the highest level of performance conditions is probable. See Instruction 3 to Item 402(c)(2)(v) and (vi), and Instruction 3 to Item 402(n)(2)(v) and (vi).

Note: This change was in response to comments that reporting the aggregate grant date fair value of performance awards based on *maximum performance* could discourage companies from granting these awards. As stated in the Preamble to the final 2009 rules, requiring disclosure of an award's value to always be based on maximum performance would overstate the intended level of compensation and result in investor misinterpretation of compensation decisions. Item 402(n)(2)(v) and (vi).

The amendments are effective February 28, 2010.

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