



PENSION & BENEFITS



DAILY

Reproduced with permission from Pension & Benefits Daily, 142 PBD, 07/28/2009. Copyright © 2009 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

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

By CHARLES C. SHULMAN

On July 17, 2009, the Securities and Exchange Commission published proposed rules, *Proxy Disclosure and Solicitation Enhancements*¹ (i) to amend the proxy disclosure (S-K) rules at 17 C.F.R. § 229 and other related rules to require enhanced proxy disclosure regarding broad-based composition policies, director qualifications and skills, leadership structure, and compensation consultant additional fees; (ii) to also amend the proxy disclosure rules to record the value of stock awards in the summary compensation table based on grant-date fair market value under FAS 123R; (iii) to require that the shareholder vote results be reported on Form 8-K (within four business days) instead of on Form 10-K; and (iv) to 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 proposed amendments in (i) and (ii) above, which relate to director and executive compensation disclosure.

1. Disclosure of How Company Compensation Plans Affect Risk Management. Under current proxy disclosure rules, the Compensation Discussion and Analysis

(CD&A) section of the proxy need 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 proposed amendments, the CD&A would also have to discuss the company's compensation policies and overall compensation practices for its employees in general even for nonexecutives and whether they create incentives that may have a material effect on the company's risk.²

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.³ 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 that address or result from changes in risk profile and monitoring of compensation policies to determine if risk management objectives are being met with respect to employee incentives.⁴

Note: This requirement to discuss role of risk in compensation plans will force compensation committees to consider how risk may play a role in incentive compensation, and to consider companywide compen-

¹ Release No. 33-9052, 74 Fed. Reg. 35,076 (July 17, 2009), available at <http://edocket.access.gpo.gov/2009/pdf/E9-16764.pdf> (131 PBD, 7/13/09; 36 BPR 1629, 7/14/09).

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

² Proposed Amendment to Item 402(b)(2).

³ *Id.*

⁴ *Id.*

sation 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 and Nominees. The proposed amendments would expand the proxy rules to provide: (i) disclosure for directors, nominees and executives of their principal occupations and employment during the past five years, (ii) whether the entity they worked at is affiliated with the company, (iii) the directors and nominees' qualifications to serve on the board or on a committee, (iv) if material, information about the director, nominee or executive's risk assessment skills, areas of expertise and other relevant qualifications, and (v) for directors, nominees and officers, any prior business experience and level of responsibility within the past five years.⁵

3. Disclosure Regarding Company Leadership Structure and the Board's Role in Risk Management Process. Under the proposed amendments, the proxy disclosure and the information statement must disclose 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.⁶ Disclosure would also be required on the extent of the board's role in the company's risk management, and the effect this has had on the leadership structure.

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

4. Disclosure Regarding Compensation Consultants and Fees for Additional Services. Current rules require disclosure of any role compensation consultants served 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. The proposed amendments would require disclosure of the fees received by, and the services provided by the compensation consultants and affiliates in the same fiscal year that such compensation consultants are also advising regarding executive or director compensation.⁷ Such disclosure must include:

(i) a description of the additional services provided to the company or affiliate in the last fiscal year by the compensation consultant or affiliate,

(ii) the aggregate fees paid for all additional services and for advising regarding executive or director compensation,

(iii) whether the decision to hire the consultants or affiliates for the additional services was made or reviewed by management, and

(iv) whether the board or the compensation committee have approved all the additional services.⁸

Note: If the role of the compensation consultants is not to provide advice specifically for executive and director compensation, but for broad-based plans that also benefit the executives, the above disclosure requirements would not be required, as stated in the Preamble.

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.

5. Reporting of Stock or Stock Option Grant-Date Value in the Summary Compensation Table. Under existing rules as amended in December of 2006, the disclosure of stock awards and option-awards in the Summary Compensation Table and in the Director Compensation Table are determined based on the dollar amount recognized for financial reporting for the fiscal year.⁹ The new proposed 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 FAS 123R.¹⁰ The proposed 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.¹¹

Note: This proposed 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, as stated in the Preamble. 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 prices drop, as also noted in the Preamble.

The proposed amendments would be effective once finalized and, according to the Preamble, it is anticipated that they will be effective for the 2010 proxy season.

⁸ *Id.*

⁹ Items 402(c)(2) and 402(v)(2), as amended in 71 Fed. Reg. 78,338 (Dec. 29, 2006), available at <http://www.sec.gov/rules/final/2006/33-8765.pdf>.

¹⁰ Proposed Amendment to Items 402(c)(2)(v) & (vi) and 402(k)(2)(iii) and (iv).

¹¹ Proposed Amendments to Items 402(d) and 402(k)(2).

⁵ Proposed Amendment to Item 401(e).

⁶ Proposed Amendment to S-K Item 407(h) and Item 7 of Schedule 14A.

⁷ Proposed Amendment to Item 407(e)(3)(iii).