

SEC Adopts Final Rules on Disclosure about Risk, Compensation and Corporate Governance

At an open meeting held on December 16, 2009, the Securities and Exchange Commission (SEC) adopted amendments to the compensation and corporate governance disclosure rules for public companies, largely consistent with the proposals originally made on July 10, 2009. The final rules require enhanced disclosure of the relationship between a company's compensation policies and risk-taking and the fees paid to compensation consultants, and they change how equity awards are reported in the summary compensation table. The final rules also expand disclosure about director qualifications, including a new requirement on board diversity, a board's leadership structure, and a board's role in overseeing risk. Finally, the final rules accelerate the timing of reporting the results of voting at stockholder meetings.

A brief description of the final rules is provided below. The text of the rules, as adopted, may be found at the SEC's website at this [link](#).

A. Disclosure about Compensation Policies and Risk

In response to widespread concerns that the compensation structures at large companies encouraged excessive risk-taking through short-term incentives, the SEC will now require a company to address its overall employee compensation policies and practices if they create risks that are reasonably likely to have a material adverse effect on the company. The original proposal would have required this disclosure where the policies "may have" a material effect. This heightened threshold for disclosure should make it easier for companies to conclude that they do not need to make this disclosure.

Because it relates to policies and practices for all employees, this disclosure – if required – will not be included in a company's CD&A and instead will be included as a separate section of a company's compensation disclosure. This disclosure will not be required for smaller reporting companies.

B. Disclosure of Compensation Consultants' Potential Conflicts of Interest

Under the final rules, if the compensation committee engages a compensation consultant to advise on executive or director compensation, the company must disclose fees paid for those services and fees paid to the consultant or its affiliates for non-executive compensation consulting services if those other fees exceed \$120,000 annually. If management engages the consulting firm to provide advice on executive or director compensation, and the compensation committee does not engage its own consultant, the same fee disclosures would be required. If, however, the compensation committee engages its own consultant separate from the firm used by management, no fee disclosure about fees paid to management's consultant is required for any service provided.

The disclosure must specify the aggregate fees paid for each type of service, and, in the case of compensation consultants engaged by the compensation committee, whether management made or recommended the decision to engage the compensation consultants for the additional services, and whether the board of directors or compensation committee approved the additional services.

Advice on broad-based, nondiscriminatory plans such as a 401(k) or health plan available generally to all employees, non-customized services (such as surveys) and customized services set by parameters designated by the company are excluded from the definition of executive compensation consulting services.

C. Reporting of Stock and Option Awards

The final rules change how stock and option awards are reported in the Summary Compensation Table and Director Compensation Table by reverting to an earlier SEC position and requiring reporting of the aggregate grant date fair value of awards in the year of grant in accordance with FASB ASC Topic 718 (formerly FAS 123(R)). The SEC retained the requirement that stock and option awards be reported in the fiscal year in which they are granted, even if the awards relate to services performed in a different fiscal year. The final rules accommodated the concerns of many commenters about performance awards. These awards will be valued based upon the probable outcome of the performance conditions as of the grant date, not the maximum possible outcome. The maximum award value, assuming achievement of the highest level of performance conditions, will be reported in a footnote to the applicable table.

Companies with fiscal years ending on or after December 20, 2009 must comply with these new rules with respect to awards made during the 2009 fiscal year and must also include re-computed disclosure in the Summary Compensation Table for the two prior years to facilitate year-to-year comparisons. The re-calculations will not affect who was required to be in the table in the two prior years.

D. Enhanced Director and Director Nominee Disclosure

The final rules expand the disclosure requirements about the business experience of directors and director nominees to require a discussion of the particular experience, qualifications, attributes and skills that led the board to conclude that the director or board nominee should serve as a member of the board as of the time of the filing in which the disclosure appears. The SEC dropped the requirement in the original proposal that similar qualification information be provided about committee membership. In addition, disclosure of other public company directorships held by directors or director nominees has been expanded to cover director positions currently held or held at any time within the prior five years, regardless of whether such position is still held.

The final rules further expand the categories of legal proceedings, the violations of which must be disclosed for directors or executive officers, and expands the time period for all disclosures to the prior ten years, rather than the current five-year requirement.

E. Diversity Considerations in the Director Nomination Process

The SEC adopted a new rule – not included in the original proposal – requiring a company's nominating committee to disclose whether and how it considers diversity in making nomination decisions and, if a diversity policy exists, how such a policy is implemented. Furthermore, if a diversity policy is used, the nominating committee must disclose how it assesses the effectiveness of its policy.

The final rules do not contain a definition of diversity, and the SEC expressed the view that the term is more appropriately defined by companies.

F. Disclosure of Board's Leadership Structure and Board's Role in Overseeing Risk

The final rules require disclosure in proxy and information statements of a board's leadership structure and why the company believes such leadership structure is appropriate for it at the time of the filing. A company is required to disclose whether and why it has decided to combine or separate the principal executive officer and board chair positions, whether and why it has a lead independent director and, if applicable, the specific role of the lead independent director in the leadership of the board.

Registrants also must provide additional disclosure in proxy and information statements about the board's role in overseeing risk at the company. Such information might include whether the board oversees risk through the whole board or through a committee and if any individual overseeing risk reports to the whole board or to a committee. The rule also requires disclosure about the "effect that [risk oversight] has on the board's leadership structure."

G. Timely Disclosure of Voting Results

The final rules transfer the requirement to disclose voting results from Form 10-Q and Form 10-K to new Item 5.07 of Form 8-K within a four business day period beginning on the day on which the meeting at which the vote was taken ended. Even if the results are not final at the end of the meeting, a company must report preliminary voting results within four business days of the meeting and then later file an amended Form 8-K within four business days of the date the final voting results are known. Supplemental disclosure with respect to preliminary voting results to explain any potential concerns as to the accuracy of such preliminary numbers may be provided in the Form 8-K.

H. Effective Date

The final rules take effect on February 28, 2010, with changes to the compensation tables applying for fiscal years that end on or after December 20, 2009. We expect guidance with respect to transition matters will be forthcoming shortly from the SEC staff.

I. Rules Governing the Solicitation of Proxies

On July 10, 2009 the SEC also proposed revisions to its rules governing proxy solicitation, which are meant to provide clarity and codify interpretations previously given by the staff. The SEC deferred consideration of these proposals, and therefore it is unlikely the proposed amendments governing the solicitation of proxies will apply to the 2010 proxy season. For further information on these proposed rules, please see our [July 17, 2009 Client Alert](#).

If you would like to discuss these or any other executive compensation, governance or securities law matters, please contact any member of Ropes & Gray's Tax & Benefits department or Securities & Public Companies practice, or your usual Ropes & Gray advisor.