SEC Proposes Rule Amendments Affecting Executive Compensation, Director Qualifications and Proxy Solicitation

On July 10, 2009, the Securities and Exchange Commission (SEC) proposed amendments to the compensation and corporate governance disclosure rules for public companies, as well as amendments to the proxy rules designed to codify existing SEC interpretations about the solicitation of proxies. The new rules would require disclosure about the relationship between a company's executive-compensation policies and risk-taking as well as fees paid to compensation consultants, and would change how equity awards are reported. The proposed amendments would also expand disclosure about director qualifications and a company's leadership structure and amend rules affecting proxy solicitation and the granting of proxy authority.

The proposed amendments are part of a broader effort by the Obama Administration to reform executive compensation and to discourage excessive risk-taking at public companies, as discussed in our June 19, 2009 Alert and our July 17, 2009 Alert. The SEC has requested comments on the proposed amendments, and the comment period will expire September 15, 2009. As described in our July 6, 2009 Alert, the SEC voted unanimously on July 1, 2009 to issue these proposed amendments.

A. Disclosure Governing Executive Compensation and Risk

In response to widespread concerns that the compensation structures at large companies encouraged excessive risk-taking through short-term incentives, the SEC has proposed amending the disclosure requirements in a company's Compensation Discussion & Analysis. Under the new rules, the disclosure would describe how a company's overall employee compensation policies (and not just executive compensation) create incentives that affect risk and how such risk is managed.

What disclosure is required would vary by company, depending on its compensation arrangements and whether they potentially create material risks to the company. For example, disclosure may be required if a particular business unit carries a significant portion of the company's risk, a business unit has a compensation structure that differs significantly from other units at the company, or a business unit has a compensation expense that is a significant portion of its revenues. Other issues that a company may need to address include how it assesses risk and incentive considerations in structuring and paying compensation, how it would adjust its compensation policies as a result of changes to its risk profile, and the extent to which it monitors its compensation policies to determine whether they are aligned with its risk-management objectives.

We note that the trend in favor of encouraging compensation structures that incentivize taking appropriate corporate risks arguably began in earnest with the initial TARP legislation and has continued thereafter. Like the say-on-pay movement, this trend has carried over to Europe and may well become a central aspect of the planning, design and establishment of certain types of compensation programs.

B. Disclosure of Compensation Consultants' Potential Conflicts of Interest

The use of compensation consultants, the conflicts that consultants may have, and disclosure relating to these matters have received increased attention from shareholders and regulators. The proposed rules would expand disclosure requirements added in 2006 about a company's use of compensation consultants.

Under the proposed rules, companies would have to disclose fees paid to compensation consultants or their affiliates who advise on executive and director compensation if the consultants or any of their affiliates also provide other services to the company (e.g., benefits consulting or actuarial services). The disclosure would include a description of the additional services provided to the company, the aggregate fees paid for each type of service, whether management reviewed the decision to engage the compensation consultants for the additional services, and whether the board of directors or compensation committee approved the additional services. The proposed rules would not apply to consultants whose role in advising on executive compensation is limited to advising on broad-based, nondiscriminatory plans such as a 401(k) or health plan in which all employees, including executives, participate.

C. Reporting of Stock and Option Awards

The proposal would change how stock and option awards are reported in the Summary Compensation Table and Director Compensation Table. The amended rules would revert to an earlier SEC position and require reporting of the full aggregate grant date fair value of awards made during the relevant fiscal year in accordance with FAS 123R. The current requirement includes only the dollar amount recognized in the relevant fiscal year for financial reporting purposes. The proposal does not clearly provide a transition method for prior years and the SEC is specifically seeking comment on that issue.

In addition, the proposed rules would modify the "Salary" and "Bonus" columns of the Summary Compensation Table so that any salary or bonus that an executive elects to forego in favor of equity would no longer need to be reported in such columns and any non-cash award received instead would be reported in the appropriate column for the form of award.

D. Enhanced Director and Director Nominee Disclosure

The proposed rules would expand the disclosure requirements about the business experience of directors and director nominees to require a discussion of the particular experience, qualifications and skills (including risk assessment skills, if material) that qualify the director or nominee to serve as a member of the board (or as a member of any applicable committee). In addition, disclosure of other public company directorships held by directors or director nominees is proposed to be expanded to cover director positions currently held or held within the prior five years, and disclosure of specified legal proceedings involving directors, director nominees or executive officers is proposed to be expanded to cover the prior ten years, rather than the current requirement of five years.

E. Disclosure of Company's Leadership Structure and Board's Role in Managing Risk

The new rules would require disclosure in proxy and information statements of a company's leadership structure and why the company believes such leadership structure is the best for it at the time of the filing. A company would be 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 company.

Registrants would also have to provide additional disclosure in proxy and information statements about the board's role in managing risk at the company. Such information might include whether the board manages risk through the whole board or through a committee and if the person overseeing risk management reports to the whole board or to a committee.

F. Timely Disclosure of Voting Results

The new rules would transfer the requirement to disclose voting results from Form 10-Q and 10-K to Form 8-K (new Item 5.07) within four business days after the end of the meeting at which the vote was taken. If a matter voted on at the meeting involved a contested election of directors and the results were not final at the end of the meeting, a company would need to disclose preliminary voting results within four business days of the meeting and file an amended 8-K within four business days of the date the final voting results were certified.

G. Rules Governing the Solicitation of Proxies

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.

Exchange Act Rule 14a-2(b)(1) exempts from most requirements of the proxy rules solicitations by any persons who are not directly or indirectly seeking proxy authority. The exemption is only available if such person is not someone who, because of a substantial interest in the subject matter of the solicitation, is likely to receive a benefit from a successful solicitation that would not be shared pro rata by all other holders of the same class of securities. Further, the exemption applies only where the soliciting person does not furnish to shareholders a form of revocation, abstention, consent or authorization.

The proposed amendments would clarify Rule 14a-2(b)(1) and provide expressly that a "form of revocation" does not include an unmarked copy of management's proxy card that the soliciting shareholder requests be returned directly to management. Further, the amendments would clarify that an individual need not be a shareholder of the class of securities being solicited and a benefit need not be derived from any security holdings in the class being solicited for that person to be disqualified from relying on the exemption.

Other proposed amendments to the proxy solicitation rules include:

- Amending Rule 14a-4(d)(4) to expressly permit a person soliciting support for a short slate of candidates to round out the short slate of nominees up to the total number of director positions then subject to election by seeking authority to vote for nominees named in the registrants' or any other persons' proxy statements;
- Amending Rule 14a-4(e), which would provide that where a soliciting person intends to vote the solicited proxies subject to reasonable specified conditions, that the conditions must be objectively determinable; and
- Clarifying Rule 14a-12(a)(1)(i), which states that required participant information must be filed under cover of Schedule 14A as part of a proxy statement or other soliciting materials no later than the time (and not in the document filed after) the first soliciting communication is made.

The SEC would like these rule amendments to be in place for the 2010 proxy season. It is likely that we will see action relatively quickly after the close of the comment period.

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.