Overhauling Exec Comp, Corporate Governance Rules

Law360, New York (January 07, 2010) -- As anticipated, on Dec. 16, 2009, the U.S. Securities and Exchange Commission presented investors and corporate governance reform advocates with a holiday gift by adopting substantial amendments to the executive compensation and corporate governance disclosure requirements for publicly held companies.

The amendments reflect the SEC’s efforts to increase investor awareness of companies’ executive compensation practices and provide shareholders with a greater voice in their companies.

The SEC’s rules as amended continue the federal government’s coordinated movement to: (1) reform executive compensation practices, (2) push corporate boards to have greater accountability, and (3) provide shareholders with greater visibility into the how and why of compensation decision-making and the relationship between compensation policies and company risk.

The SEC received numerous comments on their July 2009 proposed amendments and their final rules considered these comments and, in several cases, made changes to the proposed rules based on such comments.

The SEC’s adopting release recites that the amendments will be effective Feb. 28, 2010, although there is no discussion in the release providing more specific guidance. Presumably, companies will need to comply with the amendments for any annual proxy statements that are filed with the SEC after February 2010.

The Dec. 16, 2009, amendments generally follow the proposed rules, although there are some significant changes, and include the following:

Compensation Policies and Risk
To the extent that risks arising from a company's compensation policies and practices are "reasonably likely to have a material adverse effect on the company," then the company must provide disclosure about such policies and practices as they relate to risk management and risk-taking incentives that can affect the company's risk and management of that risk.

This would cover compensation policies affecting all employees and not just the company's named executive officers.

In a departure from the proposed rules, this new disclosure would have its own section and would not be required to be a part of the Compensation Discussion & Analysis (CD&A) section.

However, to the extent that risk considerations are a material aspect of the company's compensation policies or decisions for named executive officers, the company would be required to discuss them as part of its CD&A.

Smaller reporting companies will not be subject to this new requirement to provide disclosure on risk considerations.

Moreover, a company will not be required to make an affirmative statement in its disclosures that it has determined that the risks arising from its compensation policies and practices are not reasonably likely to have a material adverse effect on the company.

**Equity Compensation Value Change**

The grant date value for the disclosure of the estimated dollar values of equity-based compensation awards, as determined under FASB ASC Topic 718 (formerly referred to as FAS 123(r)), will now be utilized as compared to the current requirement of using the annual financial accounting expense recognized for such equity awards in the Summary Compensation Table and Directors Compensation Table.

For performance-based awards, the estimated grant values shall now be calculated based on the probable outcome of the performance condition(s) determined as of the grant date.

But, the compensation tables must be annotated with a footnote reporting the maximum value that can be earned under a performance-based award assuming the highest level of the performance conditions is achieved.

In transitioning to the new reporting requirements, companies will need to restate the values of equity compensation awards for prior fiscal years in their compensation tables but would not need to change their named executive officers based on the recomputed values.
Director Qualifications, Legal Proceedings and Board Diversity

The amendments require companies to annually disclose for all directors, and for any nominee for director, the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director for the company.

If an individual is chosen to be a director or a nominee to the board because of a particular qualification, attribute or experience related to service on a specific committee, such as the audit committee, then this should also be disclosed.

Companies must now disclose any directorships at public companies and registered investment companies held by each director and nominee at any time during the past five years.

In addition, the time period during which disclosure of legal proceedings involving directors, director nominees and executive officers is required has increased from five to ten years and the types of covered legal proceedings has been expanded as well.

Companies must also disclose whether, and how, a nominating committee considers diversity in identifying nominees for director.

The amendments expressly do not provide a definition for “diversity” and instead companies will be allowed to define diversity in ways that they consider appropriate.

Board Leadership Structure and Risk Management

Companies will now be required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company.

If the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors, then the company must disclose whether and why it has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company.

The board of directors’ role in risk management would also need to be addressed and discussed in the company’s disclosures.

Fee Disclosures for Compensation Consultants

If the board or compensation committee has engaged its own compensation consultant and if such consultant provides other nonexecutive compensation consulting services to the company, then the company must make fee and related disclosures regarding the
consultant if the fees for the nonexecutive compensation consulting services exceed $120,000 during the company’s fiscal year.

Even if the board or committee has not engaged its own compensation consultant, fee disclosures will be required if there is a consultant providing executive compensation consulting services and nonexecutive compensation consulting services to the company, provided the fees for the nonexecutive compensation consulting services exceed $120,000 during the company’s fiscal year.

The amendments do not require disclosure of the nature and extent of additional services provided by the compensation consultant to the company.

Accelerated Reporting of Shareholder Vote Results

Accelerated disclosure on Form 8-K of results on proposals voted on by shareholders will now be required within four business days of a shareholder meeting rather than the existing practice of providing such disclosures on the next filed Form 10-Q or 10-K.

Consideration of Proxy Solicitation and Other Potential Reforms is Deferred

The consideration of several proposed amendments governing the proxy solicitation process and other proposed enhanced disclosure requirements will be deferred until a later time.

What to Do Now and SEC Expectations

As we have been commenting in our recent blogs, publicly held companies should examine and revise as necessary their existing compensation/risk management processes and practices, D&O questionnaires, committee charters, organizational structure, etc., in order to be able to prepare the requisite disclosures.

The amendments significantly expand the disclosure requirements and it will not be a trivial effort for most companies to adequately comply with these new rules.

In this regard, it is worth noting that the SEC now has greater expectations for executive compensation disclosures.

In November 2009, Shelley Parratt, the SEC’s Deputy Director, Division of Corporation Finance, stated in a widely heard speech that the SEC’s expectations for "quality disclosure are heightened and we will reflect this in our comments."

She reiterated that the SEC expects companies and their advisors to understand the disclosure rules and apply them thoroughly.

Accordingly, in lieu of making "futures” comments (in which companies can provide information or required disclosures in response letters to the SEC and/or in future
filings, as opposed to having to file an amendment to the filing under review), the SEC will now be more likely to compel companies amend their filings if the company has not materially complied with the executive compensation disclosure rules.

Ms. Parratt’s speech echoed a recurring complaint of the SEC when she stated that companies should focus their attention on improving their analysis that is contained in the CD&A and providing disclosure of performance targets if such targets are material to the company’s compensation policies and decisions.

Her speech emphasized that the CD&A is to provide the how and why of the specific compensation decisions that were made and that companies need not include elaborate text reciting the framework in which decisions were made or listing out the many tools that were utilized in the decision-making process without discussing how such tools affected the resulting compensation decisions.

In summary, Ms. Parratt stated that companies need to make their disclosures "more meaningful and understandable."

Companies should consider taking a fresh look at the many areas touched upon by the amendments especially in this highly charged environment in which front page stories routinely crop up when, among other things, there appears to be a disconnect between executive pay and company performance.

Moreover, in view of the escalating scrutiny of and increased expectations regarding executive compensation practices, some boards/compensation committees may wish to consider retaining their own independent expert counsel.

Independent decision-making has become an essential ingredient in determining executive compensation. This includes separate and independent director oversight aided by independent compensation consultants.

Retaining and utilizing independent counsel, and/or other independent advisers, could enhance both the perception and reality of unbiased determinations of compensation for top management.

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