

SEC Proposes New Compensation and Governance Disclosures

August 2009

In July 2009, the Securities and Exchange Commission (the "SEC") issued for public comment a number of proposed rule changes relating to executive compensation and corporate governance disclosure. According to the SEC, these changes "would improve the disclosure that shareholders of public companies receive regarding compensation [of executives and directors] and corporate governance, and would facilitate corporate communications relating to voting decisions." The SEC release also stated that "the turmoil in the markets during the past 18 months has reinforced the importance of enhancing transparency, especially with regard to activities that materially contribute to a company's risk profile."

For a copy of the SEC proposal, see SEC Release nos. 33-9052, 34-60280 at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>.

The proposed amendments would specifically require enhanced disclosures concerning:

- Overall compensation policies and their impacts on risk-taking;
- Stock and option awards for executives and directors;
- Qualifications of directors and nominees;
- Past legal proceedings associated with directors and nominees;
- Company leadership structure and rationales for it;
- Director roles associated with risk management; and
- Potential conflicts of interest involving compensation consultants.

Changes to executive and director compensation disclosure requirements could prove to be particularly significant, as they involve not only broadened narrative analysis, but new calculations of "fair value" distinct from customary applications of

Financial Accounting Standard ("FAS") 123R. "We are proposing amendments... to require stock awards and option awards reporting based on a measure that will represent the aggregate grant date fair value of the compensation [per named person] as of the grant year, rather than the current rule, which allocates the grant value over time [associated with vesting or expiration of awards] commensurate with financial statement recognition of compensation costs."

The changes would also clarify certain exemptions from proxy solicitation rules and require much quicker disclosure of shareholder voting results by making them the subject of Form 8-K disclosure (rather than Form 10-Q or 10-K disclosure).

These amendments would apply to proxy and information statements, annual reports and registration statements for all public companies, as well as investment companies filing under the Investment Company Act of 1940. The SEC stated that if the amendments are adopted, compliance would be expected in the upcoming 2010 proxy season.

ENHANCED COMPENSATION DISCLOSURES

The SEC proposals would require new narrative compensation disclosures and analyses of risks associated with the compensation schemes used by public companies, as well as revised reporting of total compensation in the Summary Compensation Table and the Director Compensation Table.

1. Compensation Discussion and Analysis

"Companies, and in turn investors, may be negatively impacted when the design or operation of their compensation programs creates incentives that influence behavior inconsistent with the overall interests of the company," the release noted in announcing proposed changes to the Compensation Discussion & Analysis ("CD&A") section of required filings. "Indeed, one of the many

contributing factors cited as a basis for the current market [strife] is that at a number of large financial institutions, the short-term incentives created by their compensation policies were misaligned with the long-term well-being of the companies," the SEC concluded.

As a result, the latest proposals would broaden the scope of CD&A requirements by including a new section of narrative analysis to provide information about how the company's overall compensation policies for employees could create incentives that can affect the company's risk profile and management of that risk.

The proposed amendments would require a company to discuss and analyze its compensation policies and practices for employees generally (including non-executives) if risks arising from those policies or practices could have a material impact on the company.

Required risk-oriented disclosures of possible pertinence would include disclosure about compensation policies and practices:

- At a business unit that carries a significant portion of the company's risk profile;
- At one business unit which are significantly different from other business units;
- At business units that are significantly more profitable than other business units;
- At any business unit where compensation expense is a significant percentage of a business unit's revenues or earnings; and
- That vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company extend over a significantly longer period of time.

The SEC also provided specific examples of types of issues that companies should address regarding compensation and risk in their CD&A presentations, including:

- Any compensation design or philosophy for employees whose behaviors are most affected by incentives;
- Any risk assessments or incentive considerations relevant to compensation policy or practice;
- Any description of how compensation policies relate to management of risks resulting from employee actions, such as through compensation “claw-backs” and stock or option holding periods;
- Any material adjustments to compensation policy or practice as a result of changes in risk profiles; and
- The extent to which a company monitors its compensation policies and practices to determine whether its risk management objectives are being met.

2. Revisions to the Summary Compensation Table

The proposed amendments to Item 402 of Regulation S-K would also revise practices in disclosure of stock awards and option awards in the Summary Compensation Table and the Director Compensation Table. Specifically, the amendments would require for each pertinent executive or director disclosure of the aggregate grant date ‘fair value’ of awards as originally proposed in 2006.

In making this proposal, the SEC noted that it has received comments that the information that investors would find most useful and informative in the Summary Compensation Table and Director Compensation Table is the full grant date value of equity awards made during the covered fiscal year. “This is because investors may consider compensation decisions made during the fiscal year - which usually are reflected in the full grant date fair value measure, but not the financial statement recognition measure, - to be material to voting and investment decisions... Investors have commented that because full grant date fair value is indicative of which executives the company intends to compensate most highly, it is a more useful measure to include in the Summary Compensation Table as a component of total compensation. Because total compensation

is also the basis for determining which executives, in addition to the principal executive officer and principal financial officer, are the named executive officers whose compensation is reported, the full grant date fair value measure will better align the identification of named executive officers with company compensation decisions.” If a company does not believe that full grant date fair value accurately reflects the relative compensation of a named officer, it can always provide an explanatory note, the SEC said.

ENHANCED DIRECTOR AND NOMINEE DISCLOSURE

The SEC has also proposed that, for each director or nominee, narrative disclosure should be expanded to include the specific experiences, qualifications or skills that qualify that person to serve as a director and/or committee member. The SEC has proposed these revisions in order to help investors determine whether particular directors and the entire board composition is an appropriate choice for a given company as of the time that a filing containing this disclosure is made with the SEC.

Companies should also consider the relevance of disclosures about the risk assessment skills of any director or nominee, according to the release, in light of the ever-increasing challenges faced by companies from the business and social environments. “As recent markets have demonstrated, the capacity to assess risk and respond to complex financial and operational challenges can be important attributes for directors of public companies.” The SEC also suggested disclosure of specifically relevant past experiences of directors and nominees, as well as disclosure of how a company will benefit from the service of that director or nominee.

Required director and nominee biographical information would also include disclosures of any directorships held in the past five years at public companies, as well as disclosures of all legal proceedings within the last five to 10 years (expanding the current disclosure period by five years, in both cases to give investors more extensive information regarding an individual’s competence and character) with emphasis on disclosures related to past board memberships or professional or financial relationships that might pose potential conflicts of interest

(such as membership on boards of major suppliers, customers or competitors). These disclosures would be required to appear in proxy statements, annual reports and registration statements.

DISCLOSURES ABOUT LEADERSHIP STRUCTURE AND BOARD ROLES

Item 407 of Regulation S-K would also be amended to require disclosure of a company’s leadership structure and the rationale for choosing that structure. For example, affected companies would be required to address why any lead independent director is designated to chair meetings of independent directors, and why the roles of principal executive officer and board chairman are or are not combined.

Disclosure would also be required about the board’s involvement in the risk management process of a company. Information about how a company perceives the role of its board and the relationship between the board and senior management with respect to risk management would provide pertinent disclosure as well under the proposed rules. Companies would also be required to address how a board implements and manages risk functions - whether through the whole board or by delegation to a committee or expert.

DISCLOSURES REGARDING INDEPENDENCE OF COMPENSATION CONSULTANTS

Existing rules require companies to describe roles played by compensation consultants in determining or recommending the form or amount of executive and director compensation. But the latest proposals would additionally require disclosure of various arrangements with compensation consultants that could affect their independent judgment. The SEC found that many compensation consultants earn fees for other services that exceed their fees for advising on compensation matters (for example, benefits administration, human resources and actuarial services) and has therefore proposed that in cases where consultants provide consulting services related to a company’s executive or director compensation and also provide any other services to the company, the proxy statement would required disclosure as to:

- A description of the nature and scope of the additional services;
- The aggregate fees paid for executive and

director compensation and the aggregate fees paid for all other services;

- Whether the decision to engage the compensation consultant for these and other services was made, recommended or reviewed by management; and
- Whether the Board or the Compensation Committee approved the additional engagements.

The proposed amendments would not apply, however, to those situations in which the compensation consultant's only role in recommending executive compensation is in connection with consultations about broad-based plans that do not discriminate in favor of officers or directors.

REPORTING OF VOTING RESULTS

In order to provide more timely disclosure of voting results at annual or special meetings, the SEC has proposed to transfer the current vote disclosure requirements under Forms 10-K and 10-Q to Form 8-K. The new item 5.07 of Form 8-K would require a company to disclose the results of any shareholder vote and file it within four business days after the end of the meeting at which any vote was held. The SEC noted particular public concern with voting matters related to composition of the board, executive compensation or changes in shareholder rights.

GENERAL REQUESTS FOR COMMENT

In its release, the SEC also posed numerous specific questions for public comment concerning the adequacy, workability and likely effectiveness of the proposed rules. Comments from all potentially affected parties were solicited.

Comments must be received by the SEC on or before September 15, 2009.

Explanatory Notes:

This update is intended to call your attention to a number of proposed rule changes of possible interest and relevance, but it is not intended to constitute a legal opinion or definitive summary of all changes that could be material to you.

Please contact a member of the Securities Law Group at Burns & Levinson if you have any questions about these proposed rule changes or if you want to learn more about our expertise in this area.

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In the securities compliance area, we advise our clients on corporate governance/Sarbanes-Oxley and SEC and stock exchange reporting and compliance. Specifically, we assist our clients in fulfilling their ongoing SEC and stock exchange reporting obligations, managing sensitive disclosure issues internally and with industry analysts, preparing proxy statements and handling stockholder meetings, structuring employee benefit plans and executive compensation packages under the SEC's "short-swing profit" reporting and liability rules, effecting re-sales of securities in the public trading markets under the SEC's Rule 144, and advising boards of directors and board

committees concerning the requirements and restrictions imposed on their actions by the securities laws and corporate governance laws such as Sarbanes-Oxley. We have served as special securities counsel to the Boards and Audit Committees of publicly traded companies looking for opinions or advice of counsel other than their regular outside counsel.

We have counseled clients both domestic and international, from high technology and life sciences to emerging growth companies, and are positioned to provide clients with timely, expert, efficient and cost effective advice that they need to meet their business objectives. We take a practical and proactive approach to the rapidly changing securities disclosure and corporate governance laws, providing our clients with timely updates, identifying specific situations in which the new laws will impact particular clients either operationally or structurally, and working with clients to implement the changes that are either required or advisable to comply with the new regulatory schemes and investor sentiment.

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