December 2009 www.ssd.com

SEC Adopts Enhanced Disclosure About Risk, Compensation and Corporate Governance

On December 16, 2009, the Securities and Exchange Commission approved rules to enhance the information companies provide to shareholders in proxy statements and other reports filed with the SEC. The new rules are set forth in Release No. 33-9089, "Proxy Disclosure Enhancements," which was published on December 16, 2009 and takes effect on February 28, 2010. This means that the new disclosure rules apply to the coming proxy season. However, the rush to have the new rules effective for the 2010 proxy season is not accompanied by any corresponding discussion of the compliance issues that the timing raises. One can expect that the staff will issue a Compliance & Disclosure Interpretation in the near future to address the compliance issues.

The new rules require new or expanded disclosure in proxy and information statements about the following items:

Enhanced Compensation Disclosure

Narrative Disclosure of Compensation Policies and Practices as They Relate to the Registrant's Risk Management. Pursuant to new Item 402(s) of Regulation S-K, a company is required to address its compensation policies and practices for all employees, including non-executive officers, if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company. In the adopting release, the SEC highlighted that the "reasonably likely" used in this analysis parallels the MD&A requirement

Founded in 1890, Squire, Sanders & Dempsey L.L.P. has lawyers in 32 offices and 15 countries around the world. With one of the strongest integrated global platforms and our longstanding one-firm philosophy, Squire Sanders provides seamless legal counsel worldwide.

Contacts:

Frank M. Placenti
+1.602.528.4004

Joseph P. Richardson
+1.602.528.4801

David A. Zagore
+1.216.479.8610

Squire Sanders publishes on a number of other topics. To see a list of options and to sign up for a mailing, visit our subscription page.

Cincinnati · Cleveland · Columbus · Houston · Los Angeles · Miami · New York · Palo Alto · Phoenix · San Francisco · Tallahassee · Tampa · Tysons Corner · Washington DC · West Palm Beach | Bogotá+ · Buenos Aires+ · Caracas · La Paz+ · Lima+ · Panamá+ · Rio de Janeiro · Santiago+ · Santo Domingo · São Paulo | Bratislava · Brussels · Bucharest+ · Budapest · Dublin+ · Frankfurt · Kyiv · London · Moscow · Prague · Riyadh+ · Warsaw | Beijing ·

which requires risk-oriented disclosure of known trends and uncertainties that are material to the business. The new rule includes non-exclusive examples of situations that may trigger this disclosure requirement, such as compensation policies and procedures at a business unit that carries a significant portion of the registrant's risk profile. In the proposing release, the SEC proposed that this disclosure of compensation policies and practices and risk creation be made a part of the Compensation Discussion and Analysis (CD&A). As adopted, the new disclosure requirements will not be part of the CD&A and the CD&A will continue to focus discussion on compensation policies and practices applicable to the named executive officers and not to employees generally.

If a registrant determines that disclosure is required, new Item 402(s) of Regulation S-K includes examples of issues that the company may need to address regarding its compensation policies and practices. As is the case in recent SEC rules and pronouncements in the area of compensation disclosure, the new rules are principles based and the examples are meant to be illustrative and not a prescription for acceptable disclosure. The new rules do not require a registrant to make an affirmative statement 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. Smaller reporting companies will not be required to provide the new disclosure.

Revisions to the Summary Compensation Table (SCT). The new rules require disclosure of the aggregate grant date fair value of stock awards and option awards computed in accordance with FASB ASC Topic 718, with a special instruction for awards subject to performance conditions. Performance awards reported in the SCT, Grants or Plan-Based Awards Table and Director Compensation Table (DCT), should now be computed based upon the probable outcome of the performance conditions as of the grant date. New Instruction 3 to Item 402(c)(2)(v) and (vi), Instruction 8 to Item 402(d), and Instruction 3 to Item 402(n)(2)(v) and (vi) clarify that this amount will be consistent with the grant date estimate of compensation cost to be recognized over the service period, excluding the effect of forfeitures. The new rules also require footnote disclosure in the SCT and the DCT of the maximum value assuming the highest level of performance conditions is probable. The new rules require disclosure of awards granted during the year, as had been proposed. This means, for example, that awards made in year two but in respect of services in year one will be included in the SCT for year two and not for year one. The adopting release notes that companies should continue to analyze in CD&A the decisions to grant post-fiscal year end equity awards where those decisions could affect an understanding of named executive officer

compensation for the last fiscal year.

Transition. To facilitate year-to-year comparisons, the new rules require Item 402 disclosure for a fiscal year ending on or after December 20, 2009 to present recomputed disclosure for each preceding fiscal year required to be included in the SCT, so that the stock award and option awards columns present the applicable full grant date fair values, and the total compensation column is correspondingly recomputed. Companies are not required to include different named executive officers for any preceding fiscal year based on recomputing total compensation for those years pursuant to the amendments, or to amend prior years' Item 402 disclosure in previously filed Forms 10-K or other filings. If a named executive officer (NEO) in the SCT for the most recent fiscal year was not included in any prior year's SCT (for example, if an NEO to be included in the SCT for 2009 was included in the SCT for 2007 but was not included in the SCT for 2008), then under the transition rules the previously omitted year information for this NEO would be included in the 2009 SCT and all information for this NEO would be computed or recomputed as necessary to comply with the new rules.

Enhanced Director and Director Nominee Disclosure

The proposed rule changes would have amended Item 401 of Regulation S-K to require enhanced narrative disclosure regarding director and nominee qualifications, to require disclosure of any directorships held by each director and director nominee at any time during the past five years at public companies and registered investment companies, and to lengthen the time during which disclosure of legal proceedings involving directors, director nominees and executive officers is required from five years to ten years. The amendments to Item 401 as adopted are consistent with the proposed changes and also include several refinements, as follows:

- Companies must disclose for each director and 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 as of the time that a filing containing this disclosure is made with the SEC. The same disclosure, with respect to any nominee for director put forward by another proponent, is required in the proxy soliciting materials of that proponent. The new disclosure is required annually and for all nominees and for all directors including those not up for reelection in the particular year.
- Companies are not required to disclose the specific experience, qualifications or skills that qualify a person to serve as a member of a committee, as had been put forward in the proposing release.

- Companies must disclose all directorships at public companies and registered investment companies held by each director and nominee at any time during the past five years, rather than just current director positions as is required under the old rules. However, the adopting release includes the observation that if a person is chosen to be a director because of a particular qualification, attribute or experience related to service on a specific committee, this should be disclosed as part of the person's qualifications to serve on the board.
- The time during which disclosure of legal proceedings involving directors, director nominees and executive officers is lengthened from five years to ten years, and the list of legal proceedings covered by Item 401(f) of Regulation S-K is expanded to include:
    - Any judicial or administrative proceedings resulting from involvement in mail or wire fraud or fraud in connection with any business entity;
    - Any judicial or administrative proceedings based on violations of federal or state securities, commodities, banking or insurance laws and regulations, or any settlement to such actions; and
    - Any disciplinary sanctions or orders imposed by a stock, commodities or derivatives exchange or other self-regulatory organization.

The new rules also amend Item 407(c) of Regulation S-K to require disclosure of whether, and if so how, a nominating committee considers diversity in identifying nominees for director. If the nominating committee or the board has a policy with regard to the consideration of diversity in identifying director nominees, disclosure would be required of how this policy is implemented, as well as how the nominating committee of the board assesses the effectiveness of its policy. For purposes of this disclosure requirement, the rules allow each company to define diversity in the way that it considers appropriate and diversity is not defined in the amendments. Thus, a company may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill, and other individual qualities and attributes that contribute to board heterogeneity, while another company might focus on diversity concepts such as race, gender and national origin.

New Disclosure About Board Leadership and the Board's Role in Risk Oversight

CEO/Chairman Positions. Under the new rules, a company is 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 at the time of the filing. Companies with a combined principal executive officer and board chairman structure will be required to 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.

Risk Oversight Function of Board. The new rules require companies to describe the board's role in the oversight of risk. The SEC noted in both the proposing release and the adopting rule release that disclosure about the board's involvement in the oversight of the risk management process should provide information about how the company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company.

New Disclosure Regarding Compensation Consultants

Under current SEC rules, companies must describe the role of a compensation consultant in determining or recommending the amount or form of executive and director compensation. The new rules expand on this requirement and require fee disclosure in certain circumstances. The SEC summarized the new provisions generally as follows:

- If the board or the compensation committee has engaged its own compensation consultant to provide advice or recommendations on the amount or form of executive and director compensation, and if the consultant or an affiliate provides other non-executive compensation consulting services to the company, fee and related disclosure is required if the non-executive compensation consulting services exceed $120,000 during the company's fiscal year. Disclosure is also required if the decision to engage the compensation consultant or its affiliates for non-executive compensation consulting services was made or recommended by management;
- If the board has not engaged its own consultant, fee disclosure is required if there is a consultant providing executive compensation consulting services and non-executive compensation consulting services to the company if the fees for the non-executive compensation consulting services exceed $120,000 during the company's fiscal year;
- If the board had its own compensation consultant, fee and related disclosure for consultants that work with management is not required; and
- Services involving only broad-based non-

discriminatory plans or the provision of information, such as surveys, that are not customized for the company, or are customized based upon parameters that are not developed by the consultant, are not treated as executive compensation consulting services for purposes of the compensation consultant disclosure rules.

Reporting of Voting Results on Form 8-K

The new rules revise the current report such that a new Item 5.07 to Form 8-K requires companies to disclose the results of a shareholder vote and to have that information filed within four business days after the end of the meeting at which the vote was held. Forms 10-K and 10-Q are being revised to eliminate the requirement to disclose shareholder voting results on those forms. Recognizing that there are situations in which final vote tabulation is not complete within four business days following the end of a meeting, Instruction 1 to new Item 5.07 states that companies are required to file the preliminary voting results within four business days following the end of the meeting, and then file an amended report on Form 8-K within four business days after the final results are known. The adopting release includes a note in which the SEC states that these amendments to Form 8-K are not intended to preclude a company from announcing preliminary voting results during the meeting of shareholders at which the vote was taken before filing the Form 8-K, without regard to whether the company webcast the meeting.

Action Items and Implementation Issues

The new rules and the amendments to existing rules that comprise the SEC's latest rulemaking in the disclosure arena will require quite a bit of work by public companies so that they can meet the new requirements in a timely manner. Among the actions that will be necessary in the near term are the following:

Revisions to Director and Officer (D&O) Questionnaires. Most companies will need to revise their form D&O questionnaire to solicit information from directors, director nominees and executive officers that is responsive to the new and enhanced disclosure requirements. Revisions will need to solicit information regarding specific background and experience that is related to board service qualification, identify all public company and registered investment company directorships held at any time during the previous five years, expand the period for legal proceedings disclosure to cover the prior ten years, and also expand the list of legal proceedings to pick up the newly added categories of proceedings which are required to be disclosed.

Analyze Whether Compensation Policies and Practices Create Risks. Companies will need to analyze whether their compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company. If they decide that they have policies or practices to create such risk, they will have to prepare the narrative disclosure required by new Item 402(s) of Regulation S-K.

Revise Summary Compensation Table. Companies will need to compute the aggregate grant date fair value of stock awards and option awards in accordance with FASB ASC Topic 718 for all three years for each named executive office included in the table.

Draft Disclosures Relating to Directors and Director Nominees. This disclosure pertaining to particular experience, qualifications, attributes or skills of each director and nominee will likely take more time that it would appear on first glance, as these disclosures will have to be prepared by the company and reviewed by each director and director nominee.

Effective Date of New Rules. The adopting release states that the new and enhanced disclosure and other rules are effective on February 28, 2010, but offers little additional guidance. For example, does the February 28 date apply to the filing of proxy statements, or to the annual meeting date? If a preliminary proxy statement and a definitive proxy statement straddle the effective date, may the preliminary proxy statement reflect current rules or must it include disclosures required by the new rules? What if it is not clear when the preliminary proxy statement is filed whether the definitive proxy statement will be filed before or after February 28th? If a company files its Form 10-K prior to February 28th and includes Part III information in that Form 10-K, but files its proxy statement after February 28th, must it include the disclosures required by the new rules in its Form 10-K, and must it revise disclosures included in its Form 10-K for inclusion in its definitive proxy statement? Can such a company voluntarily comply with the new rules before February 28, 2010, or must it comply with the old rules until February 28? Undoubtedly, the SEC will provide guidance on these types of issues in the near term.

More to Come. The SEC continues to look at proxy statement, proxy solicitation process and shareholder access issues. Indeed, on December 14, 2009, the SEC announced that it is re-opening the public comment period for its shareholder director nomination or proposal to seek views on additional data and related analyses received by the SEC at or after the close of the original public comment period on August 17. At several places in its December 16, 2009 adopting release, the SEC noted issues that remain the subject of current rulemaking

projects, and Chairman Schapiro indicated in her remarks opening the SEC's December 16th meeting that she remains committed to bringing proposals for final rules in these areas to the SEC for consideration early in 2010.

For further information on the corporate governance listing standards, please contact your principal Squire Sanders lawyer or one of the individuals listed in this Alert.