

Latham & Watkins Update

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Update on Final SEC Enhanced Proxy Disclosure Rules

On December 16, 2009, the Securities and Exchange Commission (SEC) adopted final rules¹ that require public companies to provide enhanced disclosure in proxy statements, Form 10-Ks, Form 8-Ks and other reports filed with the SEC, concerning risk, compensation and corporate governance.

For companies with a fiscal year-end of December 31, 2009 or later, the final rules are generally effective for SEC filings on or after February 28, 2010. For example, Form 10-Ks and definitive proxy statements for fiscal year 2009 must comply with the new rules if filed on or after February 28, 2010.² Additionally, any Form 8-K filings related to shareholder meetings occurring on or after February 28, 2010, are subject to the new rules.

The proposed rules on these matters had been issued by the SEC on July 10, 2009, and introduced a number of important changes to the proxy disclosure rules previously in effect with respect to a company's compensation and corporate governance policies and practices.³ The final rules generally adopted the proposed rules, but there were some significant changes, which are summarized in this *Update*.

- **Compensation Risk.** The proposed rules requiring a company to disclose under certain circumstances how its overall compensation practices for all employees affect the company's risk were generally adopted as originally proposed, with two exceptions. First, the new disclosure will not be required as part of the Compensation Discussion and Analysis (CD&A). Because the CD&A specifically addresses the compensation of named executive officers, the SEC determined that it would be confusing to expand the CD&A to discuss the company's compensation practices with respect to all company employees. Second, the final rules raised the materiality threshold for disclosure to cover only compensation policies and practices which create risks that are "reasonably likely to have a material adverse effect" on the company. (The threshold was raised from risks that "may have a material effect on the company.") The "reasonably likely" threshold is intended to parallel the "reasonably likely" threshold applied under the SEC's Management Discussion and Analysis (MD&A) rules.
- **Grant Date Fair Value Equity Award Disclosure.** The proposed rules mandating that equity awards be reported in the Summary Compensation Table and Director Compensation Table on the basis of full grant date fair value in the year awarded were also adopted largely as proposed, with two clarifications. First, the value of a performance-based equity award is to be reported in the compensation tables based on the probability that the performance conditions are actually met, while the maximum potential value of such awards is required to be reported in a footnote. Second, whereas the proposed rules would have eliminated the requirement that the full grant date fair value of each award be reported in the Grants of Plan-Based Awards Table (and corresponding footnote disclosure to the Director Compensation Table), the final rules retained this requirement, and that information must therefore continue to be reported in those tables on an award-by-award basis.
- **Director Qualifications.** Enhanced disclosure is required with respect to directors and director nominees under the final rules. A company must essentially disclose the credentials and qualifications of all directors and nominees for director and the reasons why the board decided to select each director for service. Additionally, for each director or director nominee, a company must disclose any directorships at public companies or registered investment companies held during the past five years. The new rules also require expanded disclosure with respect to legal proceedings against directors, nominees and executive officers occurring during the preceding 10 years (prior to the adoption of the final rules, the requirement was five years). The types of legal proceedings requiring disclosure was expanded to include, among other types of proceedings, sanctions imposed by stock or commodities exchanges or other self-regulatory organizations.

- **Board Diversity.** In a change that was not part of the proposed rules, the final rules require a company to disclose whether its nominating committee considers diversity in identifying nominees for director. If so, the company must also disclose how the committee considers diversity, how the policy is implemented and how the committee assesses the effectiveness of the policy. The final rules intentionally do not define the term “diversity” and a company is permitted to define “diversity” as it sees fit.
- **Company Leadership Structure and Risk Oversight.** Companies are now required to disclose their leadership structure and discuss why the structure is appropriate for the company. Specifically, a company must disclose whether it has combined the positions of its principal executive officer and board chairman, and if so, whether it has designated a lead independent director to chair meetings of independent directors. Additionally, companies must describe the board’s role in the oversight of risk, and the disclosure should note how the board administers its risk oversight function, such as through the whole board or through a risk or audit committee.
- **Compensation Consultants.** The final rules include important exceptions to the proposed rule requiring enhanced disclosure when a company utilizes a compensation consultant that plays a role in setting or recommending executive compensation, in addition to providing other services to the company. (The enhanced disclosure, if triggered, requires disclosure of the additional services provided by compensation consultants and the aggregate fees paid both for the compensation consulting as well as the additional services, among other information.) The final rules include an exception to disclosure where the compensation consultant is paid \$120,000 or less for non-executive compensation consulting services. Additionally, the final rules do not require disclosure for a compensation consultant that works with management if the board has its own consultant, where the management consultant’s services are limited to broad-based plans that do not discriminate in favor of executives or directors, or where the management consultant merely provides information to a company (such as in the form of survey data).
- **Shareholder Voting Results.** The final rules require disclosure of the results of shareholder votes on Form 8-K within four business days after the shareholder meeting. Under prior rules the results would be reported on Form 10-Q or 10-K. If definite results are not known within four days of the meeting, preliminary results must be reported, and the definitive results must be reported later in an amended Form 8-K filing.

Endnotes

¹ To view the text of the final rules, please [click here](#). To view the SEC’s Compliance and Disclosure Interpretations concerning the effective date of the new rules, please [click here](#).

² Preliminary proxy statements must comply with the new rules if the company expects to file the definitive proxy statement on or after February 28, 2010, even if the preliminary statement is filed before that date.

³ For a discussion of these important changes, please [click here](#) to view our previous *Client Alert* regarding the proposed rules entitled, “SEC Proposes Rules to Enhance Compensation Decision-Making Transparency.”

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