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2010 Proxy Disclosure Update: Implementing the New SEC Rules

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New SEC Proxy Disclosure Requirements

Approved and Published on December 16, 2009

Effective on February 28, 2010

- **Board Leadership Structure and Risk Oversight***
 - Requires disclosure of the board's leadership structure and why the company believes it is the best structure for it
 - Requires a company that has chosen to combine the principal executive officer and board chair positions to disclose whether the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the board
 - Requires disclosure of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function, and the effect that this has on the board's leadership structure

* Regulation S-K, Item 407(h)

Board Leadership Structure and Risk Oversight

- Changes from Proposals
 - Board Leadership Structure rather than Company Leadership Structure
 - Risk Oversight rather than Risk Management

Board Leadership Structure and Risk Oversight

- Disclosure requirements only
- No specific structure or process mandated
- But do need to justify board leadership structure
- Should examine/evaluate board leadership structure and risk oversight function

Board Leadership Structure and Risk Oversight

- Board Leadership Structure
 - Trend toward separating CEO and Chairman roles
 - But roles still held by one person at majority of public companies
 - Lead Independent Director Alternative
 - Stock Exchange Requirements
 - RiskMetrics Group Policy

Board Leadership Structure and Risk Oversight

- Risk Oversight—Board's Role
 - Relevant Case Law
 - Caremark
 - Citigroup
 - Other Guidance
 - NACD
 - COSO

Additional Disclosure of Certain Risks of Compensation Policies and Practices*

- If risks arising from compensation policies or practices for employees *are reasonably likely* to have a *material adverse effect on the company*, requires the company to discuss its compensation policies and practices as they relate to risk management practices and risk-taking incentives

* Regulation S-K, Item 402(s)

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- No requirement that you confirm that a risk assessment was done
- No requirement to disclose that an assessment was conducted and there are no risks arising from compensation programs that are reasonably likely to have a material adverse effect on the company
- In determining whether or not to make disclosure, look at the company as a whole (without focusing on any particular business unit, division or individual)

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- The following types of compensation policies and practices *may* require disclosure:
 - At a business unit that carries a significant portion of the company's risk profile
 - At a business unit with compensation structured significantly differently than other units within the company
 - At a business unit that is significantly more profitable than other units within the company
 - At a business units where compensation expense is a significant percentage of the unit's revenues
 - Those that vary significantly from the overall risk and reward structure of the company
 - For example, when bonuses are awarded upon the accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- If there are identified risks, balance the impact of risk mitigation features, for example:
 - Clawbacks or other compensation recovery policies
 - Compensation limits or caps
 - Equity holding periods

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- Examples of issues a company may need to address for business units or employees discussed:
 - General design philosophy of the company's compensation policies and practices for employees whose behavior would be most affected by the incentives, as such policies and practices relate to or affect risk taking by employees, and the manner of their implementation
 - The company's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices in awarding or paying compensation
 - How the company's compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring clawbacks or imposing holding periods

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- Examples of issues a company may need to address for business units or employees discussed:
 - The company's policies regarding adjustments to its compensation policies and practices to address changes in its risk profile
 - Material adjustments the company has made to its compensation policies and practices as a result of changes in its risk profile
 - The extent to which the registrant monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- Required disclosure is “principles-based”
- Where should the disclosure be made?
 - Separate section of Executive Compensation Disclosure, or
 - Part of Compensation Committee information
 - Not required to be part of the CD&A

Additional Disclosure of Certain Risks of Compensation Policies and Practices

- RiskMetrics will assess compensation policies and practices that could potentially encourage excessive risk-taking
 - Guaranteed bonuses
 - Use of a single performance metric for short-term or long-term incentive compensation plans
 - Lucrative severance packages
 - High pay opportunity relative to industry peers
 - Disproportionately large supplemental pensions
 - “Mega annual” equity awards that provide unlimited upside with no downside risk

Director Qualifications*

- Requires disclosure detailing for each director and nominee for director:
 - any directorships during the past 5 years at public companies (rather than only current public directorships)
 - legal proceedings in the last 10 years (rather than 5)
 - An expanded list of legal proceedings
 - the specific experience, qualifications, attributes or skills that led to the conclusion that such person should serve as a director of the company, in light of the company's business and structure

* Regulation S-K, Items 401(e) and (f)

Nominating Committee Disclosure Concerning Diversity*

- In addition to existing disclosure requirements concerning the nominating committee's process for identifying and evaluating nominees for director, the following additional disclosure is required concerning diversity considerations:
 - “.... whether, and if so how, the nominating committee (or the board) 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, describe how this policy is implemented, as well as how the nominating committee (or the board) assesses the effectiveness of its policy”

* Regulation S-K, Item 407(c)(2)(vi)

Nominating Committee Disclosure Concerning Diversity

- Key definitional Issues:
 - What is meant by “diversity”
 - What is meant by a “policy”

Existing Compensation Consultant Disclosure*

- Current rules (adopted in 2006) require companies to:
 - describe any role played by compensation consultants in determining or recommending the amount or form of executive and director compensation;
 - identify such consultants, stating whether they are engaged directly by the compensation committee or any other person; and
 - describe the nature and scope of their assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

Regulation S-K, Item 407(e)(3)

Additional Compensation Consultant Disclosure*

- Scenario 1:

If a compensation consultant for executive or director compensation engaged by the compensation committee also provided “additional services” to the company in excess of \$120,000, the following disclosure is required:

- aggregate fees paid for all additional services
- aggregate fees paid for executive or director compensation consulting
- whether engagement of the consultant for additional services was made or recommended, by management
- whether the compensation committee or board has approved of the additional services

* Regulation S-K, Item 407(e)(3)

Additional Compensation Consultant Disclosure

- Scenario 2
Fee disclosures are also required where management hires a consultant and the fees for additional services exceed \$120,000.
- Scenario 3
Where both board and management have hired different consultants, no fee disclosure required unless additional services provided by compensation committee's consultant exceed \$120,000.

Note: Carve-outs for advice on broad-based plans and non-customized survey data

Revisions to Summary Compensation Table and Director Compensation Table*

- Required to disclose the aggregate grant date fair value of stock awards and option awards in the Summary Compensation Table and Director Compensation Table in place of disclosure of financial statement charges
- Special rules for performance-based awards
- Transition Rules
 - Recomputed values for 2009 named executive officers required in current proxy for all periods presented
 - No requirement to amend prior proxy disclosure or add additional officers for prior years

* Regulation S-K, Item 402(c)(2)(5)

Transition Rules*

- If fiscal year ends before December 20, 2009 - 2009 Form 10-K and related proxy statement are not required to be in compliance with the new proxy disclosure requirements, even if filed on or after February 28, 2010.
- If fiscal year ends on or after December 20, 2009 - Form 10-K and proxy statement must be in compliance with the new proxy disclosure requirements if filed on or after February 28, 2010.
 - If required to file a preliminary proxy statement and expect to file the definitive proxy statement on or after February 28, 2010, then the preliminary proxy statement must be in compliance with the new proxy disclosure requirements.
 - If file 2009 Form 10-K before February 28, 2010 and proxy statement on or after February 28, 2010, the proxy statement must be in compliance with the new proxy disclosure requirements.

Transition Rules

- If not required to be in compliance with the new proxy disclosure requirements, may voluntarily comply with the Summary Compensation Table and Director Compensation Table amendments only if also comply with all other Regulation S-K amendments.
 - May provide the other new disclosures without having to comply with all of the new requirements.
- Additional Transition Rules are applicable to registration statements.

Questions?

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