# SEC PROPOSES AMENDMENTS TO EXECUTIVE COMPENSATION DISCLOSURE

On Friday, July 10, 2009, the Securities and Exchange Commission (the "SEC") issued a release containing several proposed amendments to the executive-compensation-related disclosure requirements set forth in Item 402 ("Item 402") and Item 407 ("Item 407") of Regulation S-K, which if adopted would likely be effective for the 2010 proxy season. The SEC also extended an open invitation to comment on a variety of proposals for additional revisions to the executive compensation disclosure regime. Such an invitation may be an indication that the recently proposed amendments represent merely the beginning of a more extensive rulemaking agenda to come. In any event, this open invitation presents an opportunity to comment on other areas where the compensation disclosure rules could use improvement. The recently proposed amendments deal generally with three compensation-related issues, which are discussed in greater detail below:

- *Compensation Discussion and Analysis* -- The proposed amendments would broaden the scope of the Compensation Discussion and Analysis (the "CD&A") by requiring a registrant to include a new section providing information about how the registrant's overall compensation policies and practices for employees, including employees who are not named executive officers ("NEOs"), create incentives that can affect the registrant's risk and the management of that risk. These proposed rules would depart from the current CD&A rules by expanding disclosure beyond the NEO group.

- *Equity Award Disclosure* -- The SEC has proposed a return to the previous, and short-lived, original rules governing the disclosure of stock and option awards that were set forth in the August 2006 overhaul of Item 402. These rules required disclosure of each equity award's grant date fair value in the year of grant, as opposed to the dollar amount recognized in a given year for financial statement reporting purposes in respect of all of an NEO's or a director's outstanding stock and option awards held during such year.

- *Compensation Consultant Disclosure* -- The proposed amendments would require additional disclosure regarding a registrant's compensation consultant to the extent that the same consultant or one of its affiliates provides other services to the registrant, such as benefits administration, human resources consulting, or actuarial services, for which the fees are generally greater than the fees for the executive compensation consulting. Amended Item 407 would require disclosure of the fees paid to such compensation consultants (including both the aggregate fees for additional services and the aggregate fees for executive and director compensation consulting services), as well as a description of the nature and extent of such additional services and whether the decision to engage a particular consultant or its affiliates for such services was made, recommended, subject to screening, or reviewed, by management.

*Compensation Discussion and Analysis*

The proposed amendments would expand the scope of the CD&A to include a discussion of the registrant's policies and practices of compensating *all* of its employees as they relate to risk management practices and risk-taking incentives, but only if the risks arising from such policies and practices may have a material effect on the registrant. This disclosure will necessarily require registrants to undertake an analysis of the level of risk that their employees might be encouraged to take to meet their compensatory incentive goals. Since its debut in 2006, the CD&A has been limited to disclosure of the material information that is necessary for an understanding of the registrant's compensation policies and decisions regarding the NEOs. This proposal expands the disclosure to include compensation policies and practices covering all employees as such policies and practices relate to the registrant's risk management. Additionally, the proposal sets a standard for disclosure of compensation policies and practices that is more rigid than the current standard, which allows a registrant to determine whether a particular element of information is material and necessary for an investor's understanding of the applicable compensation policies and decisions. With respect to the relationship between compensation and risk management, the test for disclosure contains only one prong--whether the risk may be material to the registrant--and if this prong is satisfied, disclosure is mandatory. It remains to be seen whether this points to even greater rigidity in the structure of the CD&A rules in the future.

The SEC noted in the proposing release that this expansion of required disclosure is based to some extent on the oft-noted perception that the current market turmoil is at least in part due to the large financial institutions' overall broad-based non-NEO compensation policies, which created short-term incentives that were adverse to the institutions' long-term well-being.

Consistent with the approach of the current rules, which provide examples of information that, if material, may be worthy of disclosure, the proposed amendments set forth the following list of scenarios that might trigger disclosure to the extent they may generally have a material effect on the registrant:

- where compensation policies and practices are maintained at a business unit that carries a significant portion of the registrant's risk profile;

- where compensation policies and practices are maintained at a business unit with compensation structured significantly differently from other units within the registrant;

- where compensation policies and practices are maintained at business units that are significantly more profitable than others within the registrant;

- where compensation policies and practices are maintained at business units where the compensation expense is a significant percentage of revenues; and

- where compensation policies and practices vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the registrant from that task extend over a significantly longer period of time.

If the materiality threshold is crossed, and disclosure is required, facts and circumstances dictate which information is required in connection with the policies and programs to be discussed. The SEC has suggested the following nonexclusive list of topics for analysis and discussion:

- the general design philosophy of the compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk taking by those employees on behalf of the registrant, and the manner of their implementation;

- the registrant's risk assessment or incentive considerations in structuring the policies or in awarding and paying the compensation;

- how the policies relate to the realization of risks resulting from the actions of employees in both the short term and long term, such as through policies requiring clawbacks or by imposing holding periods;

- policies regarding adjustments to address changes in risk profile and any material adjustments made as a result of changes in risk profile; and

- the extent to which the registrant monitors its policies to determine whether its risk management objectives are being met with respect to incentivizing employees.

As proposed, this expansion of the CD&A leaves open many questions, and we believe that the SEC will need to provide more guidance on how the analysis and disclosure should be undertaken and implemented. For example, it is not clear to us which special types of risk deriving from compensation policies and practices will need to be analyzed and disclosed and how this differs from the analysis and disclosure already required by the general risk factor disclosure requirements of Item 503(c) of Regulation S-K. These amendments to the CD&A could make an already lengthy section of the proxy statement even longer while providing little, if any, additional meaningful information or clarity.

*Equity Award Disclosure*

The proposed amendments would also revise the Summary Compensation Table and Director Compensation Table to require disclosure of the grant date fair market value of stock and option awards received by each NEO and director, respectively, in the year of disclosure only (including, for an NEO, awards received in lieu of salary or bonus at the NEO's election), rather than the amount recognized for financial statement reporting purposes.

This change is a reversion to the original rules adopted in August 2006, prior to their being amended in December of that year. Since that amendment, the current expense-driven approach for disclosing equity awards has been criticized for providing accounting-based information that many investors do not truly understand. We believe that the proposal will result in a more understandable picture of the value of annual equity compensation awards.

*Compensation Consultants*

The proposals also contain amendments to Item 407 that would increase disclosure regarding compensation consultants hired by a registrant. Registrants are currently required by Item 407 to describe the role played by compensation consultants in determining or recommending the form of executive and director compensation. Among the items currently required to be disclosed are the identity of such consultants, the person or committee charged with engaging the consultants, the nature and scope of the consultants' assignments, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties. Registrants are not currently required to disclose the fees paid to such consultants or their affiliates or to describe any other services provided that are not related to executive or director compensation.

In proposing the amendments, the SEC noted its concern for a potential conflict of interest that might call into question the objectivity of a consultant's executive compensation recommendations. Such a conflict might arise if the same consultant or an affiliate of the consultant provides other services to the registrant, such as benefits administration, human resources consulting, or actuarial services, for which the fees are greater than the fees for the executive compensation consulting. To address these concerns, the proposed amendments to Item 407 would require disclosure of the fees paid to such compensation consultants if those consultants or their affiliates also provide other services to the registrant (including both the aggregate fees for additional services and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation). The registrant would also be required to describe the nature and extent of such additional services, and to disclose whether the decision to engage the consultant or its affiliates for services not related to executive or director compensation was made, recommended, subject to screening, or reviewed, by management. No disclosure would be required with respect to a consultant whose exclusive role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors, such as 401(k) or health insurance plans.

*Proposals Subject to Comment*

It is important to note that these are proposals for comment, and the proposals are likely to change prior to being published as final amendments to the rules. In addition to the proposed amendments discussed above, the SEC also extended an open invitation to comment on a variety of other proposals for additional revisions to the executive compensation disclosure rules. Commenters must submit comments to the SEC within 60 days following the publication of these proposed amendments in the Federal Register.

The following specific topics were singled out as part of the SEC's general invitation to comment on compensation-related disclosure:

- whether disclosure should be expanded to include more discussion of non-NEO compensation;

- whether the rules should mandate disclosure of performance targets for incentive compensation (either on a real-time or an after-the-fact basis) regardless of whether such disclosure could result in competitive harm;

- whether the Compensation Committee Report (in which a registrant's compensation committee must testify as to its review of the CD&A with management and its recommendation to the full board for the CD&A's inclusion in the proxy statement) should be considered "filed" with the SEC rather than "furnished," as is currently the case, which could result in potentially higher liability in the event of inaccurate disclosure;

- whether a registrant should be required to disclose whether members of its compensation committee have expertise in compensation matters or whether the committee has resources to hire its own independent legal counsel;

- whether additional disclosure should be required regarding whether a registrant has "hold to retirement" or clawback provisions relating to incentive compensation;

- whether disclosure should require a discussion of internal pay ratios of a registrant; and

- whether disclosure of tax gross-ups should include a requirement to disclose and quantify the tax savings to each executive.

These specific comment requests suggest that a potentially more substantial SEC review of the current executive and director compensation disclosure regime could be forthcoming. Individuals and registrants are encouraged to submit comments to provide the SEC with much-needed experience-based insight into reforming the current rules to provide better compensation-related disclosure.

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If you have any questions concerning the foregoing or would like additional information, please contact David E. Rubinsky (212-728-8635, drubinsky@willkie.com), J. Pasco Struhs (212-728-8109, pstruhs@willkie.com), Jason R. Ertel (212-728-8120, jertel@willkie.com), or the Willkie attorney with whom you regularly work.

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