Pearl Meyer & Partners
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Client Alert

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The SEC's Busy Spring/Summer Agenda:

Disclosure Rule Amendments
New Disclosure Interpretations
Proposed Proxy Access Rules

The SEC's recent flurry of activity surrounding executive pay and governance is only the beginning of what will be a year jam-packed with new guidance from the Commission, as well as the IRS, DOL and Congress. This Client Alert provides a summary and status report on the recent actions and communications on disclosure and Board governance issued by the SEC.

<u>New Disclosure Rules on the Horizon</u>

Since April, SEC Chairman Mary Schapiro has repeatedly suggested in press conferences and testimony that amendments will be proposed to executive compensation disclosure rules. The following issues are likely to be addressed in the SEC proposal, which is anticipated in July:

- **Enhanced Disclosure of Director Experience, Skills and Qualifications:** Currently, companies must provide only a general description of a member's experience over the past five years. The proposed amendment may broaden that requirement.

- **Board Leadership Structure:** The SEC may require that companies provide an explanation in the proxy of why and how their leadership structure was chosen – e.g., having an independent vs. non-independent Chair, or a separate vs. combined CEO/Chair.

- **Risk and Incentives:** The SEC is likely to call for more disclosure of how companies manage risk in their executive compensation programs, similar to what is already required from financial institutions receiving government funds.

- **Compensation Consultant Independence and Conflicts:** Enhanced required disclosure on this topic is also expected.

- **Competitive Positioning and Benchmarking:** More information will probably be required concerning how competitive benchmarking factored into compensation decisions, including whether peer performance was considered in the benchmarking process.

- **Compensation Discussion for Non-NEOs:** Disclosure of compensation decision-making for employees other than the NEOs may be required. Whether the SEC will revive the so-called "Katie Couric rule" (which would have required compensation information for the three most highly paid non-executive officers of a company on a no-names basis) or take a different approach will not be known until July.

- **Reconsideration of Equity Reporting in Summary Compensation Tables to Show Grant Date Value (as opposed to Accounting Expense):** While not mentioned specifically by Chairman Schapiro, this theme has been floating around the SEC since the current rule was instituted in late 2006 and prompted extensive criticism.

If the proposed disclosure changes are published over the summer and subject to the SEC's typical 60-day comment period, some or all of these items potentially could take effect as soon as the 2010 proxy season.

<u>Updated Interpretive Guidance on Executive Compensation Disclosure Rules</u>

The SEC's Compensation & Disclosure Interpretations (C&DI) continue to be periodically updated. The C&DI released on May 29, 2009 included the following new proxy guidance:

- **Reporting NEO Compensation in Years 1 - 3 in the SCT (New CDI 119.18):** If an individual is a named executive officer (NEO) in the first and third year (but not the second year) of a Summary Compensation Table (SCT), the individual's compensation in the second year must nonetheless be disclosed.

- **Year of Reporting Tax Gross-Up Payments in the SCT (New CDI 119.19):** Tax gross-up payments should be reported in the SCT in the same year as the corresponding perquisites are disclosed, even if actually paid in a subsequent year.

- **Reporting Grant Date Fair Value in GPBAT at Maximum (New CDI 120.05):** For incentive performance plans in which payout levels are based on actual performance, the <u>maximum</u> potential payout is reported in column (l) of the Grants of Plan-Based Awards Table (GPBAT) (as opposed to target payouts, which have commonly been reported in recent years).

- **Reporting Grant Date Fair Value in GPBAT for Multi-Year Awards (New CDI 120.06):** Column (l) of the GPBAT should include all tranches of an award for which performance targets are established at the start of the performance period. In contrast, it should exclude all tranches of an award for which performance targets are established in a subsequent fiscal year.

- **Reporting Incremental Values for Equity Awards (New CDI 120.07):** If an amendment or modification of an NEO's equity award results in incremental value, it should be reported in column (l) of the GPBAT.

- **Number of Shares in Multi-Year Performance Award (New CDI 122.03):** Equity incentive plan awards that are earned as of the last completed fiscal year end, but paid in restricted stock, should be reported in columns (g) and (h), rather than (i) and (j), of the Outstanding Equity Award Table. The number to be reported should be the actual number of shares earned (even if the actual number cannot be, or is not, determined after fiscal year end).

- **Reporting Life Insurance Proceeds (New CDI 217.14):** If an executive officer dies during the last completed fiscal year, the value of a company-funded life insurance policy paid to the estate should not be counted in determining who is an NEO, and should not be reported in the SCT.

Proposed New Proxy Access Rules

In light of the economic crisis, the SEC revisited its rules for the election of corporate directors and concluded that they impeded the ability of shareholders to exercise their right to nominate and elect new members. In June, it proposed a series of rule amendments intended to facilitate that process:

- **Current Practice:** Typically, existing directors nominate a slate of directors and the company sends that information to shareholders in the proxy materials. While shareholders can show up at the annual meeting and nominate different candidates, the proxy votes have usually been cast by that point. The only alternative for shareholders is to launch a proxy fight by mailing out their own ballots, which is extremely costly and administratively burdensome.

- **Summary of New Proxy Access Proposal:** The SEC proposes allowing qualified large shareholders to have their nominees included in the proxy ballot sent to all voters (unless that would be prohibited under state law or the company's charter or bylaws).

- **Eligible Nominating Shareholders:** The following shareholders would be permitted to have their nominees included in the proxy:

    - 1% owners of a "large accelerated filer" (market value of $700 million or more)
    - 3% owners of an "accelerated filer" (market value of at least $75 million but less than $700 million)
    - 5% owners of "non-accelerated filers" (market value of less than $75 million)

    In calculating market value, individual shareholders may aggregate their holdings, but each must have held their shares for at least one year. In addition, they must declare their intent to own their shares through the annual meeting, and certify that they are not holding stock to effectuate a change in control of the company, or to gain more than minority representation on the board of directors.

- **Requirements for Director Nominees:** Nominees must be objectively independent, according to the relevant listing standards, and the shareholder cannot field candidates for more than 25% of the total number of Board seats (i.e., if there are 8 directors, the shareholder may nominate a maximum of 2 directors).

- **Filing Requirements:** Proxy materials would include information about the nominating shareholder and the director nominee that is similar to the disclosure currently required in a contested election. Nominating shareholders would be liable for any false or misleading statements that are included in the proxy. In addition, a new Schedule 14N must be filed which would include information about the nominating shareholder's company holdings and a certification that the nominating shareholder is not seeking to change the control of the company or gain more than minority representation on the board of directors.

- **Summary of Proposal to Amend Governance Documents:** Another amendment would permit shareholders who have owned at least $2,000 (or 1%, if less) in market value for one year to submit proxy proposals to amend, or request an amendment to, provisions of a company's governing documents concerning the nomination procedures or other director nomination disclosure provisions.

- **Effective Dates:** The proposed rules were released on June 10, 2009, and are subject to a 60-day comment period following publication in the Federal Register. If approved, any changes in the rules would presumably be endorsed quickly and could become effective for the 2010 proxy season.

Pearl Meyer & Partners will continue to monitor the progress of these proposals and provide updated information as it becomes available.

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