

## **SEC Approves NYSE's Proposed Change to Broker Discretionary Voting in Uncontested Director Elections and Proposed Proxy Disclosure Enhancement Rules**

On July 1, 2009, the Securities and Exchange Commission (the "SEC") held an open meeting to consider (1) approval of proposed amendments by the New York Stock Exchange LLC ("NYSE") to NYSE Rule 452 and corresponding NYSE Listed Company Manual Section 402.08 (together, "Rule 452"), which would eliminate broker discretionary voting in uncontested director elections, (2) proposed rule amendments to enhance issuer disclosures regarding executive compensation and other corporate governance matters and (3) proposed amendments to the proxy rules for companies that have received financial assistance under the Troubled Asset Relief Program ("TARP") to permit a separate shareholder advisory vote to approve executive compensation.<sup>1</sup> This memo addresses the SEC's consideration of the first two matters.<sup>2</sup>

### **I. Approval of NYSE's Amendments to Rule 452**

The SEC, by a vote of 3-2, approved the NYSE's proposed amendments to Rule 452 regarding broker discretionary voting in uncontested director elections.<sup>3</sup> In its final order ("Final Order"), the SEC approved the NYSE's amendment to eliminate broker discretionary voting for all elections of directors at shareholder meetings held on or after January 1, 2010, whether contested or not, except for shareholder meetings for companies registered under the Investment Company Act of 1940, as amended (the "1940 Act").<sup>4</sup> This amendment adds director elections to the list of enumerated items that are deemed "non-routine," and thus a broker may not exercise discretionary voting with respect to uninstructed shares that are cast. In addition, the SEC also approved the NYSE's amendments to codify two previously published interpretations with respect to Rule 452. One amendment codifies the interpretation that Rule 452 would preclude broker discretionary voting on a matter that materially amends an investment advisory contract with an investment company. The other amendment codifies the interpretation that a material amendment to an investment advisory contract would include any proposal to obtain shareholder approval of an investment company's investment advisory contract with a new investment adviser for which shareholder approval is required by the 1940 Act and the rules thereunder.

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<sup>1</sup> A webcast of the SEC open meeting on July 1, 2009 can be viewed at: <http://www.connectlive.com/events/secopenmeetings>. Written statements of the five Commissioners at the SEC open meeting can be found at: <http://www.sec.gov/news/speech.shtml#chair>.

<sup>2</sup> For a discussion of the SEC's consideration of the third matter, please see our firm memo entitled, "SEC Proposes Amendments to Proxy Rules Requiring TARP Recipients to Seek Advisory Shareholder Votes on Compensation," dated July 6, 2009.

<sup>3</sup> For a summary of the current NYSE Rule 452 and corresponding NYSE Listed Company Manual Section 402.08 and the NYSE's proposed changes to each, see our firm memo entitled "NYSE Re-files Rule Amendment with SEC to Eliminate Broker Discretion in Director Elections," dated March 6, 2009.

<sup>4</sup> The Final Order can be found in a release, which was published in the Federal Register on July 10, 2009, at: <http://edocket.access.gpo.gov/2009/pdf/E9-16318.pdf>. In its Final Order, the SEC stated that the NYSE's amendment to Rule 452 is "consistent with the [Securities Exchange Act of 1934 (the "Act")] and the rules and regulations thereunder applicable to a national securities exchange. In particular, the [SEC] finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act which provides that the rules of the exchange must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers."

The SEC also noted the importance of shareholder education in informing investors about the amendments to Rule 452, the proxy voting process and the importance of voting, and stated it encourages the NYSE and its members to implement an investor education effort.

Although some Commissioners believed implementation of the amendments should be delayed and considered with other proxy voting changes, the SEC stated in its Final Order that it “does not believe it is appropriate to delay action on the NYSE’s proposals pending consideration of the myriad important and difficult issues relating to shareholder director nominations, proxy voting, and shareholder communication, which are outside the scope of NYSE’s proposed rule change.”

Similar to the Commissioners’ vote, there is mixed public reaction to approval of the amendments to Rule 452. Business Roundtable, an association of chief executive officers of leading U.S. companies with more than \$5 trillion in annual revenues and nearly 10 million employees, stated in its press release that it was disappointed that the SEC approved the amendments without addressing other proxy voting issues, such as effective company/shareholder communications and the increased influence of proxy advisory firms, and disregarded other solutions, such as proportional voting and client-directed voting, in favor of eliminating broker discretionary voting.<sup>5</sup> On the other hand, CtW Investment Group, which works with pension funds sponsored by unions affiliated with Change to Win, a federation of unions representing nearly 6 million members, stated in its press release that it commends the SEC’s approval of the amendments.<sup>6</sup> CtW Investment Group noted in its press release instances where it believed shareholders were disenfranchised as a result of broker discretionary voting in director elections and that approval of these amendments was long overdue.

## II. Proxy Disclosure Enhancement Proposals

The SEC unanimously approved proposed rule amendments with respect to proxy disclosures, which were presented by the Division of Corporation Finance, and requested comments on the proposed amendments.<sup>7</sup> Chairman Mary Schapiro noted in her statement that these proposals stress “the concept of better or more timely disclosure—not simply additional disclosure.”<sup>8</sup> In her statement, Chairman Schapiro noted four key areas where improvements to proxy-related disclosure could be made and what type of disclosure the SEC was seeking:

- executive compensation—better disclosure about the relationship between a company’s overall compensation policies and its risk profile, as well as about compensation consultant conflicts of interests;
- director and nominee qualifications—better disclosure about each candidate’s particular experience, qualifications, attributes or skills that qualify that person to be a board member;
- board governance—better disclosure about why a board has chosen its particular leadership structure, and a description of the board’s risk management role;
- vote results—more timely disclosure of annual meeting voting results.

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<sup>5</sup> For Business Roundtable’s complete statement, see: <http://www.businessroundtable.org/sites/default/files/SEC%20Rule%20452%20Adoption%20Statement.pdf>.

<sup>6</sup> For CtW Investment Group’s complete statement, see: <http://www.ctwinvestmentgroup.com/index.php?id=119>.

<sup>7</sup> The SEC’s proposed rules and request for comments can be found in a release, which was published in the Federal Register on July 17, 2009 (the “Release”), at: <http://edocket.access.gpo.gov/2009/pdf/E9-16764.pdf>.

<sup>8</sup> The written statement of Chairman Mary Schapiro at the open meeting can be found at: <http://www.sec.gov/news/speech/2009/spch070109mls.htm>.

In his statement, Commissioner Luis Aguilar noted that the SEC would seek comments regarding disclosures related to board diversity in addition to the topics listed above.<sup>9</sup>

The proposed amendments to the disclosure rules would be applicable to proxy and information statements, annual reports on Form 10-K and registration statements under the Act, and registration statements under the Securities Act of 1933 as well as the 1940 Act. The SEC is also proposing amendments to transfer the requirement to disclose shareholder voting results from Forms 10-Q and 10-K to Form 8-K. The SEC is also proposing revisions to the rules governing the proxy solicitation process that would clarify the manner in which soliciting parties communicate with shareholders.

Some of the proposed amendments are:<sup>10</sup>

- new disclosure and analysis of how a company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk if it may have a material effect on the company;<sup>11</sup>
- revised disclosure to require disclosure of the aggregate grant date fair value of awards made during the covered fiscal year, computed in accordance with FAS 123R, rather than the dollar amount recognized for financial statement reporting purposes, of stock awards and option awards in the Summary Compensation Table and Director Compensation Table, and elimination of the requirement to report the full grant date fair value of each individual equity award in the Grants of Plan-Based Awards Table and corresponding footnote disclosure to the Director Compensation Table;<sup>12</sup>
- new disclosure of the qualifications of directors and nominees for director, whether they are incumbent directors, nominees selected by a company's nominating committee or nominees put forward by other proponents, that discusses the specific experience, qualifications or skills that qualify that person to serve as a director and/or committee member of the company at the time at which the relevant filing is made;<sup>13</sup>
- additional disclosure of any directorships held by each director and nominee at any time during the past five years at public companies;<sup>14</sup>

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<sup>9</sup> The written statement of Commissioner Luis Aguilar at the open meeting can be found at: <http://www.sec.gov/news/speech/2009/spch070109laa.htm>.

<sup>10</sup> See *Section VIII: Statutory Authority and Text of the Proposed Amendments* of the Release for text of the proposed amendments and other proposed revisions to the rules.

<sup>11</sup> See proposed new Item 402(b)(2) of Regulation S-K.

<sup>12</sup> See proposed Item 402(c)(2)(v) and (vi) of Regulation S-K and Instructions thereto, proposed Item 402(k)(2)(iii) and (iv) of Regulation S-K and Instructions thereto, proposed Item 402(n)(2)(v) and (vi) of Regulation S-K and Instructions thereto, and proposed Item 402(r)(2)(iii) and (iv) of Regulation S-K and the Instruction thereto. Item 402(d)(2)(viii) and Instruction 7 to Item 402(d) of Regulation S-K are proposed to be removed.

<sup>13</sup> See proposed Item 401(e)(1) of Regulation S-K, proposed new Item 22(b)(3)(i) to Schedule 14A to require similar disclosure for 1940 Act companies in their proxy statements, and proposed Item 17 to Form N-1A, Item 18 to Form N-2 and Item 20 to Form N-3 to require similar disclosure for 1940 Act companies in their registration statements.

<sup>14</sup> See proposed Item 401(e)(2) of Regulation S-K, proposed new Item 22(b)(4)(ii) to Schedule 14A to require similar disclosure for 1940 Act companies in their proxy statements, and proposed Item 17 to Form N-1A, Item 18 to Form N-2 and Item 20 to Form N-3 to require similar disclosure for 1940 Act companies in their registration statements.

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- additional disclosure that would lengthen the time during which disclosure of legal proceedings involving a company's directors, nominees for director and executive officers is required from five to 10 years;<sup>15</sup>
- new disclosure of a company's leadership structure and why the company believes it is the best structure for it at the time of the filing; whether and why a company has chosen to combine or separate the principal executive officer and board chair positions; if the principal executive officer and board chair positions are combined and a lead independent director has been appointed, whether and why the company has a lead independent director and the specific role the lead independent director plays in the leadership of the company; and a board's role in a company's risk management process;<sup>16</sup>
- new disclosure about the fees paid to compensation consultants and their affiliates when they play any role in determining or recommending the amount or form of executive and director compensation if they also provide other services to the company, and a description of any additional services provided to the company by the compensation consultants and any affiliates of the consultants;<sup>17</sup>
- transfer of disclosure of the results of a shareholder vote from Forms 10-Q and 10-K to Form 8-K, and to have that information filed within four business days after the end of the meeting at which the vote was held;<sup>18</sup> and
- proposed revisions to the rules governing the proxy solicitation process to provide clarity and address issues with respect to existing requirements.

The SEC is seeking comments on the proposed amendments, other matters that might have an impact on the amendments and any suggestions for additional changes. Comments should be received on or before September 15, 2009. If the proposed amendments are adopted, the SEC indicated in its Release that the amendments would be effective for the 2010 proxy season.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com); or Leakhena Mom at 212.701.3330 or [lmom@cahill.com](mailto:lmom@cahill.com).

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<sup>15</sup> See proposed Item 401(f) of Regulation S-K and proposed Item 22(b)(11) to Schedule 14A to require similar disclosure for 1940 Act companies in their proxy statements.

<sup>16</sup> See proposed Item 407(h) of Regulation S-K, a corresponding proposed amendment to Item 7(b) to Schedule 14A, a corresponding proposed amendment to Item 22 (b)(11) to Schedule 14A to require similar disclosure for 1940 Act companies in their proxy statements, and proposed Item 17 to Form N-1A, Item 18 to Form N-2 and Item 20 to Form N-3 to require similar disclosure for 1940 Act companies in their registration statements.

<sup>17</sup> See proposed Item 407(e)(3)(iii) of Regulation S-K.

<sup>18</sup> See proposed new Item 5.07 to Form 8-K. Proposed Item 5.07 includes an instruction to the proposed item that states that if the matter voted upon at the meeting relates to a contested election of directors and the voting results are not definitively determined at the end of the meeting, companies should disclose on Form 8-K the preliminary voting results within four business days after the preliminary voting results are determined, and file an amended report on Form 8-K within four business days after the final voting results are certified.