

**Update: SEC Issues C&DI's Regarding Recent Release on the Enhanced Disclosure Rules for Compensation, Risk Oversight and Corporate Governance**

On January 20, 2010, the Securities and Exchange Commission ("SEC" or "Commission") issued new Compliance and Disclosure Interpretations (the "C&DIs")<sup>1</sup> relating to the new executive compensation and proxy disclosure enhancement rules (the "Amendments") adopted on December 16, 2009.<sup>2</sup> Among other things, this new guidance clarifies the requirements regarding the enhanced disclosure requirements relating to directors, including directors not up for re-election and director nominees, the disclosure of stock and option awards in the summary compensation table and director compensation table and the narrative disclosure of the a company's compensation policies and practices as they relate to a company's risk management. The new guidance also provides addition transitional guidance regarding the effective date of the Amendments and the preparation of disclosure materials.<sup>3</sup>

## **I. Additional Director and Officer Disclosure**

The Amendments require that companies provide additional disclosure for all directors and director nominees, including information relating to such person's "specific experience, qualifications, attributes or skills" that led the board to conclude that such person should serve as a director at the time that a filing containing the disclosure is made.<sup>4</sup>

The new guidance clarifies that the disclosure of each director or nominee's experience, qualifications, attributes or skills must be provided on an individual basis. For each person, a company must disclose why the person's *particular* and *specific* experience, qualifications, attributes or skills led the board to conclude that such person should serve as a director of the company, in light of the company's business and structure, at the time that a filing containing the disclosure is made. For example, it would not be sufficient to disclose simply that a person should serve as a director because he or she is an audit committee financial expert. Instead, a company should describe the particular and specific experience, qualifications, attributes or skills that led the board to conclude that this particular person should serve as a director at the time that a filing containing the disclosure is made.<sup>5</sup>

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<sup>1</sup> See Compliance and Disclosure Interpretations, Regulation S-K & Proxy Disclosure Enhancements Transition (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/cfnew.shtml>.

<sup>2</sup> For a more detailed discussion of these enhancements, see *SEC Approves Enhanced Disclosure Rules for Compensation, Risk Oversight and Corporate Governance* (December 22, 2009), available at <http://www.cahill.com/news/memoranda/000198>.

<sup>3</sup> These CD&Is are in addition to the transitional Compliance and Disclosure Interpretations posted on December 22, 2009, which present interpretations of how the Amendments' effective date applies to the filing of proxy statements, Form 10-Ks, Form 8-Ks and registration statements filed under the Securities Act of 1933 and the Securities Exchange Act of 1934. See *Proxy Disclosure Enhancements Transition* (December 22, 2009), available at <http://sec.gov/divisions/corpfin/guidance/pdetinterp.htm>.

<sup>4</sup> See revised Item 401(e)(1) of Regulation S-K.

<sup>5</sup> See revised Item 401(e)(1) of Regulation S-K. See Compliance and Disclosure Interpretations Section 116. Item 401, New Question 116-05: *Directors, Executive Officers, Promoters and Control Persons* (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#116-05>.

In addition, the director and officer disclosure rules apply to directors even if they are not up for reelection, as long as they will continue to serve following the election (i.e. classified boards).<sup>6</sup>

## II. Disclosure of Stock and Option Awards in the Summary Compensation Table and Director Compensation Table

The Amendments include an instruction stating that the value of stock and option awards with performance conditions should exclude the effect of estimated forfeitures.<sup>7</sup> The new guidance clarifies that the grant date fair value reported for awards subject to time-based vesting should also exclude the effect of estimated forfeitures.<sup>8</sup>

In addition, the Amendments will affect, in some instances, which individuals are included in the Summary Compensation Table, since the calculation of total compensation will be based on the grant-date fair value of equity awards made during a fiscal year rather than the expensed accounting value.<sup>9</sup> According to the new guidance, if during a fiscal year, a company grants an equity award to an executive officer and the award is forfeited during that fiscal year because the executive officer leaves the company, the grant date fair value of this award should be included for purposes of determining 2009 total compensation and identifying 2009 named executive officers.<sup>10</sup>

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<sup>6</sup> See Compliance and Disclosure Interpretations Section 116. Item 401, New Question 116-06: *Directors, Executive Officers, Promoters and Control Persons* (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#116-06>. The new guidance clarifies the rationale for this disclosure requirement as follows: “Because the composition of the entire board is important information for shareholder voting decisions, the purpose of this disclosure requirement is to elicit current information about all directors on the board, including on classified boards. For each director who is not up for re-election, the evaluation of the director’s particular and specific experience, qualifications, attributes or skills and the conclusion as to why the director should continue serving on the board, should be as of the time that a filing containing the disclosure is made.”

<sup>7</sup> See Instruction 3 to Item 402(c)(2)(v) and (vi), Instruction 8 to Item 402(d), and Instruction 3 to Item 402(n)(2)(v) and (vi) of Regulation S-K.

<sup>8</sup> See Compliance and Disclosure Interpretations, Section 119. Item 402(c), New Question 119-20: *Executive Compensation; Summary Compensation Table* (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#119-20>. FASB ASC Paragraph 718-10-30-27 provides, in relevant part, that “service conditions that affect vesting are not reflected in estimating the fair value of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which employees have not yet earned the right.”

<sup>9</sup> See new Items 402(c)(2)(v) and (vi), 402(k)(2)(iii) and (iv), 402(n)(2)(v) and (vi), and 402(r)(2)(iii) and (iv) of Regulation S-K.

<sup>10</sup> See Compliance and Disclosure Interpretations, Section 117. Item 402(a), New Question 117-04: *Executive Compensation; General* (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#117-04>.

### III. Placement of Disclosure of Compensation Policies and Practices on Risk Management

Pursuant to new Item 402(s), a company is required to provide narrative disclosure of its compensation policies and practices as they relate to the company's risk management if the risks arising from these policies are reasonably likely to have a material adverse effect on the company. The new guidance provides that this disclosure should be presented with a company's other Item 402 disclosure. According to the new guidance, "the staff would have concerns if the Item 402(s) disclosure is difficult to locate or is presented in a fashion that obscures it."<sup>11</sup>

### IV. Disclosure About Compensation Consultants

The Amendments require the disclosure of fees paid to certain compensation consultants that provide advice regarding executive or director compensation and also provide other services to the company, including disclosure regarding the aggregate fees paid for advising on the amount or form of executive and director compensation and the amount paid for the additional services.<sup>12</sup>

The new guidance provides clarity on the line between fees paid for "determining or recommending the amount or form of executive and director compensation" and fees paid for "additional services." Fees for consulting on broad-based, non-discriminatory plans in which executive officers or directors participate and for providing information relating to executive and director compensation, such as survey data, are considered to be fees for "determining or recommending the amount or form of executive and director compensation" for purposes of reporting fees under the rule.<sup>13</sup> However, "consulting" on broad-based non-discriminatory plans does not include any related services, such as benefits administration, human resources services, actuarial services and merger integration services, all of which are "additional services" subject to the disclosure requirements. In addition, if the non-customized information relates to matters other than executive and director compensation, then the fees for such information would be for "additional services."<sup>14</sup>

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<sup>11</sup> See Compliance and Disclosure Interpretations, Section 128A. Item 402(s), New Question 128A-01: Narrative disclosure of the registrant's compensation policies and practices as they relate to the registrant's risk management, (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#128a-01>.

<sup>12</sup> See revised Item 407(e) of Regulation S-K.

<sup>13</sup> Note that if a compensation consultant's role is limited to consulting on broad-based plans that do not discriminate in favor of executive officers or directors and to providing information that either is not customized for a particular registrant or is customized based on parameters that are not developed by the compensation consultant, and about which the consultant does not provide advice, then such services do not need to be disclosed under revised Item 407(e)(3)(iii) of Regulation S-K, so long as these are the *only* executive compensation services provided by the consultant.

<sup>14</sup> Section 133. Item 407, New Question 133-10 & New Question 133-11: *Corporate Governance* (January 20, 2010), available at <http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#133-10133.11>.

## V. Question & Answers Relating to Transition

The Amendments require companies to disclose, pursuant to new Item 5.07 of Form 8-K, the voting results from shareholder meetings within four business days after the end of the meeting. This replaces the requirement to disclose voting results in Forms 10-K and Form 10-Q. The effective date of the Amendments is February 28, 2010. According to the new guidance, if the annual meeting of shareholders takes place before February 28, 2010, and if the Form 10-K or Form 10-Q is due on or after February 28, 2010, the results of the meeting should be reported in the “Other Information” Item of each form, rather than in the “Submission of Matters to a Vote of Security Holders” Item, which will be deleted from Form 10-K and Form 10-Q on February 28, 2010.

If a reporting issuer with a fiscal year ending on or after December 20, 2009 files a registration statement on or after December 20, 2009, compliance with the Amendments would be required under the Securities Act of 1933 or the Securities Exchange Act of 1934 in order for such registration statement to be declared effective on or after February 28, 2010.

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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 Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); or John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com); or Lindsay Flora at 212.701.3429 or [lflora@cahill.com](mailto:lflora@cahill.com).