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SEC Update

Proxy Enhancements and Climate Change Interpretive Guidance

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The U.S. Securities and Exchange Commission's (SEC or Commission) commitment to keep investors informed through public company transparency, accountability and disclosure has been evident over the last few months. While the SEC has been busy on many fronts, the focus here is on two specific actions that all public companies should be aware of. The first was on December 16, 2009 when the SEC approved a final rule per release #33-9089 entitled *Proxy Disclosure Enhancements* by a 4-1 vote. It expands corporate proxy disclosure regarding risk management, compensation and corporate governance matters. The second was on February 2, 2010 when the SEC issued interpretive release #33-9106 entitled *Commission Guidance Regarding Disclosure Related to Climate Change* by the closest of votes (3-2). This article addresses each of these actions, concluding with disclosure control ideas to help ensure successful implementation.

More Information Required on Compensation, Risk Management and Governance

The *Proxy Disclosure Enhancements* are effective February 28, 2010 and directly amend disclosure rules applicable to proxy and information statements, annual reports and registration statements under the Securities Exchange Act of 1934. The amendments will require public companies registered with the SEC (Registrants) to make new or revised disclosures about:

- Compensation policies and practices that present material risks to the company
- Stock and option awards of executives and directors
- Director and nominee qualifications and legal proceedings
- Board leadership structure
- The board's role in risk oversight
- Fee and related disclosure of compensation consultants
- Reporting of voting results on Form 8-K

The SEC states: "*We believe that providing a more transparent view of these key risk, governance and compensation matters will help shareholders make more informed voting and investment decisions*." While it is beyond the scope of this article to discuss all aspects of Release #33-9089, here are some important changes.

Compensation: A new requirement was added in Item 402 of Regulation S-K to address compensation policies and practices for all employees, not just executive officers. This kicks-in if the compensation policies and practices create risks that are "reasonably likely" to have a

material adverse affect on a company. This is not expected to trigger disclosures for most companies, since compensation committees likely will not move forward with a plan to put the company at a material adverse risk. However, it does imply that companies will need to conduct a risk assessment in order to reach a conclusion.

Stock and option awards of executives and directors: The aggregate fair value of equity awards on the day granted, not the value according to the annual accounting charge, will now need to be reported in the Summary and Director Compensation Table and the Grants of Plan-Based Awards Table.

Director and nominee qualifications and legal proceedings: Amends Item 401 of Regulation S-K to require more extensive annual disclosure on board members and persons nominated to serve on the board. Companies will need to disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director for the company. The time period during which disclosure of legal proceedings involving directors, director nominees and executive officers was also lengthened from five to ten years.

Board leadership structure: Companies will need to disclose whether they split the chairman and CEO roles (and why or why not), as well as the role of any lead independent director if the company has one. The SEC states per release #33-9089: "*As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not intended to influence a company's decision regarding its board leadership structure*." Still, it is likely that more companies will seriously consider splitting the roles of Chairman and CEO to dodge potential criticism of not following good governance practices.

The board's role in risk oversight: Companies will need to describe the board's role in the oversight of risk management process in confronting a variety of risks, including credit risk, liquidity risk, and operational risk. This new disclosure requirement requires companies to describe how the board administers its risk oversight function. For example, does the company administer its risk oversight through the whole board, or through a separate risk committee or another committee, such as the audit committee? Companies are also encouraged to address whether the individuals who supervise the day-to-day risk management responsibilities report directly to the board or a board committee, or how the board or committee otherwise receives information from such individuals.

Potential conflicts of interest of compensation consultants: Companies will need to make more detailed disclosures about the fees paid to compensation consultants and their affiliates. The additional disclosures related to those fees generally won't be required if the consultant's additional services does not exceed $120,000 in the applicable fiscal year.

Reporting of voting results on Form 8-K: Creates a new Item 5.07 to Form 8-K requiring companies to disclose the results of a shareholder vote within four business days after the end of the meeting at which the vote was held rather than through Forms 10-Q and 10-K.

Regulators tend to be reactionary. SEC Release #33-9089 is the byproduct of risk management and board oversight shortcomings in the wake of the September 2008 financial crisis. It also addresses investor anger regarding excessive executive compensation. As a result, the 2010 proxy season is shaping up to be interesting both in terms of how a company responds to the enhanced disclosure requirements as well as investor reactions.

Climate Change Guidance

Unlike release #33-9089, the SEC Interpretive Guidance regarding climate change does not change or add any new SEC rule or regulation, but rather provides implementation guidance for existing rules and regulations. The relevant rules cover a company's:

- risk factors
- business description
- legal proceedings
- management discussion and analysis (MD&A)

Companies have long been required to discuss in their MD&A material events and uncertainties known to management that would cause the reported historical financial information not to be necessarily indicative of future operating results or of future financial condition. This guidance simply reminds companies of their disclosure requirements as may apply to climate change. Specifically, the SEC interpretive guidance highlights the following per their January 27, 2010, press release as examples of where climate change may trigger disclosure requirements:

- ***"Impact of Legislation and Regulation****: When assessing potential disclosure obligations, a company should consider whether the impact of certain existing laws and regulations regarding climate change is material. In certain circumstances, a company should also evaluate the potential impact of pending legislation and regulation related to this topic.*
- ***Impact of International Accords****: A company should consider, and disclose when material, the risks or effects on its business of international accords and treaties relating to climate change.*
- ***Indirect Consequences of Regulation or Business Trends****: Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for companies. For instance, a company may face decreased demand for goods that produce significant greenhouse gas emissions or increased demand for goods that result in lower emissions than competing products. As such, a company should consider, for disclosure purposes, the actual or potential indirect consequences it may face due to climate change related regulatory or business trends.*
- ***Physical Impacts of Climate Change****: Companies should also evaluate for disclosure purposes the actual and potential material impacts of environmental matters on their business."*

The SEC makes it clear that their actions should not be perceived as taking a position on climate change. In their press release, SEC Chairman Mary Schapiro states: "*We are not opining on whether the world's climate is changing, at what pace it might be changing, or due to what causes. Nothing that the Commission does today should be construed as weighing in on those topics.*"

The bottom line is that no matter where you stand on climate change, a company has the obligation to consider whether or not greenhouse-gas emissions and climate change are material to them so the investing community is adequately armed with intelligence. Failure to include these topics in a risk assessment could be disastrous if it subsequently comes to light that the company opted not to disclose something that they clearly should have under SEC rules and regulations.

Implementation Suggestions

Recent SEC actions need to be understood and acted upon to stay in the good graces of regulators and investors. Companies are advised to take SEC disclosures seriously and leverage disclosure controls to help ensure compliance. This includes either creating or expanding upon a company's risk assessment and risk management processes to take into consideration the new regulatory landscape. The regulatory landscape is increasing in complexity and companies must acquire the expertise to fully understand requirements and ramifications. Among potential disclosure controls and activities to consider are:

- Define responsibilities and roles for gathering information, assessing risk and materiality, preparing, and reviewing SEC filings. These should be formalized through written policies and procedures.
- Establish a training program to help ensure that all disclosure control owners are kept abreast of the ever-changing regulatory landscape.
- Ensure proper resources, including third-party advice and assurance efforts.
- Submit all draft SEC filings to a pre-filing review by an independent resource.
- Implement a sub-certification process to all relevant control owners, including those with oversight roles.
- Utilize a disclosure checklist for periodic SEC reporting.
- Incorporate a legal review process for all SEC disclosures.
- Maintain a disclosure committee and conduct robust meetings. Record attendance and significant actions in written meeting minutes for audit trail purposes. Create a schedule of risks and action items to help ensure proper follow-up.
- Build into your internal audit function testing to ensure that disclosure controls are properly working as designed.
- Capture a summary of disclosure controls in a memorandum to the periodic files and retain in accordance with the company's records retention policy.

Remember that disclosing accurate, timely, and complete information to the SEC and other regulators is not an option, but rather an obligation to the investing community. A misstep can be costly both in terms of a company's reputation and adverse legal actions.

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