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SEC Proposes Enhanced Compensation and Corporate Governance Disclosures for U.S. Public Companies

The Securities and Exchange Commission at its open meeting yesterday introduced several proposals aimed at enhancing the disclosure requirements for U.S. public companies about compensation and other corporate governance matters, and clarifying certain rules governing proxy solicitations to facilitate shareholder communication and voting.

The proposals seek to ensure that activities that materially contribute to a company's risk profile are fully disclosed to its investors, and broadly cover the following four areas:

- better disclosure of the relationship between a company's overall compensation policies and its risk profile, and conflicts of interest involving compensation consultants;
- better disclosure of each board candidate's particular experience, qualifications, skills or attributes that qualify such person to be a board member;
- better disclosure about why a board has chosen a particular leadership structure (such as a combined chair/chief executive officer position) and a description of the board's role in the risk management process; and
- more timely disclosure of voting results.

This update summarizes the proposals based on the open meeting. We will circulate a more in-depth analysis of these changes once the proposing release has been published.

CD&A. The SEC proposes to amend Item 402 of Regulation S-K to enhance the scope of the Compensation Discussion and Analysis requirements. Under the amendments, a company would be required to discuss its broader compensation policies and actual compensation practices with respect to employees generally (including non-executive officers) if the risk arising from such policies or practices may have a material effect on the company. The situations that would require such disclosure would vary depending on the company and its compensation policies.

Stock and option awards. The SEC proposes to amend the rules applicable to disclosure in the summary compensation table and the director compensation table of compensation

attributable to stock and option awards, to require that the tables show the aggregate grant-date value of these awards as computed in compliance with Statement of Financial Accounting Standards No. 123R ("FAS 123R"). This revised disclosure would replace the currently mandated disclosure of the accounting expense (i.e., the dollar amount recognized for financial statement reporting purposes under FAS 123R) associated with stock and option awards for the applicable fiscal year.

Directors and nominees. The SEC proposes to amend Item 401 of Regulation S-K to expand the disclosure requirements in relation to the qualification of directors and director nominees (whether nominated by the company or another proponent). Specifically, a company would need to disclose for each director or nominee the particular experience, qualification, attributes or skills that qualify such director or nominee to serve as a director of the company and as a member of any committee that such director or nominee serves on or is chosen to serve on, in light of such company's business. Companies would also be required to disclose directorships held by such director or nominee during the previous five years instead of the existing requirement that mandates disclosure of only current directorships. The proposed amendments would also require the expansion of disclosure of a director's, nominee's or executive officer's involvement in legal proceedings to cover 10 years instead of the currently mandated five years.

Leadership structure. The SEC proposes to amend Item 407 of Regulation S-K and Schedule 14A to require disclosure of a company's leadership structure and a discussion of why the company believes that such leadership structure is the best structure for the company, including whether and why it has chosen to separate or combine the positions of the chief executive officer and board chairman and whether it has a lead independent director. The SEC also seeks additional disclosure on the role of the board in the company's risk management process and the effect, if any, that such role has on the manner in which the company's leadership structure is organized.

Compensation consultants. The SEC seeks additional disclosure of the fees and services of compensation consultants and their affiliates similar to the disclosure currently required for independent auditors. If a compensation consultant provides consulting services in relation to director or executive compensation and any additional services to the company, the company would need to provide specific disclosure of the following:

- additional services provided by the consultant and its affiliates;
- the aggregate fees paid for all additional services;
- the aggregate fees paid for work related to director and executive compensation;
- whether the decision to engage the compensation consultants for the additional services was recommended or made by management; and
- whether the board or the compensation committee has approved the additional services.

Voting results. The SEC seeks to transfer the disclosure of voting results from annual reports on Form 10-K and quarterly reports on Form 10-Q to current reports on Form 8-K. A new item would be added to Form 8-K to require a company to disclose voting results within four business days after the relevant meeting.

Proxy rules. The SEC proposes the following amendments to the proxy rules under the Securities Exchange Act of 1934 to facilitate shareholder communication and voting:

- amendment to Rule 14a-2(b), which exempts certain solicitations from the requirements of the proxy rules, to clarify that (a) an unmarked copy of management's proxy card that is requested to be returned directly to management is not a formal revocation that would make the exemption unavailable and (b) special interest in the subject matter of a solicitation, which would make the exemption unavailable, may be present even if the soliciting party is not a shareholder;
- amendment to Rule 14a-4(d) to provide that a soliciting person can round out its "short slate" of director nominees with nominees named in a non-management proxy statement in the same manner as already provided in the rule for nominees named in the company's proxy statement;
- amendment to Rule 14a-4(e) to clarify that conditions specified by a soliciting party as to when it may not vote shares that it has received proxy authority over must be objectively determinable; and
- amendment to Rule 14a-12 to clarify that information with respect to the identity and interests of participants in the solicitation must be available in one filing no later than the time that shareholders are solicited.

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Yesterday's proposals come at a time of significant focus in boardrooms and elsewhere on risk assessments and risk management. A number of government and government-commissioned reports in Western Europe and studies in the United States have identified corporate governance reforms as an important component of the changes that financial institutions and non-financial institutions alike should embrace to address some of the structural factors that contributed to the current economic crisis. The proposed Shareholder Bill of Rights Act of 2009 calls for separate risk committees, and the proposed changes affecting compensation are designed to mitigate excessive risk-taking incentives in compensation structures.

In this context directors and management teams are re-focusing their attention on the proper allocation of responsibility for risk oversight and risk assessments, as well as more operational aspects of board oversight such as the quality, timeliness and clarity of information that flows to the board from management and the nature of the interaction between boards and board committees, on the one hand, and management teams, on the other. It is therefore not surprising that the SEC staff does not view yesterday's proposals as revolutionary.

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The foregoing summary of yesterday's proposals is based on discussions at the open meeting. The definitive proposed rule changes will not be known until the proposing release is published. Any questions concerning the issues addressed in this memorandum may be directed to Mark S. Bergman (+44-207-367-1601), Lawrence I. Witdorhcic (212-373-3237) or Frances F. Mi (212-373-3185). This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content.