

SEC Enhances Rules on Disclosures of Risk, Compensation and Corporate Governance

Information is based on an analysis of new disclosure requirements promulgated by the SEC

BACKGROUND

February 18, 2010 — In mid-December 2009, the Securities and Exchange Commission (SEC) made rule changes to how corporations, and specifically their boards, inform shareholders about the way they manage the risks of the business; the use of compensation consultants and any resultant potential conflicts of interest; and corporate governance in general. The following summarizes the key points of those changes.

KEY POINTS

The SEC rule changes address three major areas:

- 1) **Risk:** Investors and other stakeholders want to know about the company's risk management process. When it is reasonably likely there are risks that may have a material, adverse effect on the company, disclosure of the board's role in risk oversight provides useful information to the investors and other stakeholders. To the extent these risks arise from compensation policies and practices, discussion of those practices and the risk strategy related to them provides additional useful information.
- 2) **Governance and Director Qualifications:** Investors and other stakeholders are provided with useful information from the expanded disclosures relating to the background and qualifications of directors and director nominees as well as the new disclosure about a company's board leadership structure. Accelerating the reporting of information regarding shareholder voting results also provides more timely corporate governance information.
- 3) **Compensation:** Investors and other stakeholders are provided with two types of compensation information:
 - Reporting the aggregate grant date fair value of stock awards and option awards in the Summary Compensation and Director Compensation Tables brings SEC reporting in line with Financial Accounting Standards Board Standards Codification Topic 718.
 - Requiring disclosure of potential conflicts of interest of compensation consultants in certain circumstances; generally, if the consultant performs more than \$120,000 in non-compensation-related consulting during the fiscal year.

The SEC rule changes require several new or enhanced disclosures as follows:

New disclosures

- The board's role in overseeing the risk management process
- The relationship between the compensation structure and the risk management process
- The board's leadership structure
- The qualifications and background of directors and nominees for director
- Consideration of diversity in the process of selecting board candidates
- Fees paid to compensation consultants and their affiliates under certain circumstances
- Compensation practices for non-executive employees when these arrangements are reasonably likely to have a material, adverse effect on the company

Enhanced disclosures

- List of directorships held by any director in the last five years in other public companies or registered investment companies
- Legal actions for the last 10 years involving executive officers, directors or director nominees
- Stock and option awards to directors and executive management
- Disclosure of shareholder votes, using Form 8-K, within four business days

TIMELINE FOR COMPLIANCE

Issuers with fiscal years ending on or after December 20, 2009, are required to have Form 10K and proxy statements in compliance with the changed rules if they are filed on or after February 28, 2010. If an issuer releases a preliminary proxy and anticipates filing the final proxy on or after February 28, 2010, the preliminary proxy must be in compliance with the rule changes.

Smaller companies that are not required to provide Compensation Discussion and Analysis (CD&A) do not have to comply with the CD&A changes discussed in this Regulatory Review. Smaller companies are generally those with less than \$75 million in common equity public float. Changes not related to CD&A are required for all SEC issuers.

IMPACT TO BUSINESSES

The SEC's new rules have a tight timeline for implementation. We suggest the following:

Management

If you can complete and file your 10-K and proxy before February 28, 2010, you can put off compliance with these rules by one year. This could allow you to evaluate how others address these changes and plan your attack for the FY2010 filings. If this is not possible, and for most companies it will not be, we suggest the following:

- 1) Familiarize yourself with the SEC guidance to see how the rules noted above affect your company:
 - a. Final Rules - <http://www.sec.gov/rules/final/2009/33-9089.pdf>
 - b. Transition Guidance - <http://sec.gov/divisions/corpfin/guidance/pdetinterp.htm>

- 2) Determine which new requirements have to be reported. Certain rule changes have trigger events that may or may not apply to your company.
- 3) Remember, just because a trigger event does not occur for your company this year, it may in future years, and you will need to review your company's compliance with these rules annually.
- 4) Draft your proxy and 10-K; be sure to include all the required elements, both traditional and those added/changed by the new rules.

CIA or Director of Internal Audit

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 - b. Transition Guidance - <http://sec.gov/divisions/corpfm/guidance/pdetinterp.htm>
- 2) Work with management to understand its assessment of the rules that apply to your company for 2009. This will include certain testing of management's assessment to ensure compliance with the new rules.
- 3) Review the proxy and 10-K to ensure they include the appropriate language to address the new rules.
- 4) Work with management and the audit committee to provide the audit committee with ongoing guidance regarding how these rules affect it and the company.

These new disclosures provide investors and other external stakeholders with expanded insight into your company's risk management structure, potentially increasing pressure to enhance enterprisewide risk processes as these stakeholders make comparisons between companies. As a result, senior management and the board of directors will likely raise additional questions on how your organization can enhance its approach to risk management and strengthen the framework for measuring the risks associated with your business. Now is the time to begin formalizing this framework and make enterprise risk management a part of the day-to-day operations of your business.

HOW JEFFERSON WELLS CAN HELP

Our experienced enterprise risk management professionals have a proven approach and the expertise necessary to help your management and board identify, mitigate and manage risk across all functions. We leverage standard frameworks to provide practical internal control design, implementation and evaluation support within a structure that reduces and streamlines controls.

For additional information, please contact your local Jefferson Wells office.

Jefferson Wells delivers professional services in the areas of risk advisory, tax, and finance and accounting. We serve clients, including Fortune 500 and Global 1000 companies, from offices worldwide.

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