LAW OFFICES

SILVER, FREEDMAN & TAFF, L.L.P.

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

3299 K STREET, N.W., SUITE 100
WASHINGTON, D.C. 20007
PHONE: (202) 295-4500
FAX: (202) 337-5502
WWW.SFTLAW.COM

MEMORANDUM

TO: **Our Clients and Friends**

FROM: **Silver, Freedman & Taff, L.L.P.**

DATE: **December 2009**

RE: **Amendments to SEC Compensation and Corporate Governance-Related Disclosure Requirements**

On December 16, 2009, the Securities and Exchange Commission (the "SEC") approved amendments to its compensation and corporate governance-related disclosure rules. The amendments will be effective February 28, 2010, and will apply to any Form 10-K or proxy statement filed on or after that date by a company with a fiscal year ending on or after December 20, 2009. If a company files a preliminary proxy statement before February 28, 2010 and expects to file its definitive proxy statement on or after that date, then both the preliminary proxy statement and the definitive proxy statement must comply with the amended rules. As a result, the amendments will apply to the proxy statements of most calendar year-end companies for their annual meetings in 2010.

The amendments will require disclosure of the following:

- the relationship of a company's compensation policies and practices for all employees (not just executive officers) to risk management, if and to the extent the risks from these policies and practices are reasonably likely to have a material adverse effect on the company. This requirement will not apply to smaller reporting companies (i.e., those with a public float of less than $75 million);
- in the summary compensation and director compensation tables, the aggregate grant date fair value of option and stock awards made during the year, instead of the current requirement to report the annual accounting charges for these awards;
- additional information about the background and qualifications of directors and director nominees;

- legal proceedings against a director, director nominee or executive officer during the past ten years instead of the current five-year lookback, as well as an expanded list of legal proceedings subject to disclosure;

- whether and how the nominating committee considers diversity in selecting nominees, and, if there is a policy regarding the consideration of nominee diversity, how the policy is implemented and how its effectiveness is assessed;

- information about board leadership structure and the board's role in risk oversight, including whether the CEO and chairman positions are combined or separated and, if combined, whether the company has a lead independent director and what that director's specific role is;

- additional information regarding arrangements with compensation consultants under certain circumstances; and

- voting results on a Form 8-K within four business days following a shareholder meeting, rather than disclosure in the Form 10-Q or Form 10-K following the meeting.

COMPENSATION DISCLOSURES

New Discussion Regarding Relationship to Risk Management

The amendments will require narrative disclosure of a company's compensation policies and practices for employees (not just executive officers) as they relate to risk management practices and risk-taking incentives, if and to the extent that the risks arising from the company's compensation policies and practices are "reasonably likely to have a material adverse effect on the company." If applicable, this discussion would appear separately from the compensation discussion and analysis (CD&A) section, as the CD&A is limited to "named executive officer" compensation. Smaller reporting companies are not required to have the risk management discussion or a CD&A section.

The SEC provided a non-exclusive list of situations that could trigger the requirement for the risk management discussion, including compensation policies and practices at a business unit that: (1) carries a significant portion of the company's risk profile; (2) has a significantly different compensation structure from the company's other business units; (3) is significantly more profitable than the company's other business units; (4) has compensation expenses that represent a significant percentage of the unit's revenues; or (5) provides compensation that varies significantly from the company's overall risk and reward structure, such as awarding bonuses upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time. The SEC said that if a company has policies and practices for different groups that mitigate or balance incentives across business units, this can be considered in determining whether the overall risks from the company's compensation policies and practices are reasonably likely to have a material adverse effect on the company as a whole.

The SEC recognized that the risk management discussion will vary depending on a company's compensation policies and practices, and might not be required at all. If a company determines that no discussion is required, it need not make an affirmative statement regarding the

absence of a reasonable likelihood of a material adverse effect. The SEC provided examples of the types of issues that might need to be addressed if a company determines that the risk management discussion is required:

- the general design philosophy, and manner of implementation, of the company's policies and practices for employees whose behavior would be most affected by the incentives created, and how these policies and practices relate to or affect risk taking;
- the company's risk assessment or incentive considerations in structuring and providing compensation;
- how the company's compensation policies and practices relate to the realization of short-term and long-term risks resulting from the actions of its employees, such as through the use of claw backs or required holding periods;
- the company's policies regarding adjustments in compensation policies and practices to address changes in the company's risk profile, and any material adjustments actually made; and
- the extent to which the company monitors its compensation incentives to determine whether its risk management objectives are being met.

Compensation Tables

Currently, the amount disclosed in the summary compensation table and director compensation table for stock and option awards is the financial statement expense attributable to such awards for the applicable fiscal year under *Financial Accounting Standards Board Accounting Standard Codification Topic 718, Compensation – Stock Compensation* ("FASB ASC Topic 718")(formerly FAS 123(R)). The amendments will instead require disclosure of the aggregate grant date fair value of such awards made during the fiscal year (regardless of whether intended to be for services performed during that year), computed in accordance with FASB ASC Topic 718.

The SEC made this change because it believes that grant date fair value disclosure better reflects the compensation committee's decisions with regard to stock and option awards made during the year, as the current method of reporting the financial statement expense over the vesting period can include amounts relating to prior year awards. This change may result in significantly higher total compensation levels for years during which grants of stock and option awards are made, compared with years during which no grants, or smaller grants, are made. The SEC recognized that this change also may result in more frequent changes in the named executive officer group, particularly in the case of large, "one-time" awards to newly hired executives or special awards to enhance retention. The SEC said that if this results in the omission from the summary compensation table of another executive officer who otherwise would have been included in the table, the company can consider including compensation disclosure for that executive officer to supplement the required information. Although somewhat duplicative, the SEC retained the existing requirement to report the grant date fair value of such awards in the "grants of plan-based awards" table. The grants of plan-based awards table is not required for smaller reporting companies.

For awards subject to performance conditions, the amount disclosed must be based on the "probable outcome" of such conditions, consistent with the estimate of compensation cost to be recognized over the service period under FASB ASC Topic 718, excluding the effect of estimated forfeitures. The maximum value of the award, assuming the highest performance level is the probable outcome, must be disclosed in a footnote to the table.

Companies providing compensation disclosures for a fiscal year ending after December 20, 2009 must re-compute for the prior two years the amount disclosed in the stock and option award columns in the summary compensation table using the aggregate grant date fair values of awards made during the applicable prior year (except with respect to awards subject to performance conditions, as discussed above), and also must re-compute the amounts for those years under the total compensation column. There is no requirement to include different named executive officers or amend prior filings based on the re-computed amounts. The SEC said that if a person who would be a named executive officer for 2009 also was a named executive officer for 2007 but not for 2008, his or her re-computed compensation for all three years must be disclosed in the summary compensation table. If the person was not a named executive officer for 2008 or 2007, then only compensation information for 2009 need be provided.

CORPORATE GOVERNANCE-RELATED DISCLOSURES

Additional Information Regarding Background and Qualifications of Directors and Director Nominees

Currently, the background information required for directors and director nominees is limited to a brief description of business experience over the past five years, other public company directorships currently held and involvement in certain legal proceedings during the past five years. The amendments expand the existing requirements by mandating disclosure of the following:

- for each director (even if not up for re-election), the particular experience, qualifications, attributes or skills that led the board to conclude that he or she should serve as a director. The SEC did not specify the particular information that should be disclosed, saying that it wanted to give companies flexibility in this area. The SEC said, however, that if particular skills, such as risk assessment or financial reporting expertise, led the board to determine that a person should serve as a director, then this information should be disclosed. Disclosure of qualifications to serve on particular committees is not required, though the SEC said that if an individual was chosen to serve on the board because of a qualification related to service on a particular committee (e.g., audit), then this should be disclosed as part of his or her qualifications to serve on the board. The SEC retained the existing requirement to disclose the minimum qualifications and specific qualities or skills used by the nominating committee in evaluating director candidates;

- directorships at other public companies or registered investment companies held at any time during the past five years, instead of just those currently held;

- involvement in specified types of legal proceedings during the past ten years (compared with the current five-year lookback). The SEC also expanded the list of

disclosable proceedings. This disclosure requirement applies to executive officers as well; and

- whether, and if so how, the company's nominating committee considers diversity in identifying director nominees, and if the nominating committee has a policy regarding the consideration of diversity, how this policy is implemented and how the nominating committee assesses the policy's effectiveness. The SEC did not define the term "diversity," and said that it recognizes that companies define diversity in different ways (such as diversity of viewpoint, professional experience, education and/or skill versus diversity of race, gender and/or national origin).

Company Leadership Structure and Board's Role in Risk Oversight

The amendments will require a brief description of the leadership structure of the company's board of directors and why the company believes that its leadership structure is appropriate in light of the company's circumstances. If its chairman and CEO positions are combined, a company must disclose whether it has a lead independent director, and if so, the specific role the lead independent director plays in board leadership. The amendments also require disclosure of the extent of the board's role in risk oversight, such as how the board administers its oversight function (e.g., through the full board or through one or more committees), and the effect this has on the board's leadership structure. The SEC said that it wants companies to inform investors about how the company perceives the role of the board and the relationship between the board and senior management in managing material risks. The SEC suggested that companies consider addressing whether the employees who oversee day-to-day risk management duties report directly to the full board or a board committee or, if neither, how the board otherwise receives information from these individuals.

Additional Disclosures Regarding Compensation Consultants

Currently, if a company uses a compensation consultant in connection with determining executive or director compensation, the company must identify the consultant, describe the consultant's role, the nature and scope of their duties and any instructions or directions provided to them on the performance of their duties, and state whether the consultant was engaged directly by the compensation committee or by any other person. The amendments expand these requirements by mandating fee and related disclosures in certain circumstances believed by the SEC to create the potential for conflicts of interest.

If the compensation committee has engaged a consultant for executive or director compensation matters and the fees paid to the consultant (or its affiliates) for additional services (e.g., benefits administration, human resource consulting or actuarial services) exceed $120,000 during the company's last fiscal year, then the aggregate fees for both categories of services must be disclosed. A description of the additional services is not required, but the company must disclose whether the decision to engage the consultant for additional services was made or recommended by management, and whether the board or compensation committee approved these other services.

If the compensation committee has <u>not</u> engaged a compensation consultant but <u>management</u> has engaged a consultant for executive or director compensation matters, and the fees paid to the consultant for additional services exceed $120,000 during the company's last

fiscal year, then the aggregate fees for both categories of services must be disclosed. As with a consultant engaged by the compensation committee, a description of additional services provided by a consultant engaged by management is not required.

The amended rules do not require fee or other additional disclosures in situations where both the compensation committee and management have engaged compensation consultants, as long as the consultant retained by the compensation committee did not provide additional services in excess of $120,000 during the year. This is the case even if management's compensation consultant is paid more than $120,000 for additional services. The SEC said it believes that the compensation committee's engagement of its own consultant mitigates any potential conflict of interest.

Services performed by consultants involving only broad-based non-discriminatory plans or surveys or other information that are not customized for the company, or are customized based on parameters not developed by the consultant, are not considered to be executive or director compensation consulting services for purposes of the disclosure requirements.

Reporting of Shareholder Meeting Results on Form 8-K

The amendments will require that the voting results of any shareholder meeting be reported on a Form 8-K (under new Item 5.07) within four business days after the meeting. If only preliminary results are available, then an amended Form 8-K reporting the final voting results must be filed within four business days after the final results are known. As a result of this new 8-K item, voting results will no longer be reported in the company's Form 10-Q or 10-K following the shareholder meeting.

WHAT YOUR COMPANY SHOULD DO NOW

We plan to work closely with our clients in preparing the new disclosures that will be required, and will be modifying the year-end director and officer questionnaire to reflect the amendments. Steps that companies and their boards should take in the meantime include the following:

- assess whether there are any material adverse risks created by your incentive compensation policies and practices for all employees (not required for smaller reporting companies);

- as soon as practicable after year-end, calculate the total compensation earned by executive officers during the last year using the aggregate grant date fair value amounts for stock and option awards instead of the expense for these awards, as this change in methodology could affect which executive officers fall within the named executive officer group;

- for each director, attempt to articulate the particular experience, qualifications, attributes or skills that he or she adds to the board. The revised director and officer questionnaire we will provide to clients will contain questions designed to elicit this information. Directors obviously are very interested in what is said about them, so board involvement early in the process will be important and each director should be provided with the proposed disclosure before it is finalized;

- if the nominating committee does not currently have a diversity policy, consider whether one should be adopted and how diversity should be defined;
- consider what your justifications are for separating or combining the chairman and CEO positions; if the positions are combined and you do not have a lead independent director, consider whether one should be appointed and what his or her role should be (e.g., presiding over executive sessions of independent directors, acting as liaison between the independent directors and the chairman/CEO, providing input to the chairman on board meeting schedules and agendas, etc.);
- if a consultant is utilized for executive or director compensation matters and the consultant provides additional services to the company, ensure that your disclosure controls and procedures track the fees paid for these additional services; also consider whether, in light of any required additional disclosures (or the potential for such disclosures), the company's relationship with its compensation consultant should be modified; and
- modify your disclosure controls and procedures to ensure that voting results are reported on a Form 8-K within four business days after each shareholder meeting and, if the final voting results are not available within that timeframe, ensure that the final results are reported on an amended Form 8-K within four business days after they become known.

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We hope this information is of assistance. This memorandum provides a general overview and should not be used or taken as legal advice for specific situations. The matters discussed in this memorandum are complex, and we encourage you to contact us with any questions you may have.