



AMALFI  
CONSULTING, LLC

New SEC Proxy Disclosure Rules  
and  
TARP Technical Corrections

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*Todd Leone*

*President & Founder*

*todd.leone@amalficonsulting.com*

*(952) 893-6711*

*Gayle Appelbaum*

*Managing Director & Founder*

*gayle.appelbaum@amalficonsulting.com*

*(952) 893-6795*

# Webinar Agenda



- ★ The goal of today's webinar is to review two regulatory matters:
  - New SEC proxy disclosure rules → *Applicable to all public banks*
  - Technical corrections to TARP standards → *Applicable to all TARP banks*
  
- ★ *If you are neither a public bank nor a TARP bank this webinar will not be applicable to you*
  
- ★ Webinar format
  - 50 minutes covering the content of the new regulatory matters
  - 10 minutes reviewing questions from the audience



# New SEC Proxy Disclosure Rules Background

# New SEC Proxy Disclosure Rules

- ★ Actual release date was December 16, 2009
  - 129 pages of guidance
  
- ★ Published in the Federal Register on December 23, 2009
  - <http://frwebgate6.access.gpo.gov/cgi-bin/PDFgate.cgi?WAISdocID=81993210692+0+2+0&WAISaction=retrieve>
  
- ★ The new SEC rules go into effect for most filers for this upcoming proxy
  - *For companies with fiscal years ending on or after December 20, 2009*
    - *The definitive proxy statement must be in compliance if filed on or after February 28, 2010*
  
- ★ Note, this applies to all public-company SEC-filing institutions
  - This is not specific to banks in any way

The background features a blue gradient with a compass rose in the lower right quadrant. The compass rose is rendered in a light blue, semi-transparent style, showing cardinal and intercardinal directions. A horizontal brown band is positioned across the middle of the slide, containing the title text.

# New SEC Proxy Disclosure Rules

## Overview of Rules

# Topics of Conversation

- ✦ Risk management of compensation
- ✦ Equity award reporting
- ✦ Enhanced director & nominee disclosure
- ✦ Board leadership structure
- ✦ Board role in risk oversight
- ✦ Compensation consultant disclosure
- ✦ Proxy voting results
- ✦ SEC transition rules

# Risk Management of Compensation

## ★ Overview

- Item 402 of Regulation S-K is amended to require disclosure regarding how the company’s overall compensation policies for employees create incentives that can affect the company’s risk and management of that risk.
  
- The company must provide a narrative disclosure of its compensation policies and practices for all employees (including non-executive officers) if those policies and practices create risks that are “*reasonably likely to have a material adverse effect*” on the company.
  - Reasonably likely concept is the same used for companies in the MD&A disclosure in their 10-K.
  
- The Commission specifically notes that if a company has compensation policies and practices that mitigate or balance incentives, these mitigating factors can be considered in deciding whether risks arising from compensation policies and practices are reasonably likely to have a material adverse effect.
  - The Commission also notes that the “adverse” qualifier will eliminate the need for disclosure of well-designed compensation policies that could have a material positive effect on the company.
  
- This new disclosure is to be made as a separate compensation disclosure (see Item 402(s) of Regulation S-K) instead of as part of the company’s Compensation Discussion and Analysis as was originally proposed.
  - Smaller reporting companies *will not be required* to provide this new disclosure as they are considered less likely to have the types of compensation policies and practices intended to be addressed by the new rules.

# Risk Management of Compensation

## ★ Overview

- In its discussion of this new disclosure requirement the Commission also offers a non-exclusive list of situations that could trigger discussion. It includes discussion of compensation policies and practices:
  - At a business unit of the company that carries a significant portion of the company's risk profile
  - At a business unit with compensation structured significantly differently than other units within the company
  - At a business unit that is significantly more profitable than others within the company
  - At a business unit where the compensation expense is a significant percentage of the unit's revenues
  - That vary significantly from the overall risk and reward structure of the company, such as when bonuses are awarded upon accomplishment of a task, while the income and risk to the company from the task extend over a significantly longer period of time

# Risk Management of Compensation

## ★ Overview

- If a company determines that disclosure is required, the SEC provides examples of the issues that companies may need to address regarding their compensation policies or practices including:
  - The general design philosophy of the compensation policies and practices for employees whose behavior would be most affected by the incentives established by the policies and practices, as such policies and practices relate to or affect risk taking by employees and the manner of their implementation.
  - The company's risk assessment or incentive considerations, if any, in structuring its compensation policies and practices or in awarding and paying compensation.
  - How the company compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short-term and the long-term, such as through policies requiring claw backs or imposing holding periods.
  - The company's policies regarding adjustments to its compensation policies and practices to address changes in its risk profile.
  - Material adjustment the company has made to its compensation policies and practices as a result of changes in its risk profile.
  - The extent to which the company monitors its compensation policies and practices to determine whether its risk management objectives are being met with respect to incentivizing its employees.

# Risk Management of Compensation

## ★ Observations

- This is the biggest area in the SEC release.
- Note that this section applies to all public companies, not just the financial sector.
- How many companies will actually conclude that they have compensation practices which are “*reasonably likely to have a material adverse effect*” on the company?
- Note that banks that received TARP funds have, in effect, already complied with this section as they were required to review all incentive plans and modify those that could negatively impact the bank.
  - This implies that each publicly filing organization has done a thorough review of all their incentive plans. Lesson from TARP banks: many banks did not have a complete understanding of all the incentive plans they had.

# Equity Award Reporting

## ★ Overview

- For the reporting of equity awards, the grant date fair value of the equity award must now be reported in accordance with FASB ASC Topic 718 (Formally FAS 123R) in the year in which the equity is granted.
  - Historically, you had to report the annual expense associated with equity awards for the given fiscal year
- The grant date fair value of equity awards needs to be reported in the following tables:
  - The Summary Compensation Table
  - The Grants of Plan Based Awards Table
  - The Director Compensation Table
- For performance-based awards, the grant date fair value should be reported based on the probable outcome of the equity award.
  - If the maximum potential award is greater than the probable outcome, then the maximum potential award needs to be footnoted.

# Equity Award Reporting

## ★ Overview

- Each of the preceding years in the Summary Compensation Table needs to be re-computed to reflect the grant date fair value of the equity award and the associated Total Compensation column, for example:
  - 2009
  - 2008
  - 2007
- Companies are not required to include different Named Executive Officers (NEOs) based on re-computing the Total Compensation for the preceding years.

## ★ Observations

- The determination of the NEOs beyond the Principal Executive Officer (CEO) and Principal Financial Officer (PFO) will be based on the newly computed Total Compensation column.

# Enhanced Director & Nominee Disclosure

## ★ Overview

- Item 401 of Regulation S-K is revised to cover expanded disclosure for directors.
- Disclosure requirements regarding director and nominee qualifications:
  - For each individual the company must disclose the specific experience, qualifications, attributes or skills that are the basis for the individual to serve as a director. If material, the disclosure should cover more than five years.
  - If there are specific qualifications which form the basis to serve on a specific committee, these must be disclosed.
  - The disclosure must be made annually for all directors and nominees.
- Disclosure of directorships:
  - Listing of each directorship at other public companies or registered investment companies covering past five years even if no longer a director.
- Disclosure of legal proceedings:
  - Time period for which legal proceedings covering directors, nominees and executive officers must be disclosed is lengthened from five to ten years.
  - The new rules add additional legal proceedings which must be disclosed:
    - Mail or wire fraud or fraud in any business.
    - Violations of federal or state securities, commodities, banking or insurance laws including settlements.
    - Disciplinary actions imposed by a stock, commodities or derivatives exchange or any self-regulatory organization.

# Enhanced Director & Nominee Disclosure

## ★ Overview

- Disclosure regarding diversity:
  - Item 407(c) is amended to require disclosure of whether, and if so the process, a nominating committee considers diversity in identifying nominees for directors.
  - If there is a policy, how is the policy implemented and how is it reviewed for effectiveness?
  - The meaning of diversity is not defined. The definition of diversity could include:
    - Variety of professional experience, education, skills and perspectives, and/or
    - Race, gender or nationality.

## ★ Observations

- This disclosure is putting additional pressure on directors to be specifically qualified.
- How many sitting directors will have issues with these disclosures?
- How will this influence the desire of individuals to serve on boards?

# Board Leadership Structure

## ★ Overview

- Companies are required to disclose whether they have decided to separate or combine the positions of board chair and the principal executive officer (CEO).
  - The company should provide a narrative describing why its structure is appropriate.
- If the company has combined the role of board chair and principal executive officer (CEO) and has a separate position of lead director to chair meetings of independent directors, it must describe:
  - Why it has a separate position of lead director.
  - The specific duties of the lead director .

## ★ Observations

- This requirement is continued pressure to separate the role of board chair from that of the CEO role.

# Board Role in Risk Oversight

## ★ Overview

- Companies must describe the board's role in the oversight of risk. What is its process?
  - Does it oversee through the whole board, the audit committee or a risk committee?
  - Specifically, what is the relationship between the board and senior management in managing material risk?
- Possible disclosures include information regarding employees who manage at the company and what is their interrelationship to the board:
  - Do they report to the full board or a specific committee?
  - How does the board inter-relate with individuals who manage risk for the company?
- Each company has a number of different risks (credit risk, liquidity risk, operation risk, etc.) and the disclosure seeks to inform how the board is involved in overseeing these risks.

## ★ Observations

- Remember, this applies to all public filers, not just banks. This is a good example of how the experiences of the financial sector are being applied to a much broader market.

# Compensation Consultant Disclosure

## ★ Overview

- Item 407 of Regulation S-K is amended to require disclosure about fees paid to compensation consultants under certain circumstances.
  
- Disclosures required if the board's compensation consultant (or its affiliate) provides additional services (beyond executive compensation or board consulting) that exceed \$120,000 in fees in a fiscal year:
  - Aggregate amount of fees paid for executive or director compensation
  - Aggregate amount of fees paid for other services
  - Who approved the consultant for use by the company (management or the board)
  
- Disclosures required if the board does not have a compensation consultant yet the company receives executive compensation and other non-executive compensation consulting services that exceed \$120,000 in a fiscal year:
  - Aggregate amount of fees paid for executive or director compensation
  - Aggregate amount of fees paid for other services
  
- No disclosure required if the board and management have different compensation consultants.

# Compensation Consultant Disclosure

## ★ Overview

- There is an exception for consulting on broad-based plans and compensation surveys
  - No disclosures required when the compensation consultant's only role in recommending executive or director compensation is limited to:
    - Consulting on broad-based plans that do not discriminate in favor of executives or directors.
    - Providing information *which is not* customized for the particular company or is customized based upon parameters not set by the compensation consultant. However, the compensation consultant cannot be providing recommendations or advice based upon this information.

## ★ Observations

- These disclosures target firms that provide both executive compensation consulting plus material other services, such as retirement or welfare plan administration. For example, a firm that provides executive compensation consulting as well as managing a company's pension plan.
- This is putting pressure on firms that provide multiple lines of services to review conflict of interest issues.

# Proxy Voting Results

## ★ Overview

- Shareholder voting results must now be disclosed within four business days in Form 8-K.
  - Previously shareholder voting results were reported in forms 10-K or 10-Q
- When there is a contested election a company must report results:
  - Within four business days in Form 8-K after the shareholder meeting (still contested).
  - Within four business day in an amended Form 8-K after final shareholder results are known.
- Transition rules (as published by the SEC on December 22, 2009):
  - If the shareholder meeting occurs on or after February 28, 2010, the company must comply with the new Form 8-K rules.
  - If the shareholder meeting occurs prior to February 28, 2010, the company is not subject to the new rules.

## ★ Observations

- The SEC clearly wants to have the results of shareholder votes known in a much more timely fashion.
- Essentially all public companies will need to comply with the new Form 8-K rules.

# SEC Transition Rules

## ★ Overview

- On December 22, 2009 the SEC provided clarification regarding the effective date and transition rules relative to the date.
- Companies with Fiscal Years Ending on or after December 20, 2009:
  - Forms 10-K and proxy statements must be in compliance with the new proxy disclosure requirements if they are filed on or after February 28, 2010.
  - If the company is required to file a preliminary proxy statement and expects to file its definitive proxy statement on or after February 28, 2010, the preliminary proxy statement must be in compliance with the new rules even if it is filed prior to February 28, 2010.
  - If the company files its 2009 Form 10-K before February 28, 2010 and its proxy statement on or after February 28, 2010, the proxy statement must be in compliance with the new rules.

## ★ Observations

- Companies with fiscal years that end prior to December 20<sup>th</sup>, 2009 do not need to comply in this proxy season.
- Most public company SEC-filers with December 31<sup>st</sup> fiscal year ends will need to comply with the new rules.

# Technical Corrections to TARP Standards



# TARP Technical Corrections

- ★ Published in the Federal Register on December 7, 2009.
  - <http://frwebgate6.access.gpo.gov/cgi-bin/PDFgate.cgi?WAISdocID=81917112668+25+2+0&WAISaction=retrieve>
  
- ★ The new technical corrections are effective immediately and correct four issues that were in the June 15, 2009 Interim Final Rule (IFR):
  - Definition of most highly compensated employee (MHCEs)
  - Clarifying the requirement for shareholder vote
  - TARP certifications of CEOs and twenty next MHCEs
  - Applicability of Section 30.2
  
- ★ While these are technical corrections, they are important as TARP banks are processing their various TARP certifications relative to year-end.
  - Important note: This is just a “technical correction” and not a new IFR or Final Rule
  - The Treasury has suggested that a new IFR or Final Rule may be forthcoming by mid-year

# Definition of Most Highly Compensated Employee (MHCE) –

## ★ Overview

- The definition of Most Highly Compensated Employee (MHCE) has been corrected to state that the MHCE is defined as the employee or employees of the TARP recipient whose annual compensation is determined to be the highest among all employees of the TARP recipient, with an important exception. In the situation where the bonus limitation applies to both SEOs and MHCEs, then the SEOs of the TARP recipient are excluded when identifying the MHCE(s).
  - As originally written, for TARP recipients who received less than \$250 million in assistance where the bonus limitation only applies to MHCEs, the SEOs (the proxy officers) were excluded when determining the MHCEs.

## ★ Observations

- Amalfi Consulting raised this particular point with the Treasury immediately after the June 15th release.
- This clarification corrects a drafting error and is in the spirit of the overall regulations.

# Clarifying the Requirement for Shareholder Vote

## ★ Overview

- Section 30.13 of the IFR has been modified relative to the requirement for a shareholder vote for executive compensation:
  - TARP recipients must comply with the rules and regulations as set forth by the SEC with respect to this requirement
- Thus a TARP recipient that does not register securities with the SEC does not need to have a separate shareholder vote on executive compensation.

## ★ Observations

- The issue was not specifically about having the vote; the issue was about what to vote on, as these companies do not file proxy statements.
- This correction provides needed clarification on an area that was debated within the industry.

# TARP Certifications of SEOs and Next Twenty MHCEs

## ★ Overview

- Section 30.15 of the IFR has been modified to provide that the certification must state that the TARP recipient has provided the Treasury Department a complete and accurate list of the SEOs and the twenty next MHCEs for the current fiscal year, with the non-SEOs ranked in descending order of amount of annual compensation.
  - Section 30.15 covers the 16 point certification that the principal executive officer (CEO) and principal financial officer (CFO) have to attest to.
  - The Section 30.15 certification needs to be provided to different groups, depending upon filing status of the TARP recipient:
    - If the TARP recipient has securities registered with the SEC, then to Treasury and in Form 10-K.
    - If the TARP recipient does not have securities registered with the SEC, then to Treasury and the bank's primary federal regulator.
- Prior to this clarification, in the certification (30.15(xv)) the company had to list the specific names of the SEOs and the next twenty MHCEs

## ★ Observations

- This clarification ensures that the privacy of individuals beyond proxy officers is preserved.

# Applicability of Section 30.2

## ★ Overview

- As originally written, Section 30.2 of the IFR provided that the requirements of EESA Section 111(c) (relating to the establishment and maintenance of an independent compensation committee and that committee's review of employee compensation plans, as well as the establishment of a company-wide excessive and luxury expenditures policy) apply through the later of the last day of the TARP period for recipients with an obligation or through the last day of the recipient's fiscal year including the sunset date for recipients that never had an obligation.
- Since only one of these dates can be applicable to any specific TARP recipient, the "later of" language made the provision confusing. Section 30.2 was amended to remove the "later of" language.

## ★ Observations

- This provides administrative clarification on this point.

# Compensation Horizon



# Compensation Horizon

## ★ Federal Reserve Proposed Guidance

- 30-day comment period ended November 27, 2009
- There will be another round of guidance post comment period
- Applicable to 6,889 banking organizations

## ★ TARP Regulations

- Comment period on Interim Final Rule ended August 14, 2009
- Expect next round of guidance (IFR or Final Rule) in 2010; possibly first half
- Applicable to 648 TARP banking organizations

## ★ Legislative Initiatives (H.R. 4173, et al)

- The bill passed in the House and will need to be taken up by the Senate
- Applicable to all public filers and potentially all banking organizations > \$1 Billion in assets

# Webinar Questions & Answers



# Contact Information



CONTACTS	1-866-280-3720	<a href="http://www.amalficonsulting.com">www.amalficonsulting.com</a>
<hr/>		
Minneapolis		
Todd Leone	1-952-893-6711	<a href="mailto:todd.leone@amalficonsulting.com">todd.leone@amalficonsulting.com</a>
Gayle Appelbaum	1-952-893-6795	<a href="mailto:gayle.appelbaum@amalficonsulting.com">gayle.appelbaum@amalficonsulting.com</a>
Matt Brei	1-952-893-6705	<a href="mailto:matt.brei@amalficonsulting.com">matt.brei@amalficonsulting.com</a>
<hr/>		
Dallas		
Mike Point	1-972-745-1978	<a href="mailto:mike.point@amalficonsulting.com">mike.point@amalficonsulting.com</a>
<hr/>		
Boston		
Jean Riley	1-781-934-8400	<a href="mailto:jean.riley@amalficonsulting.com">jean.riley@amalficonsulting.com</a>



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