

**MEMO# 23651**

July 23, 2009

## **SEC Proposes Enhanced Compensation and Governance Disclosure for Proxy and Registration Statements; Conference Call Scheduled for July 29, 2009**

[23651]

July 23, 2009

TO: ACCOUNTING/TREASURERS COMMITTEE No. 11-09  
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 13-09  
RISK MANAGEMENT ADVISORY COMMITTEE No. 7-09  
SEC RULES COMMITTEE No. 44-09 RE: SEC PROPOSES ENHANCED COMPENSATION AND GOVERNANCE DISCLOSURE FOR PROXY AND REGISTRATION STATEMENTS; CONFERENCE CALL SCHEDULED FOR JULY 29, 2009

The Securities and Exchange Commission has proposed amendments to a number of rules and registration forms (including some that are specifically applicable to registered investment companies) to enhance the compensation and corporate governance disclosures registrants are required to make about various elements of executive compensation and corporate leadership. [\[1\]](#)

The Commission's proposal has two major elements that relate specifically to investment companies – enhanced director and nominee disclosure, and new disclosure about the structure of fund boards and the board's role in the risk management process. The proposal has two other major elements – enhanced compensation disclosure and new disclosure regarding compensation consultants. These are not applicable to funds, but would be applicable to advisers that are publicly traded. In addition to the four major

elements, the proposal also includes amendments relating to the disclosure of shareholder voting results and technical revisions to the proxy solicitation rules that are intended to address common interpretive questions that arise in the proxy solicitation process. The major elements of the proposal are summarized below.

Comments on the proposal are due to the SEC by September 15, 2009.

We have scheduled a conference call on Wednesday, July 29, 2009 at 2:00 p.m. Eastern time to discuss the proposal and potential Institute comments. If you plan to participate on the call, please contact Gwen Kelly by email at [gwen.kelly@ici.org](mailto:gwen.kelly@ici.org) or 202/326-5818. Gwen will provide dial-in information upon your RSVP.

### *1. Enhanced Director and Nominee Disclosure*

Item 401 of Regulation S-K currently requires registrants to disclose brief biographical information about directors and nominees for the past five years, and Item 407 of Regulation S-K requires general disclosure about director qualification requirements at a company.

The Commission's proposal would amend Item 401 to expand the information required about individual directors and supplement the current director qualification disclosures in Item 407. As amended, Item 401 would require more detailed disclosure for each director and nominee for director. The disclosure would describe, in light of the company's business and structure, the qualifications, attributes or skills that qualify that person to serve as a director and as a member of any committee that the person serves on or is chosen to serve on (if known). The proposal also would require disclosure of any directorships held by each director and nominee at any time during the past five years at public companies, and would lengthen the time during which disclosure of legal proceedings is required from five (as currently required) to ten years.

The proposal would extend these expanded disclosure requirements to mutual funds and closed-end funds in two ways. First, it would amend the disclosures in Schedules 14A and 14C to apply these expanded requirements to fund proxy statements where action is to be taken with respect to the election of directors. Second, it would require that funds include the expanded disclosures regarding director qualifications and past directorships in their statements of additional information ("SAIs").

The Release explains that the Commission believes that investors in mutual funds and closed-end funds, like investors in other types of public companies, would find this information useful. It specifically seeks comment, however, on whether the expanded disclosure should apply to mutual funds and closed-end funds, and if so, where each of the disclosures should be required (e.g., proxy statements, SAIs, and/or shareholder

reports). The Release also seeks comment on whether the disclosure requirement needs to be modified in any way to make it more appropriate for mutual funds or closed-end funds.

## *2. New Disclosure About Company Leadership Structure and the Board's Role in the Risk Management Process*

The proposal would add a new disclosure requirement to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A that would require disclosure of a company's leadership structure and why the company believes it is the best structure for it at the time of the filing. The proposal would also require additional disclosure in proxy and information statements about the board's role in the company's risk management process.

The Commission proposes to extend these requirements to mutual funds and closed-end funds. A fund would be required to disclose whether the board chair is an "interested person" of the fund and, if so, whether the board has a lead independent director and what specific role the lead independent director plays in the leadership of the fund. Similar disclosure would be required in SAls.

The Release explains that the Commission believes that providing this disclosure to investors in investment companies should enable them to consider their management structure preference, if any, when deciding where to invest. It specifically seeks comment on whether the expanded disclosure on the board's structure and role in risk management should apply to mutual funds and closed-end funds, and if so, where that disclosure should appear (e.g., proxy statements, SAls, and/or shareholder reports). The Release also seeks comment on whether the requirement should differentiate between mutual funds and closed-end funds. It asks, for example, whether the Commission should omit this requirement from Form N-2 because closed-end funds generally hold annual shareholder meetings and their shareholders will receive this disclosure in annual proxy or information statements.

## *3. Enhanced Compensation Disclosure*

All public operating companies are required to include a Compensation Discussion and Analysis ("CD&A") in proxy materials and 10-Ks. Item 402(b) of Regulation S-K describes the CD&A. The proposal would amend Item 402(b) to include a new section requiring registrants to provide information about how the company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk. The proposed amendments also would require a company to discuss and analyze its broader compensation policies and overall actual compensation practices for employees generally, including non-executive officers, if risks arising from those compensation policies or practices may have a material effect on the company.

If amended as proposed, Item 402(b) would not specify what situations may have a “material effect on the company” and thus require disclosure. Instead, it would state that those situations will vary depending on the particular company and its compensation programs, and then provide a non-exhaustive list of situations that could trigger discussion and analysis. The examples include 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 business units that are significantly more profitable than others within the company; at business units where the compensation expense is a significant percentage of the unit’s revenues; or that vary significantly from the overall risk and reward structure of the company.

For the business units or employees discussed, Item 402(b) also would provide several examples of the types of issues that may be appropriate for a company to discuss and analyze in the CD&A. These include:

- The general design philosophy of the registrant’s compensation policies for employees whose behavior would be most impacted by the incentives established by the policies, as such policies relate to or affect risk taking by employees on behalf of the registrant, and the manner of its implementation;
- The registrant’s risk assessment or incentive considerations, if any, in structuring compensation policies or in awarding and paying compensation;
- How the registrant’s compensation policies 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 registrant’s policies regarding adjustments to its compensation policies to address changes in its risk profile;
- Material adjustments the company has made to its compensation policies or practices as a result of changes in risk profile; and
- The extent to which the registrant monitors its compensation policies to determine whether its risk management objectives are being met with respect to incentivizing its employees.

The proposal also includes several revisions to the Summary Compensation Table and Director Compensation Table, including revisions that would require disclosure of the aggregate grant-date fair value of stock awards and option awards. This would replace the currently mandated disclosure of the dollar amount recognized for financial statement reporting purposes.

#### *4. New Disclosure Regarding Compensation Consultants*

The Commission proposes amendments to Item 407 of Regulation S-K to require

disclosure by public operating companies about the fees paid to compensation consultants and their affiliates when they play any role in determining or recommending the amount or form of executive and director compensation, if they also provide other services to the company. The proposed amendments also would require a description of any additional services provided to the company by the compensation consultants and any affiliates of the consultants.

The Release specifically points out that the proposed amendments would not apply to those situations in which the compensation consultant's only role in recommending the amount or form of executive or director compensation is in connection with consulting on broad-based plans that do not discriminate in favor of executive officers or directors of the company, such as 401(k) plans.

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Securities Regulation - Investment Companies

#### **endnotes**

[1] See Proxy Disclosure and Solicitation Enhancements, SEC Rel. No. 34-60280, IC-28817 (July 10, 2009) ("Release"), which is available on the SEC's website at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>.

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