SEC Proposes Rules on "Say on Pay" for Public Companies and Rules on Proxy Vote Reporting for Institutional Investment Managers

On October 18, 2010, the Securities and Exchange Commission proposed rules on say on pay, say on frequency and say on golden parachutes votes to implement the provisions of the Dodd-Frank Act that give shareholders of public companies a voice on executive compensation and golden parachute arrangements. In a companion release, the SEC proposed rules that would require certain investment managers to report how they voted on these executive compensation matters.

A brief description of the proposed rules and associated amendments is provided below. The SEC's proposed rules on shareholder approval of executive compensation may be found at the SEC's web site here, and the SEC's proposed rules on proxy vote reporting may be found at the SEC's web site here.

Shareholder Approval of Executive Compensation

A. Say on Pay

Proposed Rule 14a-21(a) of the Exchange Act would require an issuer to include in proxy statements for meetings at which proxies are solicited for the election of directors a separate shareholder advisory vote to approve the compensation of the issuer's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K. Approval of executive compensation would be required to be put to a vote of shareholders at least once every three years. Though the proposed rule does not require any specific language or form of resolution, a proposal that failed to include all executive compensation disclosed pursuant to Item 402 would not be acceptable (for example, a vote to approve compensation policies and procedures, without more, would not suffice).

The SEC is also proposing amendments to Item 402(b) of Regulation S-K to require that an issuer's Compensation Discussion and Analysis disclose whether (and if so, how) the issuer's compensation policies and decisions have taken into account the result of prior say on pay votes. While this requirement is for disclosure only and does not require a board to make changes to compensation policies or practices in the wake of a negative vote on say on pay, we can expect that proxy advisory groups will be intently focused on whether changes are made following such a vote.

B. Say on Frequency

Proposed Rule 14a-21(b) of the Exchange Act would require issuers, at least once every six years, to include in proxy statements for meetings at which proxies are solicited for the election of directors a separate shareholder advisory vote to determine the frequency of the say on pay vote. The proposed rule requires that shareholders be given four choices: a vote every year, a vote every other year, a vote once every three years or an abstention from the matter. If the board of directors of an issuer chooses to include a recommendation on the frequency of the vote, it must be clear that all four choices are available and that the proposal being voted upon is not one in which shareholders are voting to approve or reject the board's recommendation. To enable issuers to comply with this proposed rule, the SEC is also proposing an

amendment to Rule 14a-4, which dictates the form of a proxy card, to accommodate the presentation of these four choices.

The SEC has proposed amendments to Form 10-K and Form 10-Q to require an issuer to disclose its decision on how frequently it will conduct the say on pay vote in light of the results of how shareholders voted on this issue.

C. Amendments related to both Say on Pay and Say on Frequency

Non-Binding Nature of the Votes

The proposed rules confirm that the say on pay and say on frequency votes required by the Dodd-Frank Act are non-binding on an issuer. A new Item 24 of Schedule 14A would require that issuers disclose that they are providing a separate shareholder vote on executive compensation and on the frequency of the executive compensation vote, in proxy statements containing such votes, and briefly explain the general effect of the votes, such as whether the votes are non-binding.

Exclusion of Certain Shareholder Proposals Permitted

A proposed amendment to Rule 14a-8(i)(10) would allow issuers to exclude a shareholder proposal that would provide a say on pay or say on frequency vote, provided the issuer has adopted a policy on the latter that is consistent with the plurality of votes cast in the most recent say on frequency vote.

Broker Discretionary Voting Not Available

The proposed rules also reiterate that, as directed by the Dodd-Frank Act, broker discretionary voting would not be permitted for say on pay or say on frequency votes.

Preliminary Proxy Not Required

The SEC is proposing to amend Rule 14a-6 to add shareholder votes on say on pay and say on frequency to the list of matters for which a preliminary proxy would not be required.

D. Say on Golden Parachutes

The proposed say on golden parachutes rule not only would require a shareholder vote on golden parachutes but would impose on issuers significant, new disclosure obligations about such arrangements, which are more expansive than the current disclosure requirements of Item 402(j) of Regulation S-K (relating to potential payments upon termination or a change in control). Proposed Item 402(t) differs from Item 402(j) in that Item 402(t) would require:

- presentation of an aggregate total of all compensation based on or triggered by a transaction;
- tabular disclosure;
- disclosure of arrangements generally available to all salaried employees; and
- disclosure of de minimis perquisites and other personal benefits.

Proposed Rule 14a-21(c) of the Exchange Act would require issuers, in any proxy or consent solicitation for a meeting at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of an issuer's assets, to provide a separate shareholder advisory vote to

approve the golden parachute payments disclosed under proposed new Item 402(t) of Regulation S-K, described below.

Proposed Item 402(t)

Proposed Item 402(t) of Regulation S-K would require that all agreements (1) between the target issuer and the named executive officers of the target issuer and (2) between the acquiring company and the named executive officers of the target issuer be disclosed in both narrative and tabular format. The requirement to provide disclosure of agreements with the acquiring company was not included as part of the Dodd-Frank Act.

The narrative disclosure requirements of Item 402(t) would require issuers to describe, for each named executive officer, the individual elements of compensation that the executive would receive based on or otherwise related to the transaction and the total amount for each named executive officer. Separate quantification in tabular format would be required for:

- cash severance;
- the dollar value of accelerated stock and option awards (including the value attributable to any cash out of the awards);
- pension and nonqualified deferred compensation enhancements;
- perquisites (without the $10,000 threshold applied) and other personal benefits and health and welfare benefits;
- tax reimbursements; and
- any other compensation not specifically identified.

In addition, the table would require separate footnote identification of amounts attributable to single and double trigger arrangements. Any material conditions or obligations applicable to the receipt of payment (for example, non-compete, non-solicitation or non-disparagement covenants and confidentiality agreements), the duration of those conditions or obligations and the provisions regarding waiver or breach would also be required to be disclosed.

No disclosure would be required under Item 402(t) of compensation that would have been vested or earned without regard to the transaction, such as previously vested stock options or pension amounts. In addition, the proposed table would not require disclosure or quantification of compensation from bona fide post-transaction employment agreements to be entered into in connection with the transaction.

If any part of the disclosure required by Item 402(t) had already been disclosed in an annual meeting proxy statement and been subject to a prior shareholder say on pay vote, then the issuer would not need to include the portion already voted upon in the vote required by proposed Rule 14a-21(c), regardless of whether shareholders had approved the compensation or not. If a portion of the compensation disclosed under Item 402(t) had previously been subject to a say on pay vote, then under proposed Rule 14a-21(c), the issuer would be required to present two tables under Item 402(t), with identical column and row headings. One of the tables would present the previously voted-upon golden parachute compensation. The other table would present only that portion of the golden parachute compensation that had not been subject to prior shareholder approval, and the shareholder advisory vote would only cover the compensation disclosed in this second table. Because dual disclosure provides few practical benefits, it is likely that if the rules are adopted as proposed, issuers may not find it useful to present the golden parachute vote at an annual meeting and will instead include all proposed Item 402(t) disclosure in a merger proxy statement.

Extended Application of Disclosure Requirements

Though not required by the Dodd-Frank Act, the SEC has also proposed to require that Item 402(t) disclosure be included in essentially all documents that relate to a business combination, including:

- information statements filed pursuant to Regulation 14C;
- proxy or consent solicitations that do not contain merger proposals but require disclosure of information under item 14 of Schedule 14A pursuant to Note A of Schedule 14A (for example, proxies solicited to approve the issuance of new shares or a reverse stock split in order to conduct a merger transaction);
- registration statements on Forms S-4 and F-4 (that do not otherwise contain certain proxy statement disclosure) containing disclosure relating to mergers and similar transactions;
- going private transactions on Schedule 13E-3; and
- third-party tender offers on Schedule TO and Schedule 14D-9 solicitation/ recommendation statements.

Shareholder approval, however, would not be required.

E. Companies to Which the New Rules Would Apply

The proposed rules would apply to all issuers that are subject to the proxy solicitation requirements of the Exchange Act, including all domestic issuers. Foreign private issuers will generally not be subject to the proposed rules. Although Section 951 of the Dodd-Frank Act gave the SEC authority to exempt certain issuers from these new requirements, there is no exemption for smaller reporting companies from the application of the proposed rules. Other than in connection with a say on golden parachute vote, the rules do not, however, impose any increased disclosure requirements on smaller reporting companies.

F. Transition Period

Because the Dodd-Frank Act requires a say on pay vote and a say on frequency vote to be included in proxy statements relating to a company's first shareholder meeting on or after January 21, 2011 and final rules may not be effective sufficiently in advance of that date, the SEC has offered some transitional guidance.

The SEC will not object if:

- preliminary proxy statements are not filed if the only matters that might trigger the issuer to file in preliminary form are the say on pay and say on frequency votes;
- due to a lag in the ability of proxy service providers to reprogram their systems for the four choices offered in a say on frequency vote (a vote every one, two or three years or an abstention), a say on frequency vote only offers three choices (a vote every one, two or three years); and
- current TARP companies do not include a say on frequency vote.

Unlike say on pay and say on frequency, the new disclosure and voting requirements with respect to golden parachutes will not be applicable until final rules have been adopted by the SEC and have become effective. Once effective, the new requirements will apply to proxy statements related to an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of an issuer's assets for a shareholder meeting on or after January 21, 2011.

Proposed Proxy Vote Reporting Requirements for Institutional Investment Managers

The SEC has proposed rules that would require certain investment managers to report how they voted proxies on say on pay, say on frequency and say on golden parachutes votes on Form N-PX. The proposed rule would apply to institutional investment managers (as defined in the Exchange Act) that are required to file reports under Section 13(f) of the Exchange Act and would require that they report their proxy voting record on each shareholder vote required by Sections 14A(a) and (b) of the Exchange Act with respect to which the manager, directly or indirectly, had or shared the power to vote, or to direct the voting of, any security ("Shareholder Votes").

As proposed, amended Form N-PX would require institutional investment managers to disclose information on Shareholder Votes, including the number of shares the manager had or shared voting power over, the number of shares voted, and how the manager voted the shares.[1] To avoid duplicative disclosure, amended Form N-PX would allow an institutional investment manager that advises a registered investment company to satisfy its reporting obligations by referring to the registered investment company's filing on Form N-PX. In the case of multiple institutional investment managers sharing voting power over securities, the proposed rule and form amendments would only require that one manager disclose the required information. However, all managers would still need to file on Form N-PX and disclose, as applicable, the identity of the manager reporting on its behalf or the identity of the manager(s) on whose behalf the filing is also made.

The proposed rules would require institutional investment managers to make the required filings on Form N-PX annually not later than August 31 of each year, for the twelve-month period ended June 30.[2] According to the proposing release, the SEC expects to require institutional investment managers to file their first reports on Form N-PX not later than August 31, 2011. These reports would include any Shareholder Votes that occur at meetings between January 21, 2011 and June 30, 2011.

The SEC is accepting comments on the proposed rules until November 18, 2010.

If you would like to discuss these or any other securities law matters, please contact any member of Ropes & Gray's Securities & Public Companies or Investment Management practices or Tax & Benefits department or your usual Ropes & Gray advisor.

[1] The proposed amendments to Form N-PX would require that a registered investment company provide information beyond that currently required, such as the number of shares the investment company was entitled to vote.
[2] Registered investment companies must file on Form N-PX on the same schedule.