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Client Advisory - Say on Pay - Not Just for TARP Recipients Anymore

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The House of Representatives recently passed legislation[1] which would require, among other things, an annual stockholder vote on executive compensation. Although the Senate has yet to consider this legislation and is likely to propose differing terms, we expect some version of "Say on Pay" to be enacted that will require all public companies to put executive compensation up for a non binding stockholder vote.

TARP "Say on Pay"

The Securities and Exchange Commission has already proposed rules (per the Emergency Economic Stabilization Act of 2008 (EESA)) requiring companies that have received financial assistance under the Troubled Asset Relief Program (TARP) to include an advisory vote on executive compensation on the ballot for their annual stockholders' meetings.

This would be mandatory for TARP recipients during the period in which any obligation arising from TARP financial as-sistance remains outstanding.

Corporate and Financial Institution Compensation Fairness Act of 2009

Comprehensive "Say on Pay"

Annual Advisory Vote on Executive Compensation

The Act would require all public companies to provide stockholders with an annual vote to approve the compensa-tion of executives as disclosed in the proxy statement, which would include the compensation committee report, the Compensation Discussion and Analysis and the compensation tables, for all public companies. As with the TARP rules, the vote would be non-binding and held at the annual meeting of stockholders.

Approval of "Golden Parachutes"

In addition to the vote on executive compensation, the Act would require a non-binding stockholder vote of "golden parachute" compensation at any meeting of stockholders at which they are asked to approve an acquisition, merger, consolidation, sale or other disposition of the company. The company would be required to disclose any agreements or understanding with any named executive officer concerning any type of compensation that is based on or otherwise relates to the transaction as well as the total compensation that may become payable to each such executive officer under such agreements. If the subject compensation was already approved by stockholders at an annual meeting, no additional vote would be necessary.

Items of note:

- *Effective Date*: The effective date is six months after the adoption of SEC implementing rules and the SEC is directed to adopt such rules within six months of the enactment of the Act. This timing will make it unlikely that the "Say on Pay" and golden parachute proposals will be applicable to the 2010 proxy season.
- *Possible Exemption of Small Businesses*: The Act gives the SEC authority to exempt certain types of businesses from "Say on Pay" requirements.
- *FPIs Excluded*: Foreign private issuers are not subject to the "Say on Pay" or golden parachute proposals.

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Compensation Committee Requirements

The Act would also add requirements affecting Compensation Committees and compensation consultants. It would require that the national securities exchanges and national securities associations prohibit the listing of any class of eq-uity securities of a company unless the following requirements are met:

- Each member of the Compensation Committee, or all independent members of the board of directors if no such committee is in place, must be independent;[2]
- Independence is defined as not receiving any compensation from the issuer other than in his or her capacity as a member of the Board of Directors or its Committees;[3]
- Any compensation consultant or other similar advisor to the Compensation Committee must meet the standard for in-dependence to be established by the SEC;[4]
- The Compensation Committee will have authority to retain independent counsel and other independent advisors and will be directly responsible for the appointment, compensation and oversight of the consultant's work;
- Issuers will be required to provide appropriate funding (as determined by the Compensation Committee) for payment of compensation to any independent compensation consultant, independent counsel or other advisor to the Com-pensation Committee; and
- Beginning with annual meetings occurring one year after the date of enactment of the Act, proxy statements must dis-close whether the Compensation Committee retained and obtained the advice of an independent compensation consultant.

Items of note:

- *Effective Date*: The Act requires the SEC to adopt rules, not later than nine months after enactment, directing the national securities exchanges and national securities associations to prohibit the listing of any class of equity security of an issuer not in compliance with the Compensation Committee requirements.
- *Exemptive Authority*: The Act gives the SEC authority to exempt certain types of issuers, such as smaller reporting com-panies or foreign private issuers.

Enhanced Provisions for "Covered Financial Institutions" Compensation Structures

Certain "covered financial institutions"[5] would be required to disclose to Federal regulators[6] the structures of all incen-tive based compensation arrangements offered by such financial institutions sufficient for the regulators to determine if these compensation structures:

- are aligned with sound risk management;
- are structured to account for the time horizon of risks; and
- meet such other criteria as the regulators may jointly determine are appropriate to reduce unreasonable incentives offered by such institutions for employees to take undue risks that could:
    - threaten the safety and soundness of covered financial institutions; or
    - have serious adverse effects on economic conditions or financial stability.
    - Regulators can prohibit any incentive based payment arrangement or any feature of such arrangement determined to encourage inappropriate risks that could threaten the safety and soundness of covered financial institutions or could have serious adverse effects on economic conditions or financial stability.

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Items of note:

- *Effective Date*: The Act requires Federal regulators to jointly adopt regulations not later than nine months after enactment.
  Exemptive for Certain Institutions: The Act exempts covered financial institutions with assets of less than $1 billion.
- *GAO Study*: The Government Accountability Office would be required to carry out a study to determine whether there is a correlation between compensation structures and excessive risk taking.

The Senate is expected to turn to this legislation after Congress's August recess.

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[1] H.R. 3269 "Corporate and Financial Institution Compensation Fairness Act of 2009" (the "Act") (July 31, 2009).
[2] Both NYSE and NASDAQ listing requirements already contain independence requirements for Compensation Committee members.
[3] The SEC is given authority to exempt from the independence requirements a particular relationship with respect to compensation committee members.
[4] The SEC is to ensure that in promulgating regulations or other with respect to compensation consultants that such regulations are competitively neutral among categories of consultants and preserve the ability of the compensation committee to retain the ser-vices of members of any such category.
[5] Includes depository institutions, registered broker dealers, credit unions, investment advisers, Fannie Mae and Freddie Mac, or any other financial institution determined to be includible by the Federal regulators.
[6] The Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Board of Directors of the FDIC; the Director of the Office of Thrift Supervision; the National Credit Union Administration Board; the Securities and Exchange Commission; and the Federal Housing Finance Agency.

This advisory is for guidance only and is not intended to be a substitute for specific legal advice. If you would like further information, please contact the Edwards Angell Palmer & Dodge LLP attorney responsible for your matters or one of the attorneys listed below:

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