

Comparing the Executive Compensation Reform Proposals – An Update

On May 20, 2010, the United States Senate approved its proposed legislation to reform the financial services industry, the “Restoring American Financial Stability Act of 2010.” (While the legislation has the same bill number as the legislation approved by the House of Representatives in December 2009, the “Wall Street Reform and Consumer Protection Act of 2009,” the bill’s content reflects the proposals that were introduced by Senator Christopher J. Dodd (D-CT) earlier this year and amended in the Senate over the past several weeks.)

The provisions of the bill now need to be reconciled with the House version. As the present time, it is expected that

a House-Senate conference committee will be appointed to work out the differences between the two pieces of legislation, with the goal of sending a final bill that has been approved by both bodies to President Obama for his signature by the Fourth of July.

Both bills contain several significant reforms that will affect corporate governance and executive compensation policies and practice. To assist you in monitoring the status of these reforms, we summarize below the relevant provisions from the current versions of the House and Senate bills. This article updates our previous Thoughtful Pay Alert, Comparing the Executive Compensation Reform Proposals, dated March 31, 2010.

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
<p>Advisory vote on executive compensation ("Say on Pay")</p> <ul style="list-style-type: none"> ▶ Would require public companies to hold annual nonbinding shareholder vote on compensation of executives as disclosed pursuant to the SEC's compensation disclosure rules for named executive officers ▶ Vote would apply to any shareholder meeting to elect directors occurring six months after SEC issues final rules implementing provision (the SEC would have six months from date of enactment to issue such rules) 	<ul style="list-style-type: none"> ▶ Similar to House version, with the following differences: <ul style="list-style-type: none"> – would apply to any meeting of shareholders (not just annual meeting to elect directors) – vote would apply to any such meeting occurring six months from date of enactment 	<ul style="list-style-type: none"> ▶ As proposed, it could be up to one year before the House version becomes effective, while the Senate version would be effective no later than six months from enactment. Observers believe that the Senate version is likely to prevail, which would mean that Say on Pay will be effective for the 2011 proxy season ▶ The House version would give the SEC the authority to exempt certain categories of companies (such as "smaller reporting companies"; that is, companies with less than \$75 million in common equity public float) from the vote requirement

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House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
<p>Advisory vote on "golden parachutes"</p> <ul style="list-style-type: none"> ▶ Would require public companies to disclose, and hold nonbinding shareholder vote on, any agreements or understandings with any named executive officer concerning any compensation based on or otherwise related to the acquisition, merger, consolidation, sale, or other disposition of assets of the company (unless previously subject to an annual advisory vote on executive compensation) 	<ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Absence of provision in Senate version raises a question about level of support for this secondary "advisory" vote
<p>Compensation committee independence</p> <ul style="list-style-type: none"> ▶ Would require companies listed on a national securities exchange to have a compensation committee comprised solely of independent directors ▶ "Independence" would mean that a committee member could not accept any consulting, advisory, or other compensatory fee from the company (other than for serving as a member of the compensation committee). Further, the SEC would have the authority to exempt particular relationships from the independence requirement where appropriate 	<ul style="list-style-type: none"> ▶ Similar to House version, with the following differences: <ul style="list-style-type: none"> – would direct national securities exchanges to establish definition of "independence," subject to consideration of source of compensation and affiliation of committee member with company – The national securities exchanges would have the authority to exempt particular relationships from the independence requirement where appropriate 	<ul style="list-style-type: none"> ▶ The House version would give the SEC the authority to exempt certain categories of companies (such as "smaller reporting companies") from these requirements ▶ With respect to determining "independence," the Senate version is similar to the standard currently used for determining audit committee membership

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House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
<p>Compensation committee advisors</p> <ul style="list-style-type: none"> ▶ Would require any compensation consultant or similar advisor to the compensation committee of a listed company to meet independence standards established by the SEC ▶ Would confer authority on compensation committee to retain, compensate, and oversee the independent compensation consultant ▶ Would require proxy statement disclosure of whether compensation committee retained an independent compensation consultant ▶ Would confer authority on compensation committee to retain, compensate, and oversee the independent counsel and other advisers ▶ Would require listed companies to provide appropriate funding for compensation committee to engage independent compensation consultants, independent counsel, and other advisers 	<ul style="list-style-type: none"> ▶ While similar to House version, would not require compensation committee to use an independent compensation consultant, legal counsel, or other advisers. Instead, the committee would be required to take into consideration several factors that affect independence as identified by the SEC before selecting a consultant, legal counsel, or other adviser, including: <ul style="list-style-type: none"> – the provision of other services to the company; – the fees received by the consultant, legal counsel, or other adviser as a percentage of its total revenue; – the policies and procedures of the consultant, legal counsel, or other adviser to prevent a conflict of interest; – any business or personal relationship of the consultant, legal counsel, or other adviser with a compensation committee member; and – any company stock owned by the consultant, legal counsel, or other adviser ▶ Would require proxy statement disclosure of whether compensation committee retained a compensation consultant, whether its work raised any conflict of interest, and, if so, how the conflict is being addressed 	<ul style="list-style-type: none"> ▶ The Senate version would leave to the company – and its shareholders – the decision on whether a compensation consultant, legal counsel, or other adviser is an appropriate adviser to the compensation committee ▶ Both versions would give the SEC the authority to exempt certain categories of companies (such as "smaller reporting companies") from these requirements ▶ The Senate version's proxy disclosure requirement would not go into effect until one year following the date of enactment, so would not be effective for the 2011 proxy season

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<p>Disclosure of pay versus performance</p> <ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Would require public companies to include a clear description of their named executive officers' compensation in their annual meeting proxy statements, including information that shows the relationship between executive compensation actually paid and the financial performance of the company, taking into account stock price changes, dividends paid, and any distributions ▶ Would require public companies to disclose in any filing including executive compensation information: <ul style="list-style-type: none"> – the median annual total compensation of all employees (excluding the CEO); – the annual total compensation of the CEO (as disclosed in the Summary Compensation Table); and – the ratio between employee and CEO pay 	<ul style="list-style-type: none"> ▶ While somewhat opaque, appears to call for a return of the Stock Performance Graph to proxy statements ▶ May also be read to confer greater authority on the SEC to insist on detailed disclosure of incentive compensation arrangements
<p>Recovery of erroneously awarded compensation</p> <ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Would require companies listed on a national securities exchange to adopt a policy providing for: <ul style="list-style-type: none"> – disclosure of their policy on incentive-based compensation that is based on financial information required to be reported under the securities laws; and – recovery from any current or former executive officer any erroneously-paid incentive-based compensation (including stock options) during the prior three years in the event of an accounting restatement due to material non-compliance with any financial reporting requirement under the securities laws 	<ul style="list-style-type: none"> ▶ This provision goes farther than Section 304 of the Sarbanes-Oxley Act as it would apply to all executive officers (not just the CEO and CFO) and is not predicated on anyone's "misconduct," but is less inclusive than the TARP compensation recovery requirement which is applicable in certain situations not involving a financial restatement

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<p>Disclosure of employee and director hedging</p> <ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Would require public companies to disclose in their annual meeting proxy statements whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities granted as part of their compensation 	
<p>Broker voting</p> <ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Would prohibit brokers from voting shares on the election of directors, executive compensation, or any other significant matter (as determined by the SEC) unless they have received voting instructions from the beneficial owner 	<ul style="list-style-type: none"> ▶ This provision would codify the recent amendment to NYSE Rule 452 which prohibits brokers from voting uninstructed shares in uncontested director elections ▶ It also would preclude brokers from voting shares in advisory votes on executive compensation ("Say-on-Pay" votes) ▶ As it would apply to any shareholder vote involving "executive compensation," it could extend to other compensation-related matters, such as the adoption of an employee stock plan and the approval of severance agreements
<p>Proxy access</p> <ul style="list-style-type: none"> ▶ Would amend the Securities Exchange Act to expressly confer authority on the SEC to prescribe rules and regulations that would permit shareholders to include director-nominees in a public company's proxy materials 	<ul style="list-style-type: none"> ▶ Similar provision 	<ul style="list-style-type: none"> ▶ Enactment of this provision may spur SEC to adopt some version of its proxy access proposals, which have now been pending for over a year

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House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
<p>Majority vote standard for director elections</p> <ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Would require companies listed on a national securities exchange to adopt a majority vote standard for uncontested director elections ▶ Would require a board of directors to either <ul style="list-style-type: none"> – accept the resignation of any director receiving less than a majority of the votes cast in an uncontested election or – upon a unanimous vote to decline to accept such resignation, publicly disclose the reasons for not accepting the resignation and why this is in the best interests of the company and its shareholders 	<ul style="list-style-type: none"> ▶ Would go into effect no later than one year from date of enactment ▶ SEC would have authority to exempt certain categories of issuers (such as "smaller reporting companies") from this requirement
<p>Disclosure of chairman and CEO Structures</p> <ul style="list-style-type: none"> ▶ No provision 	<ul style="list-style-type: none"> ▶ Would require the SEC to issue rules requiring public companies to disclose in their annual proxy statements the reasons why the company has chosen the same person to serve as chairman of the board and CEO, or different individuals to serve as chairman of the board and CEO 	<ul style="list-style-type: none"> ▶ This provision would largely codify the SEC's recent amendment to its proxy rules to require companies to provide disclosure about their board's leadership structure, including whether the positions of chairman of the board and CEO are combined or separate, and why the structure is appropriate for the company

Comparing the Executive Compensation Reform Proposals – An Update (continued)**Need Assistance?**

Compensia has had significant experience in helping companies to design and implement their executive compensation programs. If you have any questions on the subjects addressed in this Thoughtful Pay Alert or would like assistance in assessing their likely impact on your executive compensation plans and arrangements, please feel free to contact us. ■

About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

San Francisco

770 Tamalpais Drive
Suite 207
Corte Madera, CA 94925
415.462.2990

Mark H. Edwards, Chairman
medwards@compensia.com
415.462.2985

Michael Benkowitz
mbenkowitz@compensia.com
415.462.2996

Mark A. Borges
mborges@compensia.com
415.462.2995

Southern California

Anna-Lisa Espinoza
alespinoza@compensia.com
858.509.1179

Mathew T. Quarles
mquarles@compensia.com
323.919.7338

Silicon Valley

1731 Technology Drive
Suite 810
San Jose, CA 95110
408.876.4025

Timothy J. Sparks, President
tsparks@compensia.com
408.876.4024

Thomas G. Brown
tbrown@compensia.com
408.876.4023

Susan Gellen
sgellen@compensia.com
408.907.4302

Tom LaWer
tlawer@compensia.com
408.907.4309