SEC Adopts "Say on Pay" Rules

On January 25, 2011, the Securities and Exchange Commission adopted rules implementing the various shareholder advisory votes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Largely procedural in nature, the rules address a number of questions about how companies are to conduct the new advisory vote to approve the compensation of their executive officers and the advisory vote to determine whether subsequent executive compensation advisory votes will be held annually, biennially, or triennially, both of which went into effect on January 21, 2011.

In addition, the rules cover the shareholder advisory vote on executive change-in-control arrangements and related disclosure that are required when companies seek shareholder approval of a merger or other acquisition.

This article summarizes the key features of the final rules.

Three Key Changes to the SEC's Final "Say-on-Pay" Rules

While the final rules are largely consistent with the SEC's original proposals, they vary in three key areas:

- Smaller reporting companies (that is, companies with a public float of less than $75 million) do not have to comply with the shareholder advisory vote requirements until their first shareholder meeting on or after January 21, 2013.
- A company's decision on the frequency of future say-on-pay votes must be reported on a current report on Form 8-K within 150 days after the date of its shareholder meeting, rather than on Form 10-Q or 10-K after the end of the fiscal quarter in which the meeting was held.
- Companies may exclude shareholder proposals that seek shareholder advisory votes on certain executive compensation matters if the company has adopted a policy on the frequency of future say-on-pay votes that is consistent with a majority of votes cast in the most recent shareholder vote on the matter, rather than the plurality standard originally proposed.

Shareholder Advisory Vote on Executive Compensation

The Dodd-Frank Act requires companies to conduct, at least once every three years, a shareholder advisory vote to approve the compensation of their executive officers, as disclosed in their proxy materials, at their annual meeting of shareholders (the "Say-on-Pay Vote"). The final rules contain the following guidance on the Say-on-Pay Vote:

- Companies are not required to file a preliminary proxy statement if the only matters that would require a preliminary filing are the Say-on-Pay Vote and the Frequency Vote (as discussed below).
- The Say-on-Pay Vote is to be based on a company's Compensation Discussion and Analysis, the compensation tables, and the narrative disclosure accompanying the compensation tables.
- Companies are not required to use any specific language or form of resolution to conduct the Say-on-Pay Vote. However, the rules contain a non-exclusive example of a shareholder resolution that may be used for the vote. The SEC Staff has subsequently indicated that the Say-on-Pay resolution need not include an express reference to Item 402 of Regulation S-K; instead, it may simply refer to the "compensation disclosure rules of the Securities and Exchange Commission."
- Companies are required to explain in their proxy materials the general effect of the Say-on-Pay Vote, including that the vote is non-binding.
- Companies are required to address in their Compensation Discussion and Analysis whether and, if so, how their compensation policies and decisions have taken into account the results of the most recent Say-on-Pay Vote. (As proposed, companies would have been required to discuss the impact of all prior Say-on-Pay Votes, not just the most recent vote.)

- Companies' director compensation arrangements and compensation-related risk disclosure (unless addressed in the CD&A) are not subject to the Say-on-Pay Vote.

The SEC also confirms that, under Section 957 of the Dodd-Frank Act, brokers are not permitted to vote uninstructed shares in a Say-on-Pay Vote.

Shareholder Advisory Vote on Frequency of Say-on-Pay Vote

The Dodd-Frank Act also requires companies to conduct, at least once every six years, a shareholder advisory vote at their annual meeting of shareholders to determine whether Say-on-Pay Votes will be held annually, biennially, or triennially (the "Frequency Vote"). The final rules contain the following guidance on the Frequency Vote:

- Companies are not required to file a preliminary proxy statement if the only matters that would require a preliminary filing are the Say-on-Pay Vote and the Frequency Vote.
- Companies must give shareholders the opportunity to specify whether to hold the Say-on-Pay Vote every year, every two years, every three years, or to abstain. In addition, companies may include their own recommendation as to how shareholders should vote, but must make clear that shareholders are not voting on the company's recommendation.
- The SEC Staff has subsequently indicated that the Frequency Vote need not take the form of an actual resolution. It is sufficient to conduct the vote pursuant to a narrative description of the proposal's purpose.
- Companies are required to explain in their proxy materials the general effect of the Frequency Vote, including that the vote is non-binding.
- Since the Frequency Vote is non-binding on a company and its board of directors, the company is not obligated to follow the results of the vote. However, a company is required to disclose in a current report on Form 8-K that must be filed within 150 days after its annual shareholder meeting whether it intends to follow the results of the most recent Frequency Vote or conduct the Say-on-Pay Vote on a different schedule. (As proposed, companies would have been expected to disclose this decision in their next required quarterly report on Form 10-Q or annual report on Form 10-K.)

The final rules state that a company may exclude a shareholder proposal under Exchange Act Rule 14a-8 concerning a Say-on-Pay Vote or Frequency Vote only if it has adopted a policy for future Frequency Votes that is consistent with a majority of the votes cast in the most recent Frequency Vote. (As proposed, this ability to exclude Say-on-Pay-related shareholder proposals would have been available where a company adopted a policy that conformed to the plurality of the votes cast in the most recent Frequency Vote.)

The SEC also confirms that, under Section 957 of the Dodd-Frank Act, brokers are not permitted to vote uninstructed shares in a Frequency Vote.

Shareholder Advisory Vote on Change-in-Control Arrangements

The Dodd-Frank Act requires companies, in connection with any meeting of shareholders at which shareholders are asked to approve a merger or acquisition, to:

- disclose in their proxy materials any agreements or understandings that the company has with any named executive officer concerning any compensation that is based on or relates to the merger or acquisition, as well as the aggregate total compensation that may be paid to each named executive officer under such agreements or understandings; and
- conduct a shareholder advisory vote to approve the agreements and understandings and compensation totals (the "Change-in-Control Vote"), unless such agreements and understandings have previously been subject to a Say-on-Pay Vote.

Disclosure Requirements

The final rules require narrative and tabular disclosure of any change-in-control compensation arrangements among the target and acquiring companies in a merger or other acquisition and the named executive officers of each company. In the case of the aggregate total compensation to be paid to any named executive officer under these arrangements, the final rules introduce a new disclosure table to quantify cash severance, equity awards that are either accelerated or cashed out, pension and non-qualified deferred compensation enhancements, perquisites, and tax reimbursements (an example of the table is provided on page 3.

Golden Parachute Compensation

Name (a)	Cash ($) (b)	Equity ($) (c)	Pension/ NQDC ($) (d)	Perquisites/ Benefits ($) (e)	Tax Reimbursement ($) (f)	Other ($) (g)	Total ($) (h)
PEO							
PFO							
A							
B							
C							

Other notable features of the table are as follows:

- Disclosure covers only compensation that is based on or otherwise relates to the proposed transaction (in other words, it does not require disclosure of "walk-away" numbers).
- Companies are required to separately identify (by footnote) amounts attributable to "single-trigger" arrangements and amounts attributable to "double-trigger" arrangements.
- In quantifying payments based on a company's stock price, a company should use the closing price per share as of the latest practicable date.

Advisory Vote Requirements

The final rules contain the following guidance in connection on the Change-in-Control Vote:

- Companies are not required to use any specific language or form of resolution to conduct the Change-in-Control Vote.
- As provided in the Dodd-Frank Act, companies are not required to conduct a Change-in-Control Vote on their change-in-control arrangements if the disclosure described above (including the presentation of the new disclosure table) has previously been included in the executive compensation disclosure subject to a prior Say-on-Pay Vote.
- This exception applies only to the extent that the change-in-control arrangements subject to the Say-on-Pay Vote have not been subsequently modified. New change-in-control arrangements, and revisions to arrangements that were previously subject to a Say-on-Pay Vote, are subject to a new Change-in-Control Vote.

The SEC Staff has subsequently clarified that the named executive officers subject to the Change-in-Control Vote are a company's CEO and CFO as of the time of the proposed transaction and the three other most highly-compensated executive officers as of the company's most recent filing that includes executive compensation disclosure (which, typically, should be the company's most recently-filed definitive proxy statement).

Effective Date

Even though, technically, under the Dodd-Frank Act, the Change-in-Control Vote applies to meetings of shareholders to approve a merger or acquisition held on or after January 21, 2011, because the statute also states that the disclosure requirement is subject to SEC rulemaking, the Commission has taken the position that the disclosure requirement and the Change-in-Control Vote requirement will be effective for merger proxy materials filed on or after April 25, 2011.

Need Assistance?

Compensia has extensive experience in helping companies draft the executive compensation disclosure in the proxy materials for their annual meetings of shareholders and analyze the potential impact on the Dodd-Frank Act executive compensation provisions on their pay programs. If you would like assistance in preparing your executive compensation disclosure for the new required shareholder advisory vote on executive compensation, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Mark A. Borges. ■

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