

Comparing the Executive Compensation Reform Proposals

On March 21, 2010, the Senate Committee on Banking, Housing, and Urban Affairs approved the “Restoring American Financial Stability Act of 2010,” as introduced by the Committee’s Chairman, Senator Christopher J. Dodd (D-CT). At this time, the bill reflects the Senate’s primary vehicle for reforming the financial services industry.

Like its analog, H.R. 4173, the “Wall Street Reform and Consumer Protection Act of 2009,” which was passed by the House of Representative in December 2009, the bill contains a number of provisions that would increase the involvement

of investors and regulators in executive compensation matters. If enacted into law, these provisions have the potential to dramatically alter the executive pay landscape.

The Dodd bill now goes to the Senate floor where it is likely to be amended (perhaps significantly) and, if eventually approved, must be reconciled with its House counterpart. Nonetheless, to enable you to monitor the progress of the executive compensation (and related corporate governance) reforms being debated in Congress, we summarize below the relevant provisions from the current versions of the House and Senate bills.

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
Advisory vote on executive compensation ("Say on Pay") <ul style="list-style-type: none"> ▶ Would require public companies to hold an annual nonbinding shareholder vote on the compensation of their 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 the SEC issues final rules implementing the provision (the SEC would have six months from the 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 an annual meeting to elect directors) — vote would apply to any such meeting occurring six months from the 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 ▶ 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

Comparing the Executive Compensation Reform Proposals (continued)

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
Advisory vote on "golden parachutes" <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 second "advisory" vote
Compensation committee independence <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 board of directors). 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

Comparing the Executive Compensation Reform Proposals (continued)

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
Compensation committee advisors <ul style="list-style-type: none"> ▶ Would require any compensation consultant or similar advisor to the compensation committee of a company listed on a national securities exchange to meet independence standards established by the SEC ▶ Would confer authority on the compensation committee to retain, compensate, and oversee the independent compensation consultant ▶ Would require proxy statement disclosure of whether the compensation committee retained an independent compensation consultant ▶ Would confer authority on the compensation committee to retain, compensate, and oversee independent counsel and other advisers ▶ Would require companies listed on a national securities exchange 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 personal or business relationship of the consultant, legal counsel, or other adviser with a 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

Comparing the Executive Compensation Reform Proposals (continued)

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
Disclosure of pay versus performance <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, this first provision appears to call for a return of the Stock Performance Graph to proxy statements
Recovery of erroneously awarded compensation <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 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

Comparing the Executive Compensation Reform Proposals (continued)

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
Disclosure of employee and director hedging <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 	
Broker voting <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
Proxy access <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"> ▶ This provision is intended to help rebut criticism that the SEC doesn't have the statutory authority to adopt a "proxy access" requirement

Comparing the Executive Compensation Reform Proposals (continued)

House bill ("Wall Street Reform and Consumer Protection Act of 2009")	Senate bill ("Restoring American Financial Stability Act of 2010")	Observations
Majority vote standard for director elections <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 	
Disclosure of chairman and CEO Structures <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 statement 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 disclosure 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 (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