Client Alert

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Executive Compensation
& Benefits

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New Executive Compensation Corporate Governance Rules Proposed

by Susan P. Serota

The Restoring American Financial Stability Act of 2010 was released by Senator Christopher Dodd (D-CT), Chairman of the Senate Banking Committee, on March 15, 2010 (the "Financial Reform Bill"). In addition to the many financial services reform items contained in the proposed legislation, there are a number of provisions that would affect the corporate governance of executive compensation at public companies, including provisions that will be mandatory for companies to continue being listed on a national securities exchange such as the NYSE or NASDAQ.

Non-Binding "Say on Pay" Vote on Executive Compensation

The Financial Reform Bill would require a separate non-binding vote by shareholders on the compensation reported in a company's proxy for the Principal Executive Officer, the Principal Financial Officer and the other Named Executive Officers disclosed, beginning with the proxy for an annual or other meeting of shareholders occurring after the end of the six-month period beginning on date of enactment.

Compensation Committee Independence

The Financial Reform Bill directs the SEC to issue rules prohibiting the listing of any security on a national securities exchange or national securities association (referred to as "Exchanges") of any issuer that does not comply with the independence requirements for members of the compensation committee, who must be members of the issuer's board of directors and must meet certain independence standards. In addition, the Exchanges would be required to consider certain relevant factors such as the source of compensation of a member of the compensation committee, including any consulting, advisory or other compensatory fee paid by the issuer to such member and whether the member is affiliated with the issuer, a subsidiary or an affiliate. The Exchanges may exempt a particular relationship of the member and the issuer as it deems appropriate in light of the size of the issuer and any other relevant factors.

Independence of Compensation Committee Consultant and Other Advisers

The Financial Reform Bill provides that compensation committees must have the authority, in their sole discretion, to hire independent compensation consultants, legal counsel and other advisers. The SEC is to issue rules that identify the independence standards that are to be used, including fees received from the issuer by the employer of the consultant, legal counsel or other adviser, the policies and procedures of such employer designed to prevent conflicts of interest, any business or personal relationship of such person with the compensation committee, and any stock of the issuer owned by such person. Disclosure in a proxy relating to a shareholder meeting occurring on or after one year after enactment of the Bill must include whether the compensation committee retained or obtained the advice of a compensation consultant and the whether the work has raised any conflict of interest, and if so, the nature of the conflict and how the conflict is being addressed. Funding of reasonable compensation to pay such independent persons is to be provided by the issuer. The SEC rules are directed to be issued within 360 days after enactment and the SEC is required to direct the Exchanges to prohibit the listing of any security of an issuer that is not in compliance with these independence requirements, subject to an opportunity to cure and an exemption applicable in appropriate circumstances and taking in the impact on smaller reporting issuers.

New Disclosure Required of Executive Compensation

A clear description of any compensation required to be disclosed in the annual proxy would be required to include information showing the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions.

Clawback Policy Required

Exchange-listed issuers are required to develop and implement a policy providing (A) for disclosure of the issuer's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws and (B) that in the event an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current or former executive officer of the issuer who received incentive-based compensation (including stock options) during the three-year period preceding the date on which the issuer is required to prepare a restatement, based on erroneous data, any amount in excess of what would have been paid to the executive under the restatement.

Disclosure Regarding Hedging by Employees and Directors

To the extent any employee or director of the issuer (or any of their designees) is permitted to purchase financial instruments (including prepaid variable futures contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities granted as compensation by the issuer to the employee or director or held, directly or indirectly, by the employee or director would be required to be disclosed in the annual proxy statement of the issuer in accordance with rules to be issued by the SEC.

Excessive Compensation of Bank Holding Companies

The Board of Governors of the Federal Reserve System would be required to establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company that provides

an executive officer, director or principal shareholder of the bank holding company with excessive compensation, fees or benefits or could lead to a material financial loss to the bank holding company.

The Financial Reform Bill is substantially different from Senator Dodd's bill that was released in November 2009, and from the legislation passed by the House in December 2009. We will continue to follow and report on the legislation as it develops.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or any member of the Executive Compensation & Benefits group.

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