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COVINGTON & BURLING LLP

E-ALERT | Securities

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FINANCIAL REGULATORY REFORM LEGISLATION

EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE

On May 20, 2010, the Senate passed its version of comprehensive financial regulatory reform legislation. The Senate bill must now be reconciled with the House of Representatives' version, which was passed in December 2009.[1] The reconciliation process may occur either though a House-Senate conference or through reciprocal action by both Houses of Congress.

Both bills contain provisions aimed at greater shareholder and regulatory oversight of executive compensation. Among other things, both bills give shareholders a "say on pay" vote on the compensation of their companies' executives, and both bills enhance the power of regulators to oversee executive compensation at financial institutions. Both bills also include provisions that would affect corporate governance practices at many public companies.

Below is a side-by-side comparison of certain key provisions of the House and Senate bills regarding executive compensation and corporate governance, as available at the time of writing this alert. If you have any questions regarding the two bills, please free to contact the Covington attorneys listed at the end of this alert or any other members of Covington's Securities practice group.

HOUSE BILL	SENATE BILL
EXECUTIVE COMPENSATION - GENERALLY	
■ Annual say on pay vote for all public companies ➢ Public companies would be required to provide their shareholders with non-binding votes on the compensation of their "named executive officers," at each annual meeting of shareholders (or special meeting in lieu of the annual meeting), for which proxies, consents or authorizations are solicited. ➢ Shareholder vote would not overrule any determination of the board of directors, nor would it create or imply any additional fiduciary duty of the board of directors.	■ Generally the same, but under the Senate bill's wording, the separate shareholder vote on executive compensation would be required not just for annual shareholder meetings, but also for any shareholder meeting for which the SEC's proxy solicitation rules require compensation disclosure (e.g., special meetings in lieu of annual meetings, and shareholder meetings in respect of certain business combination transactions).

[1] The House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) on December 11, 2009.

■ Golden parachute say on pay vote ➢ Public companies would be required, in connection with proxy or consent solicitations relating to merger or acquisition transactions, to provide their shareholders with specific disclosures about, and separate non-binding votes on, any "golden parachute" compensation arrangements, which would include any type of compensation (present, deferred or contingent) based on or related to the merger or acquisition transaction. ➢ Disclosure regarding golden parachute arrangements would have to be provided in clear and simple tabular form, based on rules to be adopted by the SEC.	■ Not included.
■ Compensation committee independence requirements for listed companies– ➢ Companies with securities listed on a national securities exchange would be subject to listing standards requiring that their compensation committees be comprised entirely of independent directors. ➢ Director would not be considered "independent" if he or she received any consulting, advisory or other compensatory fee from the company (other than board compensation).	■ Largely the same, except: ➢ Director's "independence" would be determined not only by whether the director received any compensatory fees from the company, but also by whether the director is affiliated with the company or any of its subsidiaries. (This standard would be more consistent with the independence criteria used for audit committee membership under Exchange Act Rule 10A-3.)
■ Use of consultants and other advisers by compensation committees of listed companies ➢ Compensation consultants and similar advisers to the compensation committee of listed companies would be required to meet independence standards to be established by the SEC. ➢ Compensation committees of listed companies would have the authority to retain independent compensation consultants, independent counsel, and other independent advisers.	■ Generally the same, except: ➢ Compensation committees would not be required, *per se*, to use independent consultants, but they would be required to consider specific factors identified by the SEC before selecting a compensation consultant, legal counsel, or other adviser to the compensation committee. ➢ Factors to be identified by the SEC would be those affecting the independence of a compensation consultant, legal counsel or other adviser to the compensation committee, and would include: ○ provision of other services to the listed

■ Disclosure of pay versus performance– ➢ Not included.	company by the person that employs the compensation consultant, legal counsel or other adviser o amount of fees received from the listed company by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of such person's total revenue o policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest o business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee o stock of the listed company owned by the compensation consultant, legal counsel or other adviser ➢ Listed companies would be required to disclose in their annual proxy statements whether the compensation committee has retained a compensation consultant and whether the committee's work has raised any conflicts of interest (and, if so, the nature of the conflict and how it was addressed). ➢ Public companies would be required to provide in their annual proxy statements a clear description of any compensation required to be disclosed under Item 402 of Regulation S-K, including information showing the relationship between compensation paid and the company's financial performance (which may be shown graphically). ➢ Public companies would be required to disclose annually (i) the median of annual total compensation of all employees of the company other than the CEO, (ii) the CEO's annual total compensation, and (iii) the ratio of the amounts shown in clauses (i) and (ii).

■ **Recovery of erroneously awarded compensation** ➢ Not included.	■ Companies with securities listed on a national securities exchange would be required to implement a policy providing: ➢ for disclosure of the company's policy on incentive-based compensation that is based on financial performance required to be reported under the securities laws, and ➢ that, if the company is required to restate its financial statements due to the company's material noncompliance with any financial reporting requirement, the company will recover from any current or former executive officer who received incentive-based compensation during the three-year period preceding the date of the restatement, based on the erroneous data, in excess of what would have been paid to the officer under the restatement.
EXECUTIVE COMPENSATION RESTRICTIONS APPLICABLE TO FINANCIAL INSTITUTIONS	
■ **Restrictions on incentive-based compensation at certain financial institutions** ➢ Federal bank regulators and the SEC would have the authority to require "covered financial institutions" (defined below) to disclose to such regulators the structures of their incentive-based compensation arrangements for their officers and employees. ➢ "Covered financial institutions" are banks and thrifts and their respective holding companies, credit unions, registered broker-dealers, investment advisers, Fannie Mae, Freddie Mac, and "any other financial institution" that the federal regulators jointly determine should be treated as a covered financial institution. ➢ Federal regulators would also be required jointly to promulgate new rules prohibiting "any incentive-based payment	■ Not included, but the Senate bill would amend the Bank Holding Company Act to require the Federal Reserve to establish standards prohibiting, as an unsafe and unsound practice, any compensation plan of a bank holding company that: ➢ provides an executive officer, employee, director or principal shareholder of the bank holding company with *excessive* compensation, fees or benefits, or ➢ could lead to material financial loss to the bank holding company.

arrangement" that the regulators determine encourages "inappropriate risks" by financial institutions or their officers or employees, where such risks could threaten an institution's safety and soundness or could have serious adverse effects on economic conditions or financial stability. ➢ Institutions with less than $1 billion of assets would be exempt from the provisions regarding disclosure and oversight of incentive-based compensation.	
CORPORATE GOVERNANCE PROVISIONS	
■ **Shareholder access to the proxy–** ➢ Would amend Section 14 of the Exchange Act to make clear that the SEC has authority to adopt rules requiring public companies to include Board nominees submitted by shareholders in the company's proxy materials.	■ Same
■ **Disclosure of employee and director hedging–** ➢ Not included.	■ Public companies would be required to disclose in their annual proxy statements whether employees or directors are permitted to purchase financial instruments (such as prepaid variable forward contracts, equity swaps, collars and exchange funds) designed to hedge the market value of the company's equity securities.
■ **Election of directors by majority vote** ➢ Not included.	■ Companies with securities listed on a national securities exchange would be subject to new listing standards requiring that, in an uncontested election of directors, each director receiving a majority of votes cast would be elected. ➢ Nominee receiving less than a majority of votes cast would be required to tender his or her resignation. ➢ Board of directors would then be required either to accept the resignation

	or, upon a unanimous vote, decline to accept the resignation and publicly disclose the board's analysis used in reaching such decision, including the specific reasons that the board chose not to accept the resignation and the reasons that the decision was in the best interests of the company and its shareholders.
■ Voting by brokers– ➢ Not included.	■ The rules of national securities exchanges would be required to prohibit members of the exchange (i.e., brokers) from granting a proxy to vote shares on specified matters, including election of directors, executive compensation, or any other "significant matter" (as determined by the SEC), unless the beneficial owner of the shares has given the broker instructions on how to vote.
■ Disclosure regarding chairman and CEO structures– ➢ Not included.	■ Public companies would be required to disclose in their annual proxy statements the reasons why the company has chosen either (i) the same person to serve as chairman of the board of directors and chief executive officer, or (ii) different individuals to serve in those positions. ➢ Similar disclosure is already required under recently-adopted SEC rules.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our securities practice group:

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