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Updated July 23, 2009

Treasury Proposes Legislation to Congress for Say-on-Pay and Compensation Committee Independence

On July 16, 2009, as part of the Investor Protection Act of 2009, the U.S. Treasury Department delivered proposed legislation to Congress that is consistent with the Obama Administration's efforts to reform corporate governance and executive compensation practices[1]. The proposed legislation, which applies to all publicly traded companies, includes (1) a non-binding "Say-on-Pay" vote for shareholders at each annual meeting and in connection with every change-in control transaction, and (2) measures to tighten the standards of independence required of compensation committees[2].

The bill has the following key provisions:

1. <u>Say on Pay</u>
   - Shareholders must be provided with an annual, non-binding vote on executive compensation matters as disclosed in the proxy statement, including the compensation committee report, the CD&A, and the compensation tables
   - In the event of a change-in-control transaction (i.e., acquisition, merger or asset sale), shareholders must be provided with a non-binding vote on named executive officer compensation related to the transaction (also known as "golden parachute" compensation); companies would be required to disclose such compensation in the transaction proxy statement in "clear and simple tabular form"
   - Votes would be effective for any proxy statement for shareholder meetings held on or after 12/15/09

2. <u>Compensation Committee Independence</u>
   - Each member of the compensation committee must be independent (i.e., not accept "compensatory" fees from the issuer or be an "affiliated person" of the issuer or any of its subsidiaries), except if exempted by the SEC
   - Any compensation consultant, legal counsel, or other adviser to the compensation committee must meet standards of independence as defined by the SEC

[1] Refer to our letter of June 12, 2009, "Obama Administration Releases Executive Compensation Principles and Proposals for U.S. Public Companies," http://www.fwcook.com/alert_letters/06-12-09_Obama_Administration_Releases_Executive_Compensation.PDF
[2] Text of proposed legislation can be found at http://www.treas.gov/press/releases/reports/ titleixsubt%20d.pdf

- Every compensation committee must be allotted the funds and authority to retain the services of an independent compensation consultant, independent counsel and other advisers
- Beginning one year after the enactment of the legislation, companies must disclose whether their compensation committees obtained the advice of an independent compensation consultant, and if not, explain why

The more rigorous standards of independence that would be required of compensation committees are intended to make the proposed legislation for compensation committees the equivalent of what Sarbanes Oxley was for audit committees. In its fact sheet on New Independence for Compensation Committees, the Department of the Treasury states that, "the independence of audit committees has been a critical factor in restoring investors' confidence in American companies."[3]

The future of the bill is not known, although it should be noted that it is virtually identical to draft legislation circulated by Representative Barney Frank a day later on July 17, 2009 to members of the House Financial Services Committee, with respect to Say on Pay and compensation committee independence. However, Representative Frank's bill also proposes that banks, broker-dealers, and investment advisors (covered financial institutions) be required to disclose incentive-based compensation structures for all employees to their applicable federal regulator, and that regulations be issued for these companies that prohibit compensation structures that either: "(1) could have serious adverse effects on economic conditions or financial stability; or (2) could threaten the safety and soundness of the covered financial institution."

On July 21, 2009, Representative Frank revised the bill to change the effective date for Say on Pay votes to shareholder meetings six months after the final rules are passed (it was 12/15/09 in the first version). Also, the deadline for finalizing the rules was changed from one year after legislation to six months.

Both the Investor Protection Act legislation and Representative Frank's bill would require the SEC to study the use of compensation consultants meeting the SEC's standards of independence, and the effects of such use, and to report to Congress on the results of the study within two years of enactment.

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This letter is intended to alert compensation professionals about developments that may affect their companies and should not be relied on as providing specific company advice. General questions about the subjects in this letter may be directed to Alexa Kierzkowski at 310-734-0110 (ahkierzkowski@fwcook.com) or Fred Cook at 914-460-1101 (fwcook@fwcook.com). Copies of this letter and other published materials are available on our website at www.fwcook.com.

[3] The Treasury's Fact Sheet can be found at http://www.treas.gov/press/releases/tg218.htm