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Executive Compensation and Corporate Governance Provisions in Restoring Financial Stability Act of 2009

On November 10, 2009 Senator Christopher Dodd and eight other members of the Senate Committee on Banking, Housing and Urban Affairs (Senate Banking Committee), including Senator Charles Schumer, introduced the Restoring Financial Stability Act of 2009**,** which was referred to the Senate Banking Committee.

Although the vast majority of the bill relates to financial services reform, it includes executive compensation and corporate governance provisions, many of which are similar to provisions in the Corporate and Financial Institution Compensation Fairness Act of 2009 (H.R. 3269)[1] that was approved by the House on July 31, and the Shareholder Bill of Rights Act of 2009 (S. 1074) that was introduced on May 19 by Senator Schumer. Both H.R. 3269 and S.1074 have been referred to the Senate Banking Committee.

The following is a summary of the executive compensation and corporate governance provisions in the Dodd bill, which would apply to public companies:

1. Shareholders must be provided with an annual non-binding vote on executive compensation as disclosed in the proxy statement (i.e., "say on pay").
2. Companies must give shareholders a separate non-binding vote on any policy for compensation to the CEO related to a change in control transaction (i.e., "golden parachute compensation"), unless it has been subject to a prior say on pay vote.
   — Note that this provision in H.R. 3269 applies to all named executive officers.
3 Each member of the compensation committee must be independent under rules to be issued by the applicable stock exchange.
4. Each compensation consultant, legal counsel or other adviser to the compensation committee must be independent under rules to be issued by the SEC.
5. The compensation committee is to be directly responsible for the appointment, compensation and oversight of any compensation consultant, legal counsel or other adviser that the committee retains.
6. The company must provide funding that the compensation committee determines is appropriate for payment of reasonable compensation to the committee's compensation consultant, legal counsel or other adviser.
7. The proxy statement must disclose whether the compensation committee has retained a compensation consultant, whether the compensation consultant's work has raised any conflict of interest and, if so, the nature of the conflict and how it is being addressed.

[1] See our letter of August 18, 2009, "House Passes the Corporate and Financial Institution Compensation Fairness Act of 2009 (H.R. 3269)" http://www.fwcook.com/alert_letters/08-18-09_House-Passes-Corporate-Financial-Institution.pdf

8. Proxy statement executive compensation disclosure must include information showing the relationship between executive compensation and the company's financial performance, together with a graphic or pictorial comparison of the amount of executive compensation and the company's financial performance or return to investors over a 5-year period.

9. Companies must develop and implement a "clawback" policy for recovery of compensation that would apply to all executive officers in the event of a financial restatement due to material non-compliance with the financial reporting requirements of the securities laws.

   — The policy would apply to incentive-based compensation (including stock options) received during the three-year period preceding the restatement in excess of what would have been paid under the restatement.

10. The proxy statement must disclose whether any employees are permitted to purchase financial instruments that would hedge the value of company equity securities granted to employees as compensation.

11. The proxy statement must disclose the reasons why the company has chosen to have the same person or different persons serve as chairman of the board of directors and CEO.

12. Directors must be elected by a majority of the votes cast in uncontested elections; any director who does not receive a majority of the votes cast in an uncontested election must submit his or her resignation.

    — The board of directors may only decline to accept the resignation by unanimous vote; if so, the reasons for doing so must be publicly disclosed within 30 days.

13. The SEC is directed to establish rules relating to the use of company proxy statement materials by shareholders to nominate directors (i.e., "proxy access").

14. The Financial Institution Regulatory Agency (FIRA) that would be created under the bill would be required to establish standards prohibiting as an unsafe and unsound practice any bank holding company compensation plan that provides an executive officer, employee, director, or principal shareholder with excessive compensation fees or benefits, or that could lead to material financial loss to the bank holding company.

15. The appropriate Federal banking agency would be permitted to impose higher capital standards for an insured depository institution if its compensation practices pose a risk of harm to the institution.

15. The appropriate Federal banking agency would be required to prohibit a depository institution holding company from paying executive compensation that is excessive, or could lead to material financial loss to the holding company or the institution controlled by the holding company.

The say on pay and golden parachute compensation votes would not be applicable until shareholder meetings that occur one year after the Dodd bill becomes law. The effective date of the other compensation and corporate governance provisions (excluding those applicable to banks and depository institutions) would depend on the timing of rules to be issued by the SEC. The effective date of the compensation provisions applicable to banks and depository institutions would depend on the timing of rules to be issued by FIRA and the applicable Federal banking agencies.

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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 this letter may be directed to Richard Alpern at 212-299-3599 (rlalpern@fwcook.com). Copies of this letter and other published materials are available on our website at www.fwcook.com.