Administration Proposes Giving SEC New Rulemaking Authority on Executive Compensation Matters for all Public Companies

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Responding to continuing public concern about executive compensation practices, the Obama Administration has proposed legislation that would grant the Securities and Exchange Commission additional rulemaking power with respect to executive compensation matters for public companies. Treasury Secretary Timothy Geithner, accompanied by SEC Chairman Mary Schapiro, announced the proposals on June 10, 2009. While Secretary Geithner emphasized that it was not the Administration's intention to cap executive compensation or dictate companies' compensation schemes, the Administration's proposals would require non-binding "say-on-pay" votes and establish independence requirements for board compensation committees.

Say-on-pay. The Administration's "say-on-pay" bill would direct the SEC to adopt regulations which would require public companies to:

- Include a shareholder resolution in annual proxy statements requesting that shareholders cast a non-binding vote approving or disapproving executive pay packages;
- Provide shareholders with the right to vote on annual compensation, including salary, bonus, stock and option awards and other forms of compensation for the company's top 5 executives;
- Permit shareholders to vote on all compensation disclosed in the annual proxy and any other specific compensation decisions that the company desires; and
- Provide shareholders with an opportunity to cast a non-binding vote on golden parachutes.[1]

Compensation Committee. The compensation committee legislation would direct the SEC to adopt regulations requiring companies listed on national securities exchanges to meet standards for the independence of compensation committees. Specifically, the legislation would direct the SEC to:

- Issue rules that will require members of compensation committees to meet independence standards similar to those standards prescribed in the Sarbanes-Oxley Act of 2002 for audit committee members;

- Issue rules giving compensation committees the authority to: (i) appoint, compensate, retain and oversee the work of any compensation consultants, (ii) engage outside legal counsel of their choice, and (iii) determine the funding necessary to enable the compensation committee to engage and compensate consultants, outside counsel and any other advisors; and

- Establish standards which will ensure the independence of compensation consultants and outside counsel.

In announcing the Administration's proposals, Secretary Geithner outlined certain principles to "better align compensation practices...with sound risk management and long-term growth:"

- Compensation should be performance-based rather than incentive-based to ensure "long-term value creation."

- Compensation should be conditioned on longer-term performance to account for the "time horizon of risks."

- Compensation practices should be aligned with sound risk management, and compensation committees should conduct risk assessments of pay packages "to ensure that they do not encourage imprudent risk-taking."

- Golden parachutes and supplemental retirement packages should be reevaluated in light of whether they are aligned with shareholders' interests and whether they provide true incentives for performance.

- There should be increased transparency and accountability in the process of setting compensation.

In light of the Administration's view that executive compensation practices were a contributing factor to the financial crisis, Secretary Geithner stated that the Administration "will continue to work to develop standards that reward innovation and prudent risk-taking, without creating misaligned incentives." To achieve this goal, Secretary Geithner further stated that the "President's Working Group on Financial Matters will provide an annual review of compensation practices to monitor whether they are creating excessive risks," and the Administration will encourage experts in the field to identify best practices and alert the Administration of risks that might be overlooked.

In conjunction with Secretary Geithner's announcement, SEC Chairman Schapiro reiterated the SEC's commitment to improvements in executive compensation and corporate governance. Stating that it was not the SEC's role to "set pay scales or cap compensation," Chairman Schapiro emphasized the SEC's obligation to protect investors by "ensuring that they have the information needed to make sound investment decisions." Consistent with prior public statements, Chairman Schapiro indicated that the SEC was actively considering proposals for additional disclosure requirements in the following areas:

- How a company and its board manages risk;
- A company's overall compensation approach;
- Potential conflicts of interest by compensation consultants, including disclosure of relationships between the company and its affiliates;
- Experience and qualifications of board nominees to serve on the board or on particular board committees; and
- Why a board has chosen a particular leadership structure.

The announcement of these proposals—which are not limited to companies that received government assistance under Treasury's Troubled Asset Relief Program—reemphasizes that executive compensation remains a major hot-button issue in the executive and legislative branches.[2] It is too early to assess the prospects of the proposed legislation outlined by Secretary Geithner, or other pending legislation regarding executive compensation. The ultimate impact of the proposals also remains to be seen. Current stock exchange listing requirements already require compensation committee independence, and the compensation committee charters of many companies already permit boards to engage their own compensation consultants and outside counsel.[3] Thus, even if adopted, the compensation committee legislation may not result in radical changes in current compensation committee practices. With respect to say-on-pay, enactment of mandatory legislation may have more of an impact, as most U.S. companies do not yet give shareholders say-on-pay votes. Even if the legislation is not enacted, the Administration's high-visibility endorsement may provide additional impetus for companies to voluntarily permit non-binding say-on-pay votes.

[1] A golden parachute is a clause in an executive's employment contract that specifies that he/she will receive large benefits in the event that control of the company changes hands due to acquisition, merger or another change of control situation, and the executive's employment is terminated.

[2] The same day as Secretary Geithner's announcement, Treasury released its long-awaited rules implementing the executive compensation provisions of the American Recovery and Reinvestment Act of 2009. These rules, while applicable only to recipients of TARP financial assistance, include, among other things, detailed governance provisions with respect to structure and responsibilities of compensation committees, public disclosures regarding compensation decisions, and management and compensation committee certifications regarding compliance with the new regulations. *See* Wilmer Cutler Pickering Hale and Dorr LLP, *Treasury Issues TARP Executive*

Compensation Regulations, June 12, 2009, *available* here.

[3] NYSE Listed Company Manual § 303A.05; NASDAQ Rules § 4350(c)(3).

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