The Harvard Law School
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SEC Reverses Course on TARP-Related Shareholder Proposal

Posted by Jeremy L. Goldstein, Wachtell, Lipton, Rosen & Katz, on Saturday March 7, 2009 at 10:05 am

(Editor's Note: This post by Jeremy Goldstein is based on a client memo by Mr. Goldstein and his colleagues Lawrence S. Makow, Jeannemarie O'Brien, Nicholas G. Demmo, and David M. Adlerstein of Wachtell, Lipton, Rosen & Katz.)

The SEC staff has denied a no-action request by Regions Financial to exclude a shareholder proposal requesting that Regions impose numerous restrictions on executive compensation in light of the company's participation in the TARP Capital Purchase Program (CPP). Several unions have reportedly submitted the proposal (or a variation thereof) at nearly two dozen financial institutions. Its restrictions, if adopted, would severely hamstring a company in designing compensation to attract, retain and incentive senior management. The union proposal would micromanage executive compensation with a laundry list of rigid, inflexible restrictions, including an annual cap on incentive compensation, a requirement of performance vesting for most long-term equity compensation, a requirement that stock option strike prices be peer-indexed, a bar against executives selling more than 25% of their equity awards while they remain employed, a prohibition on accelerated (e.g., non-cause firing) vesting for all executive equity awards, a limit on severance payments to no more than annual salary and a freeze on the accrual of retirement benefits under SERPs.

Regions argued that the proposal is actually multiple proposals in violation of Rule 14a-8 and is vague and indefinite (among other reasons, for failing to say whether the restrictions would be permanent or limited to the period of TARP participation). Regions also argued that it had substantially implemented the proposal by agreeing to limit executive compensation in its CPP investment agreement with the U.S. Treasury. Last December, the SEC staff granted no-action relief to SunTrust on a substantially identical shareholder proposal. In denying Regions' request for no-action relief, the staff provided no explanation for its about-face.

As described in our memorandum of February 13, 2009, the just-enacted stimulus bill requires Treasury to implement harsh compensation restrictions for TARP participants. Last week, Treasury announced its own distinct set of compensation requirements for prospective TARP participants. Each of these differs from the contractual compensation restrictions that CPP participants believed they were signing up for in round one of the TARP. Right now, directors and managers of financial institutions are being compelled to spend significant time grappling with responses to these developments. In this overheated environment, boards of many major financial companies will now also have to contend with the recent wave of "kitchen sink" shareholder initiatives on executive compensation. The SEC and investors alike would be well served to consider whether a continual ratcheting up of distraction and pressure on financial institutions is the best path to hastening economic recovery and restoring credit markets.