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Corporate Governance and Compensation Provisions
Applicable to all Public Companies in Senate Financial Reform Bill

The financial reform bill that passed the Senate yesterday continues to include a number of corporate governance and executive compensation-related provisions that would apply to all public companies. The bill must now be reconciled with the corresponding House bill adopted late last year, but it appears likely that most of these provisions will remain in the final legislation.

The corporate governance provisions of the bill address four issues: proxy access, majority voting, separation of Chair and CEO, and broker discretionary voting. The bill expressly authorizes the SEC to adopt proxy access rules, under which shareholders would be able to nominate directors using the company's proxy materials. While this is a change from the proxy access mandate contained in the initial version of the bill, the change may be a distinction without a difference in light of the SEC's continued commitment to proxy access. We believe that proxy access has the potential to wreak havoc with American business and that the SEC's adoption of proxy access rules is dangerous and unwise. While the advocates of proxy access argue that it is designed to "help shift management's focus from short-term profits to long-term growth and stability," given the short-term outlook of many hedge funds and other institutions most likely to use proxy access, we believe it will do just the opposite. We also believe that, if the SEC does move forward with proxy access rules, it should increase the eligibility thresholds and otherwise take steps to try to address the many risks that proxy access entails. (See our prior memos, including "Proxy Access Revisited" and "Comments on the SEC's Proxy Access Proposals.") The financial reform bill also continues to require that the stock exchanges implement majority voting in uncontested elections and that the SEC mandate disclosure of whether a company has separated its Chair and CEO positions and why. With respect to the separation of Chair and CEO disclosure, it is not clear whether the bill's mandate goes beyond the rules that the SEC has already adopted. Finally, the bill would require that the stock exchanges prohibit broker discretionary voting in connection with the election of directors, executive compensation or any other significant matter, as determined by the SEC.

The executive compensation provisions of the bill are largely unchanged from the first version of the bill. See our prior memo, "Financial Reform Bill Includes Executive Compensation Provisions Applicable to All Public Companies," for a summary of these provisions. These include: requiring an annual advisory vote on executive compensation ("say on pay"); setting enhanced independence requirements for compensation committee members and consultants/advisers and requiring enhanced disclosure in this area; requiring enhanced disclosure on the relationship between pay and performance; requiring a mechanism for recovering incentive compensation in the event of specified accounting restatements; and requiring disclosure with respect to director and employee hedging activities. One new provision in the Senate bill is to require companies to disclose the ratio between the CEO's compensation and the median compensation of all other employees.

While we continue to advocate, and encourage others to advocate, for the elimination or revision of the corporate governance provisions of the bill, the growing likelihood is that they will be enacted and companies will have to address them in their proxy and compensation program planning going forward.

Martin Lipton
Steven A. Rosenblum
David A. Katz