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Executive Compensation Provisions Under the Financial Reform Bill

The financial reform bill that Senator Dodd released yesterday includes several executive compensation provisions that would apply to all public companies. The bill largely includes the same executive compensation provisions set forth in the discussion draft of the bill proposed in November 2009, but some of the measures contained in the earlier draft have been liberalized or eliminated.

Say-on-Pay. The proposed bill would mandate a non-binding shareholder vote to approve the compensation of named executive officers at annual or other shareholder meetings for which the SEC requires compensation disclosure. The requirement would apply to shareholder meetings occurring after the six-month anniversary of the statute's enactment, and therefore would not affect the 2010 proxy season.

The Compensation Committee and its Advisors. The bill would require compensation committee members to satisfy independence standards to be established by the applicable stock exchange. In addition, under the bill, a compensation committee may engage compensation consultants, legal counsel or other advisers to the compensation committee only after considering factors to be promulgated by the SEC that might affect the independence of such advisors. Finally, the bill would authorize compensation committees to retain independent advisors and would require compensation committees to oversee the advisers they retain.

Additional Proxy Disclosure. The bill would mandate annual proxy disclosure (1) indicating whether the compensation committee has retained a compensation consultant and whether the work of the compensation committee has raised any conflicts of interest (this requirement would apply with respect to annual meetings occurring on or after the first anniversary of the statute's enactment), (2) demonstrating the relationship between executive compensation and financial performance, and (3) indicating whether company employees (not just executive officers) may engage in hedging transactions with respect to company stock.

Clawbacks. The bill would require companies to adopt a clawback policy applicable in the event of an accounting restatement due to material noncompliance with financial reporting requirements and providing for the recovery of amounts in excess of what would have been paid under the restated financial statements from any current or former executive who received incentive compensation (including stock options) during the 3-year period preceding the date of the restatement. In contrast, the clawback provision of the Sarbanes-Oxley Act covers only the chief executive officer and chief financial officer, applies only if the noncompliance results from misconduct, and relates to compensation events during the year following the misstatement.

Financial Institutions. In addition to the foregoing requirements that would apply to all public companies, with respect to financial institutions, the draft bill would require the Federal Reserve to establish standards prohibiting compensation that provides excessive pay, fees or benefits or that could lead to material financial loss.

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The draft bill raises significant interpretive questions and may evolve over time. Public companies and their directors should monitor the progress of the proposed legislation.

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