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CORPORATE ALERT

TREASURY DEPARTMENT AND SEC ADDRESS PLANS FOR REFORMING EXECUTIVE COMPENSATION

On June 10, 2009, Treasury Department Secretary Timothy Geithner announced the Obama administration's initiatives on executive compensation reform. These initiatives, which are intended to apply not just to financial institutions but to all public companies, consist of several broad-based principles for companies to consider when designing and implementing their executive compensation programs, as well as proposals for Congress to pass "say-on-pay" legislation and legislation giving compensation committees greater independence. In addition to the Treasury Department's statement, SEC Chairman Mary Schapiro issued a statement on June 10, identifying several new executive compensation proxy disclosure rules that the SEC is actively considering. If these reforms move forward, they will likely have a major impact on executive compensation practices at all U.S. public companies.

BROAD-BASED COMPENSATION PRINCIPLES

Secretary Geithner outlined five principles that are designed to bring compensation practices more closely in line with the interests of shareholders and reinforce the stability of firms and the financial system. The principles include—

- **Compensation plans should properly measure and reward performance**. Compensation should be tied to performance to link incentives with long-term value creation. Performance-based pay should be conditioned on a variety of internal and external measurements that take into account the company's results relative to its peers, as well as individual and company performance.
- **Compensation should be structured to account for the time horizon of risks**. Executive compensation should be tightly aligned with long-term value and soundness of the firm, which can be accomplished by, among other things, requiring executives to hold stock for a longer period of time.
- **Compensation practices should be aligned with sound risk management**. Compensation committees should conduct and publish risk assessments of pay packages to ensure that such packages do not encourage excessive risk taking.
- **Golden parachutes and supplemental retirement packages should be reexamined to align the interests of executives and shareholders**. Companies should re-examine such pay packages to determine whether they truly incentivize performance and whether they reward executives even if the company's shareholders lose value.
- **Transparency and accountability in the process of setting compensation should be promoted**. Based on the belief that compensation committees lack independence and shareholders need more clarity, Secretary Geithner stated that the Treasury Department will support Congress's efforts to pass legislation on "say on pay" and propose legislation relating to compensation committee independence (each as described below).

LEGISLATIVE PROPOSALS

Secretary Geithner discussed the following two legislative initiatives of the Obama administration, which are designed to promote transparency and accountability in the executive compensation setting process.

- **Say on Pay**

  The proposed "say on pay" legislation is designed to improve board accountability and better align compensation with long-term value creation for shareholders. The legislation would give the SEC authority to require companies to give shareholders a non-binding vote on executive pay packages, including with respect to—

- a company's overall executive compensation program
- annual compensation, including salary, bonus and other forms of compensation for the top five executives, as disclosed in the company's proxy statement
- golden parachute compensation in connection with merger proxies

Companies would also have the opportunity to include additional resolutions to ask shareholders their views on specific compensation decisions, including decisions related to various aspects or categories of pay.

- **Providing Compensation Committees with New Independence**

  This proposed legislation is designed to give compensation committees greater independence by directing the SEC to—

- issue rules requiring that compensation committee members meet independence standards similar to those for audit committee members under Sarbanes-Oxley
- issue rules giving compensation committees the authority and tools they need to be truly independent, including enabling the committee to engage and adequately compensate compensation consultants and legal counsel
- provide standards for ensuring the independence of compensation consultants and outside counsel.

SEC'S UPCOMING DISCLOSURE PROPOSALS

SEC Chairman Schapiro recently announced that the SEC is actively considering several new proxy disclosure rules intended to provide greater transparency on compensation decisions for all U.S. public companies. The proposals would require enhanced disclosure relating to—

- how a company and its board of directors manage risks
- a company's overall compensation approach
- potential conflicts of interest by compensation consultants, including disclosure of relationships between the consultants and the company and their affiliates
- director nominees, including their experience and qualifications to serve on the board or on particular board committees—and the reason(s) why a board has chosen its particular leadership structure.

CONCLUSION

The principles and proposals on executive compensation outlined by the Treasury Department and the SEC demonstrate the importance that the Obama administration is placing on the role of executive compensation in restoring trust and confidence in our financial system. Based on the attention the government is placing on executive compensation practices, companies should be prepared for future changes in this area.

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