Client Advisory



Corporate

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Senate Financial Reform Bill Would Impose Additional Corporate Governance and Disclosure Requirements

On May 20, the Senate passed the Restoring American Financial Stability Act of 2010 (the Senate Bill). Although most of the Senate Bill focuses on increased regulation of financial markets and institutions, significant changes to corporate governance and executive compensation and disclosure are also included. The Senate Bill must now be reconciled with the Wall Street Reform and Consumer Protection Act of 2009, which the House passed on December 11, 2009 (the House Bill). Lawmakers are hoping to have a final bill for the President to sign by July 4. Described below are some of the major corporate governance and executive compensation provisions of the Senate Bill and, where appropriate, comparison to the House Bill.

Corporate Governance

- Say on Pay. Within six months of enactment, any proxy statement that requires
 compensation disclosure must include a separate non-binding shareholder vote on
 the compensation of named executive officers. The House Bill is similar but would
 only require a non-binding shareholder vote in annual meeting proxy statements.
- Majority Voting. Within one year, the SEC must direct the listing exchanges to adopt rules effectively requiring directors in uncontested elections to be approved by a majority of the votes cast. If a director receives less than a majority of the votes cast, the director must tender his or her resignation to the board. The board can either accept the resignation or, upon a unanimous vote, decline to accept the resignation. If the board rejects the resignation, the board must within 30 days make public the specific reasons for the rejection and explain why it deemed the rejection to be in the best interest of the company and shareholders, including a discussion of the analysis used in reaching such conclusion. The House Bill does not contain a similar provision.
- Proxy Access. The SEC is given the explicit authority to adopt rules granting
 shareholders proxy access so they can require their company to include the
 shareholder's director nominations in the company's proxy statement. This provision
 is meant to counter contentions to the effect that the SEC does not currently have
 the authority to mandate such access. The House Bill contains the same provision.
- Clawbacks. The SEC must direct the listing exchanges to adopt rules requiring an
 issuer to recover incentive-based compensation (including stock options) from
 any current or former executive in the event of an accounting restatement due to
 the material noncompliance with any financial reporting requirement under the
 securities laws. There would be a three-year look-back period for compensation
 paid. The amount of the clawback would be any excess paid to the executive over

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the amount the executive would have been paid under the accounting restatement. No similar provision exists in the House Bill. Note that this provision is far broader than the Sarbanes-Oxley clawback provisions, which apply only to the compensation of the chief executive and chief financial officers; only in the event of a restatement due to "material noncompliance of the issuer, as a result of misconduct...."; and has a 12-month look-back.

- Compensation Committee Independence. The SEC must direct the listing exchanges to prohibit from listing any issuer that does not comply with additional independence requirements for directors on the compensation committee and consultants, legal counsel and other advisors to the compensation committee. Such requirements include that for purposes of determining "independence," factors such as consulting, advisory or other fees paid by the issuer to such director as well as the affiliations of the director with the issuer would need to be considered. The compensation committee would also be required to select compensation consultants, legal counsel or other advisors after determining the independence of such advisors. The independence of such advisors would be based on factors including the other services provided to the issuer, the amount of fees received, any business or personal relationships, and any equity ownership in the issuer. In addition, the compensation committee must have sole discretion to retain a compensation consultant and independent legal and other advisors, and will be directly responsible for the selection, compensation and oversight of such advisors. The exchanges may exempt a category of issuers from these requirements. The House Bill contains similar provisions.
- **Broker Voting**. Brokers would be prevented from voting shares held in street name with respect to director elections, executive compensation or "any other significant matter" as determined by the SEC, unless the beneficial owner provides the broker with specific voting instructions. No similar provision exists in the House Bill.

Additional Disclosure Requirements

- Executive Compensation Disclosures. The SEC would be required to promulgate a rule requiring issuers to disclose the relationship between executive compensation actually paid and the financial performance of the issuer. Issuers would also be required to disclose (1) the median of the annual total compensation of all employees, except the CEO; (2) the annual total compensation of the CEO; and (3) the ratio of the median compensation of all employees to the compensation of the CEO. No similar provision exists in the House Bill.
- **Hedging.** Issuers would be required to disclose in annual meeting proxy statements whether any director or employee is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities owned or granted to employees or directors as compensation. No similar provision exists in the House Bill.
- Chairman and CEO Structures. Issuers would be required to disclose why they have separated or combined the positions of CEO and chairman of the board. Under current SEC rules, issuers are now required to disclose their leadership structure and reasons for adopting such a structure. For that reason and because no similar provision exists in the House Bill, we anticipate that this provision will be dropped in the reconciliation process.
- Compensation Consultant and Conflict. In any proxy solicitation materials for an annual meeting, issuers would be required to disclose whether the compensation committee has retained a compensation consultant. In addition, disclosure would also have to be made as to whether the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. Again, current SEC disclosure requirements already contain similar provisions, as does the House Bill, although the latter does not specifically require disclosure regarding conflicts of interest.



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