

PUBLICATION

Treasury Proposes Legislation on "Say-on-Pay" and Compensation Committee Independence

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On July 16, 2009, the U.S. Department of the Treasury (Treasury) presented to Congress two separate pieces of proposed legislation related to executive compensation: a shareholder "say-on-pay" proposal and a proposal designed to ensure that compensation committees of corporate boards of directors are independent. These two proposals are part of the Investor Protection Act of 2009 and if adopted would be implemented through rulemaking by the Securities and Exchange Commission (SEC). We will monitor this as it proceeds through Congress and present the following summary of Treasury's proposals:

"Say-on-Pay"

Proposals allowing shareholders of a public company to vote on the compensation of the company's executive officers, known as "say-on-pay," have gained increased attention in recent years and say-on-pay is currently a hot topic in securities law. Aflac was the first public company in the U.S. to implement say-on-pay when it voluntarily placed a say-on-pay vote before its shareholders in 2007, which was approved by 93% of the voting shares. Since then, the number of shareholder proposals asking for say-on-pay votes has increased every year and say-on-pay is becoming increasingly popular with shareholders, as its proponents argue that it leads to greater accountability to shareholders in setting executive pay to correlate with performance. Other countries, such as the United Kingdom, Australia and Sweden, have instituted a shareholder vote requirement for executive compensation. In its fact sheet Treasury noted that, in these countries, shareholder say on executive compensation has led to a modification of executive compensation practices and a stronger correlation between executive pay and performance.

Treasury's proposed say-on-pay legislation has two main components:

- an annual non-binding shareholder vote on executive compensation; and
- a separate non-binding shareholder vote on golden parachutes executives will receive in the event of a merger or acquisition.

Annual Advisory Vote on Executive Compensation

Treasury's proposed legislation would require any proxy statement or consent solicitation for a public company's annual shareholders meeting held on or after December 15, 2009 to include a proposal for shareholders to approve the compensation of the company's executive officers as disclosed pursuant to the SEC's executive compensation rules. The shareholder vote pursuant to this annual proposal will not be binding on the company.

Separate Golden Parachute Vote in the Event of a Merger or Acquisition

Treasury is also proposing a separate shareholder vote on golden parachutes in the event of a merger, acquisition, consolidation, or sale of all or substantially all of the company's assets. A proxy statement or consent solicitation in connection with such an action must disclose in a tabular format any agreements about

compensation an executive will receive that is based on or relates to the merger, acquisition or other transaction, as well as the amount of such compensation.

The proxy statement or consent solicitation must provide for a separate shareholder vote to approve such compensation agreements. Like the annual vote on executive compensation, this shareholder vote will not be binding on the company.

Compensation Committee Independence

Treasury also presented to Congress proposed legislation related to compensation committees, with three components:

- stricter independence standards for compensation committee members;
- provisions for compensation committees to have the authority and funding to retain compensation consultants and outside legal counsel; and
- requirements that compensation consultants and legal counsel to compensation committees be independent from management.

Stricter Independence Standards

Treasury's proposed legislation would implement stricter independence standards for members of a company's compensation committee. Specifically, under the proposals each member of a compensation committee must be independent. To be deemed independent, a committee member may not accept any consulting, advisory or other compensatory fee from the issuer (other than in his capacity as a member of the board or a board committee), or be an affiliated person of the issuer.

Authority and Funding for Compensation Consultants and Outside Legal Counsel

The proposed legislation also would give authority to the compensation committee to retain a compensation consultant in order to give the committee access to its own experts in negotiating executive pay. Similarly, compensation committees would have authority to hire their own outside legal counsel that reports only to the committee. This hiring authority is designed to put the compensation committee on more equal footing with executives in negotiating executive pay. The proposed legislation also requires public companies to provide funding for the compensation committee's retention of compensation consultants and outside legal counsel.

Compensation Consultants and Legal Counsel Independence

Finally, Treasury's proposed legislation provides that those persons or entities serving as compensation consultants or legal counsel to the compensation committee must also meet independence standards to be promulgated by the SEC. Requiring compensation consultants and legal counsel to meet independence standards seeks to ensure that such consultants and advisors truly are independent of management in order to protect shareholder interests.

Depending on the final independence requirements adopted pursuant to SEC rulemaking, it may be prudent for public companies to re-evaluate the composition of their compensation committees and the professional advisors their compensation committees use to ensure that they each meet the applicable independence standards.