

“Say on Pay” and Other Executive Compensation Changes in Wall Street Reform Act

By **Charles C. Berquist**
Best & Flanagan LLP

Congress recently passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in response to the financial crisis that plunged the country into the most serious recession since the 1930s. Included in the Act are a number of new corporate governance and executive compensation reforms applicable to public companies, which are designed to provide greater transparency and accountability for executive compensation.

These changes generally become effective in 2011, and many of them require the adoption of new rules by the SEC and the stock exchanges for their implementation. The SEC recently announced that it expects to have the new rules in place before the start of the 2011 proxy season.

The new law applies mainly to public companies. The highlights of the new law (or lowlights, depending on your perspective) are as follows:

- Requires each public company beginning in 2011 to give its shareholders a non-binding “say on pay” with respect to the company’s executive compensation programs as a whole. After the initial vote in 2011, companies can conduct say on pay votes every one, two or three years, as determined by the shareholders. Also requires a nonbinding say on pay vote in merger proxies on golden parachute arrangements that have not previously been subject to a shareholder vote.
- Directs the SEC to require stock exchanges and associations (NASDAQ) to require companies to have independent compensation committees, similar to the requirement in Sarbanes-Oxley for independent audit committees. Most public companies already have independent compensation committees in order to comply with SEC and IRS requirements for qualified stock option plans.
- Allows retention of compensation consultants and other advisors by a compensation committee only after the committee has considered whether they are “independent” based on factors identified by the SEC.

- Directs the SEC to issue rules to require proxy disclosure by public companies of the relationship between executive compensation and company financial performance, and the ratio between CEO total compensation and the median total compensation of all employees.

- Directs the SEC to issue rules requiring disclosure of a company’s policies applicable to hedging by employees and directors, i.e., purchasing hedging instruments to protect against declines in shares and options granted as compensation.

- Requires the SEC to issue rules mandating public companies to develop and implement “clawback” policies requiring current and former officers to return incentive compensation (including stock options) paid based on erroneous financial statements. This is similar to the clawback rules that have applied to a company’s CEO and CFO since Sarbanes-Oxley.

- Prohibits brokers from voting uninstructed shares for the election of directors, for approval of any executive compensation matters (including say on pay), and for any other significant action as determined by the SEC. This is consistent with recent changes made by the NYSE for voting by member brokers.

- Authorizes the SEC to adopt rules providing greater proxy access for shareholders of public companies.

It is said that sunlight is the best disinfectant, and perhaps the new say on pay and other disclosure rules will change behavior by executives and board members in setting executive compensation. Until now, however, public scrutiny has never had much of a deterrent effect. Congress hopes that this time will be different.

Charlie Berquist is a partner with the Minneapolis law firm of Best & Flanagan LLP. He practices in the areas of executive compensation, securities law, and mergers and acquisitions. He can be reached at cberquist@bestlaw.com, or 612-341-9726.