The Prospective Impact on Public Companies of the Financial Regulatory Reform Bills: A Legislative Update

June 3, 2010

On May 20, 2010, the U.S. Senate passed a comprehensive set of financial regulatory reforms that, if enacted, will represent the most sweeping set of changes to the U.S. financial regulatory system since the Great Depression. The reforms, which are set forth in a bill of more than 1,500 pages called the Restoring American Financial Stability Act of 2010 (S. 3217, or the "Senate Bill"), come after nearly a year of Congressional hearings and months of stop-and-start legislative negotiations.[1] The Senate Bill tracks many of the themes contained in the Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173, or the "House Bill") that was passed by the U.S. House of Representatives on December 11, 2009.[2] Both bills mandate specific executive compensation and corporate governance practices at U.S. public companies generally.

Set forth below are highlights of the provisions of the Senate Bill and the House Bill relating to executive compensation and corporate governance. In some cases, the requirements of the bills would only apply to companies that have listed their securities on a national securities exchange such as the New York Stock Exchange ("NYSE") or the NASDAQ Stock Market, but, in other cases, the requirements would apply to all companies that are required to deliver a proxy or information statement to shareholders.

- *Compensation Committee Independence; Independence of Compensation Committee Consultants and Advisers* – The Senate and House Bills would require the SEC to issue rules directing the national securities exchanges to prohibit the listing of any security of a company that fails to have a compensation committee comprised entirely of members subject to a heightened independence standard. This prospective legislative mandate tracks the Sarbanes-Oxley requirement that audit committees of listed companies be composed entirely of independent directors that meet a higher standard of independence.[3] To the extent that the SEC, in promulgating rules defining "independence" for compensation committee purposes, adheres to the same standards applicable to independence for audit committee purposes, public companies may have to exclude private equity sponsors from their compensation committees. The bills would also impose additional requirements relating to the retention and independence of compensation consultants and to disclosure regarding the use of such consultants.

---

1 The Senate Bill is available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h4173eas.txt.pdf.

2 The House Bill is available at: http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/FinancialRegulatoryReform/hr4173eh.pdf.

3 Section 952 of the Senate Bill requires that, in determining independence for purposes of membership on the compensation committee, companies must consider any consulting or other compensatory fees paid to a director as well as any affiliation that a director may have with the company, its subsidiaries or any affiliates of the company's subsidiaries.

- *Annual Shareholder "Say on Pay" and "Golden Parachute" Votes* – Both the Senate and House Bills generally provide that proxy statements that contain compensation disclosure under SEC rules must include a separate non-binding annual shareholder vote on compensation paid to certain executive officers. In addition, to the extent that any "golden parachute"-related compensation is not approved at the annual "say on pay vote," the House Bill, but not the Senate Bill, would require a separate shareholder vote on such golden parachute compensation at any meeting at which shareholders are asked to approve a merger, acquisition or other extraordinary transaction. The Senate Bill also includes a requirement that the national securities exchanges prohibit broker discretionary voting in connection with the election of directors, executive compensation or any other significant matter (as determined by the SEC), which would ensure that discretionary voting by brokers would not be permitted in say on pay or golden parachute votes.

- *Additional Compensation Disclosures* – Under the Senate Bill, the SEC would be directed to issue rules requiring companies to disclose in annual proxy statements a "clear description" of compensation that is being offered to executive officers, including information that shows, graphically or otherwise, "the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions." The SEC would also be directed to require companies to make additional disclosure regarding internal pay disparity between the CEO's compensation and the median annual total compensation of all employees (other than the CEO) and regarding whether directors and employees of the companies are permitted to hedge their equity in the companies. There are no comparable provisions in the House Bill.

- *Clawback of "Erroneously Awarded" Compensation* – Under the Senate Bill, the SEC is also directed to require national securities exchanges to prohibit the listing of any security issued by a company that fails to adopt and implement a policy providing for the clawback of "erroneously awarded" incentive-based compensation received by any current or former executive officer on the basis of financial statements that had to be restated due to material noncompliance with any financial reporting requirement under the securities laws. There is no comparable provision in the House Bill.

- *Majority Voting Standard* – Under the Senate Bill, public companies would be required to apply a majority voting standard in uncontested elections for directors. If a director were to receive less than a majority of votes cast in such an election, then the director would be required to tender his or her resignation. However, the board of directors may, upon a unanimous vote, decline to accept such resignation, provided that within 30 days after the uncontested election the board publicly discloses the specific reasons why it chose not to accept the resignation and how it determined such a decision was in the best interests of the company and its shareholders. There is no comparable provision in the House Bill.

- <u>*Proxy Access for Shareholder Nominees*</u> – Both the Senate and House Bills would authorize the SEC to promulgate rules requiring issuers to include in their proxy materials director nominees submitted by shareholders.

- <u>*Disclosure on Dual CEO/Chairman Roles*</u> – Under the Senate Bill, the SEC would be required to promulgate rules requiring public companies to disclose in their annual proxy statements the reasons why they have chosen either to have one person to serve in the dual roles of chairman of the board of directors and chief executive officer or to have different individuals serve in such roles. It is unclear whether the Senate Bill would require companies to disclose information that they are not already required to disclose by SEC rules. There is no comparable provision in the House Bill.

*　　　*　　　*

The Senate and House Bills contain important provisions applicable to public companies. While these bills share many of the same features, there are some significant differences, and the legislative terrain is far from settled as the bills undergo the reconciliation process. Even after the reconciled legislation is enacted into law, many key details will be left to regulators to deal with through the rulemaking process, which itself will present further questions and uncertainties. In the weeks and months ahead, we will continue to monitor legislative and regulatory developments affecting public companies.

This memorandum is for general informational purposes and should not be regarded as legal advice. Furthermore, the information contained in this memorandum does not represent, and should not be regarded as, the view of any particular client of Simpson Thacher & Bartlett LLP. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as additional memoranda, can be obtained from our website, www.simpsonthacher.com.

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication.

UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017-3954
+1-212-455-2000

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2550 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3119 China World Tower One
1 Jianguomenwai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Tokyo
Ark Mori Building
12-32, Akasaka 1-Chome
Minato-Ku, Tokyo 107-6037
Japan
+81-3-5562-6200

LATIN AMERICA

São Paulo
Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000