

CORPORATE AND SECURITIES LAW

Alert

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Development in Executive Compensation: The SEC's Stronger Stance and New Proposed Legislation

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Last week Shelley Parratt, Deputy Director of the SEC's Division of Corporation Finance, [delivered a speech](#) at the 4th Annual Proxy Disclosure Conference regarding the current state of executive compensation disclosure under the SEC's rules and what the SEC expects to see by way of disclosure during the 2010 proxy season.

Parratt indicated that the SEC believes that many companies now understand the executive compensation disclosure rules, but are hesitant to conform their disclosures to common SEC comment themes until they themselves receive specific comments requesting enhanced disclosure. She urged companies to be more proactive, reporting that the SEC is planning to take a stronger position in its comment process and require amendment to materially deficient filings:

After three years of futures comments, we expect companies and their advisors to understand our rules and apply them thoroughly. So, any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules.

In its review of 2009 executive compensation disclosures, the SEC observed that companies still need to include detailed and enhanced disclosure surrounding their analysis of how and why they made particular compensation decisions and what the particular elements of compensation are designed to reward. Parratt noted that there was too much discussion of the framework in which decisions are made and not enough insight into the reasons behind compensation policies and decisions. Therefore, for the upcoming 2010 proxy season, companies should present a thorough analysis of their compensation decisions, avoiding boilerplate and unnecessary information and instead providing the specific details of the actual decisions that were made.

In addition, the SEC observed that there continues to be a need to provide enhanced disclosure surrounding performance targets and benchmarking. In fact, the SEC issues more comments on performance targets than any other executive compensation disclosure item and expects specific qualitative and quantitative (if applicable) disclosure of material performance targets, unless it would cause substantial competitive harm. Parratt commented that while a company must first determine whether the performance targets are material to its compensation policies and decisions, a performance target not being met or being disregarded is not a dispositive factor in this analysis. With respect to

competitive harm, Parratt stated that companies need to conduct the same analysis that they would for a formal confidential treatment request. She also remarked that it is more difficult to persuade the SEC of the merits of a competitive harm argument after the amounts have been disclosed by the company, especially in the context of publicly reported company-wide financial results for which the SEC has “yet to see any persuasive analyses explaining how competitors could pull together sufficiently-specific information about a company’s future operations and strategy...to cause the company competitive harm.” In concluding on this point, Parratt emphasized the need to provide meaningful degree of difficulty disclosure when targets are not disclosed for competitive harm reasons.

Parratt also indicated that in drafting 2010 compensation disclosure, one area companies should focus on is their benchmarking process, including specific disclosure of the peer group, how they were selected, and how actual awards compared to the benchmark.

In light of Parratt’s speech, companies should focus on proactively conforming their compensation disclosures to the SEC’s stated areas of focus in order to avoid the prospect of amending their filings in the face of SEC comments.

Restoring American Financial Stability Act of 2009

Also last week, Senator Christopher Dodd released a [discussion draft](#) of the “Restoring American Financial Stability Act of 2009” containing several executive compensation provisions:

Shareholder Vote on Executive Compensation (Say-on-Pay): For shareholder meetings occurring after the first anniversary of the proposed bill’s enactment, companies subject to the SEC’s proxy disclosure rules would be required to provide shareholders with an annual, nonbinding vote to approve the compensation of the company’s named executive officers.

Shareholder Vote on Golden Parachutes (Say-on-Pay): For shareholder meetings occurring after the first anniversary of the proposed bill’s enactment, companies would also be required to give shareholders a separate nonbinding vote on any policy not previously subject to a say-on-pay vote that the company has relating to the award of any type of compensation to any CEO upon the occurrence of a merger or acquisition.

Compensation Committee Independence: Under the proposed bill, the SEC would direct the national securities exchanges to require, as a condition to listing, that companies have entirely independent compensation committees. Furthermore, any compensation consultants, legal counsel and other advisors to the compensation committee also would be required to be independent and the compensation committee would have sole discretion to retain or obtain the advice of independent compensation consultants, legal counsel and other advisors as well as be directly responsible for their appointment, compensation, and oversight. The proposed bill would also require companies to provide appropriate funding, as determined by the compensation committee, to engage these independent compensation consultants, legal counsel or other advisors. For shareholder meetings occurring after the first anniversary of the proposed bill’s enactment, companies would also be required to disclose within their proxies (as directed by the SEC) whether (1) the compensation committee retained or obtained the advice of a compensation consultant and (2) whether the work of the compensation consultant raised any conflict of interest and how the conflict is being addressed.

Executive Compensation Disclosure: The proposed bill requires additional executive compensation proxy disclosure that presents (1) information showing the relationship between executive compensation and the financial performance of the company and (2) a graphical or pictorial comparison of the amount of executive compensation and the financial performance of the company over a five-year period (or such other period as determined by the SEC).

Clawbacks: Under the proposed bill, companies would be required to develop and implement a policy that, in the event a company is required to prepare a financial restatement due to material noncompliance with any financial reporting requirement, would provide for the recovery of any incentive-based compensation (including stock options) that would not have been paid to any current or former executive officer under the restated financials during the three-year period preceding the date on which financial statement is required.

Disclosure Regarding Employee Hedging: The proposed bill would require companies to disclose in their annual proxy statement whether their employees are permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of awards of company equity.

Compensation Standards for Holdings Companies of Depository Institutions: The proposed bill also contains several executive compensation provisions related to financial institutions that (1) prohibit compensation practices by bank holding companies that provide for excessive compensation or could lead to a material financial loss of the bank holding company, (2) permit the imposition of higher capital standards for insured depository institutions with compensation practices that pose a risk of harm to the depository institution and (3) require regulators to prohibit depository institution holding companies from paying compensation that is excessive or could lead to a material financial loss to the institution controlled by the depository institution holding company or to the consolidated depository institution holding company.

We believe that it is unlikely that the bill will become a law as currently drafted.

Bass, Berry & Sims PLC's Executive Compensation Subgroup is comprised of tax and corporate attorneys who monitor and advise on developments in the tax rules, securities laws and corporate governance standards relating to executive compensation. Our attorneys have a wide array of expertise in these areas and provide advice to both public and private companies as well as individual executives and directors.

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