

EXECUTIVE COMPENSATION

Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

New Developments in Executive Compensation: The SEC and Treasury Speak on Executive Compensation Practices

June 16, 2009

On Wednesday, June 10, 2009, Treasury Secretary Tim Geithner and SEC Chairman Mary Schapiro issued statements on the current state of executive compensation - shedding light on principles that should be applied, as well as the proposals to be expected.

The Treasury's Announcement on Compensation Principles

In his statement, Secretary Geithner noted that our financial system is built on "trust and confidence" and requires rules to encourage "long-term growth and value creation." He also stated that executive compensation practices were a contributing factor to the current financial crisis. In considering reforms to better align compensation practices with "sound risk management" and "long-term growth," Secretary Geithner [outlined](#) five broad-based principles that should be considered when designing and implementing executive compensation programs.

1. *Compensation plans should properly measure and reward performance*
 - Compensation should be tied to performance in order to link incentives to long-term value creation, and should be conditioned on a wide range of internal and external metrics, not just stock price.
2. *Compensation should be structured to account for the time horizon of risks*
 - Compensation should be tightly aligned with creating long-term value by conditioning compensation on longer-term performance.
3. *Compensation practices should be aligned with sound risk management*
 - Compensation committees should conduct and publish risk assessments of compensation arrangements to ensure that they do not encourage imprudent risk-taking. Firms should focus on managing the relationship between incentives and risk-taking.
4. *Golden parachutes and supplemental retirement packages should be re-examined*

- Golden parachutes and supplemental retirement packages should be re-examined to determine whether they enhance long-term shareholder value, and whether they incentivize performance or instead reward executives irrespective of shareholder value.

5. *Promotion of transparency and accountability in the process of setting compensation*

- Many of the problematic compensation practices could have been subject to greater scrutiny if compensation committees were more independent and shareholders had better disclosure. Secretary Geithner specifically singled out the typical failure of existing disclosures to clearly specify “walkway” amounts for executives.
- Secretary Geithner announced the Administration’s intent to work with Congress to pass legislation for all public companies in two specific areas: (i) establishing a requirement for all public companies to give shareholders a non-binding annual vote on executive compensation (“Say-on-Pay”); and (ii) creating greater compensation committee independence.
 - Say-on-Pay. The Administration’s Say-on-Pay [proposal](#) would involve at least two shareholder votes each year: (i) a non-binding vote approving or disapproving executive pay packages as described in the proxy; and (ii) a non-binding vote on the annual compensation for the Named Executive Officers. Furthermore, shareholders would have the right to cast a non-binding vote on golden parachute compensation as disclosed in any proxy materials relating to a change in control.
 - Compensation Committee Independence. The Administration’s [proposal](#) would direct the SEC to: (i) issue rules requiring that compensation committee members meet similar independence requirements as audit committee members under Sarbanes-Oxley; (ii) issue rules giving compensation committees the authority and resources to appoint, compensate, retain and be responsible for the oversight and reporting of compensation consultants, as well as to engage counsel and other advisors as necessary to carry out their duties; and (iii) provide standards for ensuring the independence of compensation consultants and outside counsel.

The SEC’s Statement on Executive Compensation

In keeping pace with new developments in compensation practices, Chairman Schapiro [stated](#) that the SEC is considering new proxy disclosure rules that will require additional disclosure in such areas as: (i) how a company and the board manages risks; (ii) how a company’s overall compensation approach functions (e.g. does the company incentivize short-term risk taking without consideration of the long-term effects); (iii) potential conflicts of interest between compensation consultants, the company and their affiliates; and (iv) director nominees’ experience and qualifications, and the decisions of the board with regard to its leadership structure. As indicated by Deputy Director Brian Breheny of the SEC’s Division of Corporation Finance in his testimony before the House Committee on Financial Services on June 11, 2009, the SEC plans to take up this broad package of proxy disclosure enhancements next month.

Bass, Berry & Sims PLC’s Executive Compensation Practice 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. If you have any questions regarding the issues addressed in this Corporate and Securities Law Alert please feel free to contact any of your regular contacts in our Corporate and Securities Group or any of the attorneys in our Executive Compensation Subgroup listed below.

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