ALL PUBLIC COMPANIES SUBJECT TO ADDITIONAL COMPENSATION REQUIREMENTS INCLUDED IN FINAL FINANCIAL REFORM BILL

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To Our Clients and Friends:

The final financial reform bill, if and when enacted, will require all reporting or listed companies to change their executive compensation practices in significant ways. The following discussion describes the compensation-related content of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

REQUIREMENTS APPLICABLE TO ALL PUBLIC COMPANIES

Say-on-Pay; Golden Parachute Shareholder Vote. The bill requires all public companies to provide for a separate, non-binding shareholder vote to approve the compensation of named executive officers at least once every three years. At least once every six years, shareholders must be provided with a separate, non-binding vote on whether the say-on-pay vote should occur every one, two or three years.

"Golden parachute" payments—any compensation payments triggered by an acquisition, merger or other extraordinary transaction—must be disclosed in proxy materials related to any meeting where shareholders are asked to approve the transaction; golden parachute compensation must be put to a separate, non-binding shareholder vote, to the extent not subject to a prior shareholder say-on-pay vote.

The say-on-pay and golden parachute provisions will apply to annual or proxy meetings occurring six months or more after enactment of the bill. As appropriate, the SEC may exempt an issuer or class of issuers from these requirements.

Broker Voting Restrictions. Effective immediately on enactment, the bill prohibits brokers from voting securities they do not beneficially own in a shareholder vote with respect to election of directors (excluding uncontested elections), executive compensation or any other "significant matter" (as determined by the SEC), unless they receive specific voting instructions from the securities' beneficial owners.

Executive Compensation Proxy/Filing Disclosures. Proxy materials requiring compensation disclosures must also include a clear description of compensation, including information showing the relationship between executive compensation actually paid and the financial performance of the employer, as well as disclosure of (a) median employee compensation, excluding the compensation of the issuer's CEO (or equivalent executive), (b)

CEO compensation, and (c) the ratio of median employee compensation to CEO compensation.

Clawback on "Erroneous" Compensation. As a listing requirement, listed companies must develop and implement policies providing for both (a) disclosure of the issuer's policy on incentive compensation based on reported financial information and (b) clawback from current or former executive officers of "erroneously awarded" incentive compensation in the event of an accounting restatement required due to material noncompliance with financial reporting requirements under the securities laws. For purposes of the clawback, "erroneous compensation" is the incentive compensation paid to an executive officer of the issuer during the three years prior to the restatement in excess of what would have been paid under the restatement. Unlike current requirements, the new provision will apply to all executive officers, will apply whether or not there was any misconduct involved, and will go back three years instead of 12 months.

Hedging Disclosure. All issuers must include hedging policy disclosure in annual meeting proxy or consent solicitation material indicating whether employees or directors are permitted to purchase financial instruments designed to hedge or offset any decrease in the market value of equity securities of the issuer held by or granted to an employee or director.

Compensation Committee Independence. As a listing requirement, the bill requires the compensation committee of each listed company to consist entirely of independent directors. Independence is to be determined by considering relevant factors, including the source of all compensation paid to a director and any affiliation the director may have with the issuer. The compensation committee must have authority to hire outside advisors, including compensation consultants, legal counsel or other advisors, and must consider the independence of any outside advisor it engages, applying independence factors to be identified by the SEC. The company's proxy statement for any shareholder meeting occurring one year or more after the bill's enactment must include disclosure of whether the compensation committee retained a compensation consultant, as well as a discussion of any conflict of interest raised by the consultant's work.

Issuers will have an opportunity to cure any independence requirement defect that would result in delisting, and exemptions from independence requirements will be allowed for certain categories of issuers (such as smaller reporting issuers), as the SEC determines appropriate. The independence requirements for committees and consultants do not apply to any "controlled company"—a listed company with more than fifty percent of its voting power held by an individual, a group or another issuer.

Chairman and CEO Structure. SEC rules, to be issued within 180 days of the bill's enactment, will require listed company proxy statements to disclose why the company has chosen the same person or two different people to serve as chairman of the board and CEO.

REQUIREMENTS APPLICABLE ONLY TO FINANCIAL INSTITUTIONS

Financial Institution Compensation Prohibitions. Within nine months of the bill's enactment, Federal regulators, including (among others) the U.S. Federal Reserve Board, the Comptroller of the Currency, the FDIC and the SEC, must issue guidelines prohibiting compensation practices that encourage inappropriate risks by covered financial institutions, including practices that provide for excessive compensation, fees or benefits, or could lead to "material financial loss." The bill also requires disclosure of the structure of incentive-based compensation arrangements of covered financial institutions. Covered financial institutions include (among others) bank holding companies, registered broker-dealers, credit unions and investment advisors, but exclude financial institutions with assets of less than $1 billion.

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While the final bill may be approved by Congress as soon as this week, the precise impact of the legislation will not be known until regulators promulgate all of the rules and regulations required by the bill. However, what is clear is that public companies are facing significant new oversight that will impact how they, and their shareholders, approach executive compensation.

Please feel free to contact us with any questions.

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