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House Passes Bill to Give Shareholders Advisory Vote on Executive Compensation

H.R. 3269, entitled the “Corporate and Financial Institution Compensation Fairness Act of 2009,” was introduced by Rep. Frank (D-MA) on July 21, 2009. The bill, which amends the Securities Exchange Act of 1934, proposes to give shareholders a “say on pay.” Additionally, the bill would require federal regulators to disallow inappropriate or imprudently risky compensation practices as part of the solvency regulation of all financial institutions. Further, financial firms would be required to disclose any compensation structures that include incentive-based compensation.

Background

Following Treasury Secretary Tim Geithner's announcement in June that the Obama Administration would support legislation giving shareholders a vote on executive compensation paid by public companies, the Financial Services Committee, Chaired by Barney Frank (D-MA) reported out the bill by a vote of 40-28 on July 30, 2009, and the full House passed the bill by a vote of 237-185 on July 31, 2009. On August 3, 2009, the bill was referred to the Senate Committee on Banking, Housing and Urban Affairs. In a parallel development, prompted by a broad consensus of prominent financial experts such as the Group of 30 and Lord Turner of the United Kingdom's Financial Services Authority, the United Kingdom and the European Union are considering similar limitations.

"Say on Pay" Provisions. H.R. 3269 requires all publicly traded companies hold an annual, non-binding shareholder vote on compensation for executives. The bill also directs that a separate, non-binding shareholder vote on golden parachute compensation be held when a public company is merged or acquired.

Disclosure of Incentive Compensation Arrangements by Financial Institutions. The bill would require the government regulatory agencies to develop joint regulations that would require financial institutions to disclose to the regulatory agencies the structures of all incentive-based compensation arrangements offered by the financial institutions in such a manner that the regulatory agencies could determine whether the compensation structures (i) are aligned with sound risk

management; (ii) are structured to account for the time horizon of risks; and (iii) meet such other criteria as the regulatory agencies determine to be appropriate to reduce unreasonable incentives offered by the financial institutions for their employees to take undue risks that could threaten the safety and soundness of covered financial institutions or could have serious adverse effects on economic conditions or financial stability. However, the bill clarifies that financial institutions would not have to report the actual compensation of particular individuals, but rather would only have to disclose the structures of the incentive-based compensation arrangements.

Compensation Restrictions for Financial Institutions.

The bill also requires that government regulatory agencies develop joint regulations prohibiting any compensation or incentive-based payment arrangement which supports unacceptable risks which could threaten the soundness or present serious adverse effects to economic conditions or financial stability of financial institutions with more than \$1 billion in assets.

Independent Compensation Committee. The bill establishes the requirement that each member of the compensation committee of the board of directors be independent. To be considered independent, a committee member may not receive compensation from the company, other than compensation for compensation committee duties. This restriction on compensation includes any consulting, advisory or “other compensatory fee” from the Company.

Mandated Study of Compensation Practices and Risk Taking. Finally, the bill requires the Comptroller General of the United States to examine the issue of whether there is a connection between excessive risk taking and compensation structures.

Clarifications in H.R. 3269 Final Mark-up. The bill as reported out by the Financial Services Committee in the Committee Manager's Amendment includes the following substantive and clarifying changes:

- a requirement that the independence standards for compensation consultants drafted by the SEC be "competitively neutral among categories of consultants and preserve the ability of compensation committees to retain the services of members of any such category";
- making clear that the compensation committee independence standards apply to public companies only, not necessarily to companies that issue publicly registered debt;
- providing that financial companies which do not have incentive-based payment arrangements are not required to make disclosures regarding incentive-based payment arrangements; and
- narrowing the regulators' authority to prohibit compensation to that of incentive based payment arrangements to only "covered" financial institutions.

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