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Employee Benefits and Executive Compensation

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Treasury Department and SEC Move Forward on Executive Compensation Reform

On June 10, the United States Treasury Department (Treasury) and the Securities and Exchange Commission (SEC) announced new rules for companies receiving funds under Treasury's Troubled Asset Relief Program (TARP) and initiatives to reform executive compensation, which reach beyond the financial sector.

Reforms Announced and Legislation Proposed

Treasury Secretary Timothy Geithner issued a statement indicating that the executive branch will be considering executive compensation reforms with the goal of "bringing compensation practices more tightly in line with the interests of shareholders and reinforcing the stability of firms and the financial system." Secretary Geithner indicated that such reform will be guided by the following principles: (1) proper measurement and reward of performance; (2) accounting for the time horizon of risks; (3) alignment with sound risk management; (4) reexamination of "golden parachutes" and supplemental executive retirement packages; and (5) promotion of transparency and accountability for setting compensation.

More specifically, Secretary Geithner indicated that the executive branch intends to work with Congress to pass legislation regarding shareholder "say on pay" (and legislators have already introduced similar legislation) and compensation committee independence. The "say on pay" proposal seeks to give the SEC authority to require companies to give shareholders a non-binding vote on executive compensation practices. The compensation committee independence proposal seeks to heighten the independence of compensation committees and grant them additional authority and resources similar to those of audit committees. Secretary Geithner also stated that the executive branch is not seeking specific caps on compensation, which was originally contemplated for companies receiving TARP funds.

SEC "Actively Considering" New Proxy Disclosure Rules

SEC Chairperson Mary Schapiro also issued a statement in which she indicated that the SEC is developing new executive compensation proxy disclosure rules to require more elaborate disclosures of companies' compensation decisions. Specifically, Schapiro stated that the proposals under consideration include greater disclosure regarding (1) how a company manages risk; (2) a company's overall compensation approach; (3) conflicts of interest between a company and its compensation consultants; and (4) director nominees.

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Treasury Issues Rules for TARP Participants

Treasury issued an interim final rule elaborating on the statutory executive compensation restrictions imposed on recipients of TARP funds. Additionally, such rule imposes new requirements, including the appointment of a "pay czar" to review compensation plans at certain TARP recipients, as well as an outright prohibition of tax "gross-up" payments.

Legislation Pending

In addition to the above, multiple bills impacting executive compensation have been introduced in Congress during the current legislative session. For instance, Senators Durbin and Schumer have introduced legislation to (1) prohibit the deduction of "excessive compensation"; (2) require 60% of shareholders to approve compensation beyond a certain limit; and (3) mandate that the chairperson of a company's board of directors be "independent." Other legislators have introduced bills that would impose additional executive compensation restrictions on TARP recipients.

Based on the foregoing developments and the continuing public outcry over perceived compensation excesses, it is clear that changes are in store for executive compensation practices. In addition to federal mandates, companies should expect new executive compensation "best practices" to emerge and activist investors to seek non-mandated reforms through shareholder proposals. We will continue to provide information and updates on these changes as they develop.

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