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O'MELVENY & MYERS LLP

**Key Issues Facing Boards of Directors**  
**Marty Dunn, Directors Roundtable, Aug. 19, 2009**

## Trends in Recent Federal Proposals

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- Significant changes to the proxy process.
- Heightened disclosure requirements.
- Increased independence requirements for comp committees and comp consultants.
- Heightened scrutiny of executive compensation.
- Mandating corporate governance “best practices.”

# Current SEC Proposals – Director and Nominee Disclosure

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- The proposed amendment would require disclosure of:
  - Each director nominee’s experience, skills, and attributes that qualify him or her to serve on the board and committee;
  - The directorships held at public companies at any time in the past five years;
  - Certain legal proceedings that occurred in the past 10 years - does not include lawsuits where directors are named in their capacity as a director.
- *Effects:*
  - Will have to amend the D&O questionnaire.
  - Potential disclosure of experience, skills, and attributes may affect the ability of companies to attract directors.

# Current SEC Proposals – Board Leadership Structure Disclosure

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- The proposed amendment would require disclosure of:
  - Whether a company combines or splits the CEO and Chairman positions;
  - Whether a company has a lead independent director; and
  - The board’s role in a company’s risk management process and the effect that this role has, if any, on the manner in which a company has organized its leadership structure.
- The SEC has indicated that it is seeking information regarding whether:
  - The board implements and manages its risk management function through the board as a whole or through a committee;
  - The persons who oversee risk management report directly to the board as whole or to a standing committee of the board; and
  - Whether and how the board, or board committee, monitors risk.

# Current SEC Proposals – Discussion of Risk in CD&A

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- The proposed amendment would require new CD&A disclosure regarding overall policies and practices regarding compensation for employees and the material impacts of those policies and practices on the company's risk profile and risk management.
- Disclosure would include employees who are not executive officers.
- Companies would have to conduct the following analysis for all employees:
  - Whether a company's compensation policies and overall actual compensation practices for employees generally give rise to risks;
  - If so, whether the risks may have a material effect on the company; and
  - If so, the company must discuss its policies or practices of compensating its employees – including non-executive officers – as they relate to risk management practices and/or risk taking incentives.

# Current SEC Proposals – Disclosure Regarding Compensation Consultants

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- The proposed amendment would require disclosure of the fees paid to, and the services provided by, a compensation consultant that provides services relating to executive and director compensation, including:
  - Additional services provided;
  - Aggregate fees paid for the additional services;
  - Executive officer and director compensation consultant services provided; and
  - Whether the board approved the engagement of the consultant for additional services.

# Current SEC Proposals – Disclosure Regarding Equity Grants

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- The proposed amendment would require reporting equity grants in the Summary Compensation Table and Director Compensation Table at the “FAS 123R grant-date value” instead of the FAS 123R expense that is booked for that year, as currently required.
- *Effects:*
  - This change will impact the amounts reported for “Stock Awards” and “Options/SAR Awards” in the SCT table.
  - The proposal may change the identity of the NEOs.
  - In preparation, companies should produce mock-ups of the SCT and DCT reflecting the FAS 123R grant-date value.

# Current Legislative Initiatives – Say-on-Pay

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- On July 31, 2009, the House passed H.R. 3269, the “Corporate and Financial Institution Compensation Fairness Act of 2009,” introduced by Congressman Barney Frank.
- Three main sections:
  - Say-on-Pay
    - Requires all publicly-held companies to hold non-binding annual shareholder votes on executive compensation and golden parachutes.
  - Compensation Committee Independence
    - Requires that compensation committee members be independent.
    - Directs the SEC to adopt independence standards for compensation consultants.
  - Regulation of Compensation at Financial Institutions
    - Regulates pay at financial institutions with more than \$1 billion in assets.
    - Prohibits certain compensation structures that could have a “serious adverse effect on financial stability.”

## Current Legislative Initiatives – Shareholder Bills of Rights

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- Two broad proposals to mandate certain corporate governance standards for public companies:
  - On May 19, 2009, Senator Schumer introduced S. 1074, the “Shareholder Bill of Rights Act of 2009” (the “Senate Bill”).
  - On June 12, 2009, Congressman Peters introduced H.R. 2861, the “Shareholder Empowerment Act of 2009” (the “House Bill”).

# Current Legislative Initiatives – Shareholder Bills of Rights

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- The House Bill and Senate Bill propose changes in the following areas:
  - Advisory vote on golden parachute compensation;
  - Independent board chair;
  - Annual election of directors;
  - Majority vote for directors;
  - Establishment of a risk committee;
  - Adoption of a clawback policy; and
  - Additional disclosure of specific performance targets.

# Current Legislative Initiatives – Limits on Executive Compensation

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- S. 1006, the “Excessive Pay Shareholder Approval Act;” – requires a supermajority vote (60%) to approve a compensation structure in which any employee is paid more than 100 times the average employee.
- S. 1007, the “Excessive Pay Capped Deduction Act,” – limits the federal income tax deduction for compensation paid to executives that is more than 100 times the average employee.
- S. 1006 would require proxy disclosure of, and S. 1007 would require a report to be filed with Treasury disclosing, specific compensation data for a company.

## Amendment to NYSE Rule 452

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- Rule 452 currently permits brokers to vote uninstructed shares on “routine” matters.
- Amendment removes an uncontested election of directors from the list of “routine” matters.
- Applies to all shareholder meetings after January 1, 2010.
- Applies to all brokers who are NYSE members, and therefore will impact all publicly listed companies whose shares are held through those brokers.
- Greatest effect on companies with majority voting.

# Current SEC Proposals – Proxy Issues

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## Proxy Access – Proposed New Rule 14a-11

- Creates a Commission-mandated process for shareholders to nominate one or more directors and have the directors included in a company's proxy materials.
- A nominating shareholder or group of shareholders must:
  - have owned the securities for at least one year;
  - intend to hold the securities through the date of the annual meeting; and
  - meet the following ownership requirements:
    - Large accelerated filers – 1% of the company's securities.
    - Accelerated filers – 3% of the company's securities.
    - Non-accelerated filers – 5% of the company's securities.

# Current SEC Proposals – Proxy Issues

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## Proxy Access – Proposed New Rule 14a-11

- Reflects a one-size-fits-all approach;
- Has a threshold requirement that is too low in amount and short in duration;
- Ignores the role of a company's nominating committee;
- Does not provide all information necessary for shareholders to make a fully informed voting decision;
- Does not require a shareholder nominee to meet company-adopted independence standards;
- Does not require a shareholder nominee to be independent of the nominating shareholder;
- Does not allow companies with advance notice by-laws sufficient time to complete the process; and
- Could negate shareholder-approved proxy access bylaws.

# Current SEC Proposals – Proxy Issues

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## Proxy Access – Proposed Amended Rule 14a-8(i)(8)

- Would allow shareholder proposals to amend, or request an amendment to, a company's governing documents to require proxy access.
- Shareholders need only own \$2,000 in stock for one year to submit a proposal.
- Shareholder proposals may be excluded if they conflict with state law or Rule 14a-11.
- Effects/Concerns:
  - Focuses improperly on a shareholder right to *nominate* a candidate for election to the board of directors, rather than the right to have a nominated candidate *included in the company's proxy materials*.
  - Could limit the ability of shareholders to adopt a proxy access process.
  - Does not carve out proposals with the potential to result in a change-in-control.
  - Uncertainty in interaction between Rule 14a-8(i)(8) and 14a-11 and other provisions in Rule 14a-8.



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