

**Towers Watson
Monthly Regulatory Round-Up**

December 2009

- - Executive Compensation - -

The Monthly Regulatory Round-Up is a high-level summary of legal and regulatory developments that occurred during December 2009 that may be relevant to large employers. Developments are sorted according to

- federal legislative developments,
- federal regulatory guidance
- other developments (e.g., significant litigation, studies, select state law developments).

The Monthly Regulatory Round-Up is prepared by Towers Watson's Technical Services staff, located in Valhalla, NY. This material is not a substitute for legal, accounting, actuarial or other professional advice.

LEGISLATIVE

1. ***Executive compensation and governance reforms.*** Rep. Frank (D-MA) released a financial system reform bill, the Wall Street Reform and Consumer Protection Act (H.R. 4173), which incorporates the executive compensation and corporate governance provisions of the Corporate and Financial Institution Compensation Fairness Act of 2009 (H.R. 3269) that was passed by the House on July 31, 2009. In particular, the bill would:
 - give shareholders of public companies (unless exempted by the SEC) an annual advisory vote on the executive compensation disclosed in a company's proxy materials;
 - require disclosures respecting any compensation that is related to corporate transactions (i.e., "golden parachutes") and give shareholders a separate advisory vote on such compensation, unless it was previously the subject of a shareholder vote under the more general "say on pay" requirement above;
 - require compensation committees of public companies to be independent;
 - require that compensation consultants satisfy independence standards established by the SEC which would have to be "competitively neutral" among categories of consultants and preserve the ability of compensation committees to retain the services of members of any such category;
 - require disclosures by most large financial institutions about incentive pay programs sufficient for their regulators to evaluate whether these programs are properly aligned with risk; and
 - require the appropriate federal regulators to jointly issue regulations prohibiting certain incentive arrangements that they determine encourage inappropriate risks by covered financial institutions.

REGULATORY

1. ***Technical corrections to TARP interim final regulations.*** The Treasury Department has issued some technical amendments to the interim final rules concerning the Troubled Asset Relief Program (TARP) standards for compensation and governance that were issued on June 15, 2009. It also published some related Frequently Asked Questions (FAQs) on the Treasury website. Many of the changes and FAQs address fairly technical issues. However, one item is particularly noteworthy. The change will shield TARP recipients from the need to publicly disclose the names of their 20 most highly paid non-SEO employees for each year. Before this change, such a list was required to be included as an exhibit to a company's 10-K each year. The public disclosure will now be limited to an affirmation that the company has submitted such a list to the Treasury.
2. ***SEC changes to proxy disclosure rules.*** The SEC adopted a number of revisions to the proxy disclosure rules regarding executive compensation that it had proposed in July. The final rules largely follow the proposals, with some noteworthy changes. The final rules, which are effective on February 28, 2010, will require reporting of the full grant date fair value of a stock option or other equity award in the Summary Compensation Table (and the Director Compensation Table) in the year of grant rather than reporting merely the amount of an award that is being expensed for the year under FAS 123(R) (now ACS 718). In addition the final rules will require disclosures as to:

- the relationship of a company's overall compensation policies (for both executives and other employees) to risk;
- the qualifications (e.g., relevant background) of directors and nominees;
- the reasons for a company's leadership structure (e.g., whether the roles of Chairman and CEO have been combined and the reasons behind this decision); and
- compensation consultant fee information, if the consultant also provides additional services.

The proposed disclosure regarding the connection between compensation programs and risk has been modified to apply a higher threshold. Such disclosure is only required when a company concludes the risks posed are "reasonably likely" to have a material adverse effect on a company as opposed to any "material effect." This disclosure will now be made separately from the CD&A (since it might be confusing if the CD&A were expanded beyond NEOs).

The disclosure concerning executive compensation consultants who also provide other services to the company was modified from the proposal in several important respects. Where a multi-service consulting firm is retained by management, rather than the board of directors or a committee of the board (e.g., the compensation committee), fee disclosure is not required of the multi-service firm's fees if the committee retains its own consultant. Also, under the final rules, the provision of information, such as executive compensation surveys, by a consultant does not, in and of itself, trigger fee disclosure requirements except for certain customized surveys or information. Finally, no executive compensation or other fee disclosures are required if the "other" (non-executive compensation services) are \$120,000 or less.

3. ***SEC guidance regarding the effective date of the changes to the proxy disclosure rules.***

The SEC staff issued some Compliance and Disclosure Interpretations (C&DIs) relating to the effective date of the changes to the proxy disclosure rules that were adopted on December 16, 2009. The formal rule indicated simply that the changes were effective on February 28, 2010, raising a number of interpretive questions. The C&DIs clarify that the changes apply for filings done on or after that effective date. By implication, the changes would not need to be reflected in disclosures filed before that effective date. The C&DIs also indicate that all of the changes only apply to disclosures for fiscal years that end on or after December 20, 2009. The C&DIs also clarified the following points, among others:

- a preliminary proxy statement must comply with the changes even if filed before February 28, 2010, provided the company expects to file its definitive proxy statement on or after February 28, 2010;
- an issuer that wants to voluntarily comply "early" with the changes may generally do so on a selective basis (except that if the Summary Compensation Table and the Director Compensation Table are prepared pursuant to the revisions, all of the other changes to the proxy must also be implemented early);
- the accelerated disclosure of the results of a shareholder vote on Form 8-K applies to any shareholder meeting that occurs on or after February 28, 2010 even if the proxy statement for the meeting was mailed to shareholders before that date; and
- a company that files a registration statement for an IPO on or after December 20, 2009 must comply with the new disclosure requirements in order for the statement to be declared effective on or after February 28, 2010.

4. ***409A not violated by changes to comply with TARP Special Master advisory opinions.***

The IRS issued Notice 2009-92, which clarifies that subject to certain conditions, if a financial institution that has received financial assistance under TARP changes the time or form of payment of an amount of deferred compensation or conditions payment upon a TARP-related condition (e.g., the prior repayment of some or all of the financial assistance) to comply with an advisory opinion of the Office of the Special Master for TARP Executive Compensation issued after September 30, 2009 it will not be treated as a failure to comply with the requirements of IRC § 409A.

5. **TARP Special Master rulings on compensation structures at companies that received exceptional assistance.** According to a Treasury press release, "...the Special Master for TARP Executive Compensation, Kenneth R. Feinberg, released his second round of rulings on executive compensation packages for firms that received exceptional TARP assistance. These determinations cover compensation structures for the 26 – 100 most highly compensated employees plus executive officers, who were not subject to the Special Master's October 22, 2009, decisions." The rules would generally restructure compensation packages to focus executives on long-term value creation rather than on short-term goals. This is accomplished by requiring at least 50% of pay to be held for at least three years, requiring incentive pay to be subject to clawback and based on objective performance measures to be reviewed by the Special Master and by restricting the use of short-term cash, among other things.

OTHER

1. **Conference Board executive compensation report.** The Conference Board issued the 2009 Top Executive Compensation Report, which examines the compensation elements for senior executive officers by industry category.