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Legal Risk Management Tip
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SEC PROPOSES "SAY-ON-PAY" REGULATION AND ITS IMPACT TO INSTITUTIONAL INVESTMENT MANAGERS

On October 18, 2010, the Securities and Exchange Commission ("SEC") proposed rules that would enable shareholders of public companies to cast non-binding advisory votes on executive compensation and "golden parachute" arrangements.[1] Collectively, these votes are referred to as say-on-pay votes. The issuing of these rules was mandated by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2]

Under the SEC's proposed rules, public companies subject to federal proxy rules would be required to:

- Allow shareholders to hold a non-binding advisory vote on executive compensation and non-binding advisory vote on how often these votes should be held;
- Allow shareholders to hold a non-binding advisory vote on executive compensation arrangements resulting from merger transactions, known as "golden parachute" arrangements; and
- Require institutional investment managers to provide their voting records on say-on-pay, frequency of say-on-pay votes, and "golden parachute" arrangements to the SEC on an annual basis.

In December of 2009, following the passage of the Troubled Asset Relief Program (TARP)[3], the SEC adopted rules requiring publicly traded companies with outstanding obligations under TARP to include in their proxy statements a shareholder vote on executive pay packages. Additionally, at that time, the SEC finalized rules requiring publicly held companies to expand upon the information regarding executive compensation in their proxy statements. It appears that this proposal now calls for similar requirements applying to public companies regardless of their involvement with TARP.

Non-Binding Shareholder Votes on Executive Compensation Packages

Under the proposed rules, public companies subject to the federal proxy rules would be required to provide shareholders with an advisory vote on executive compensation. Specifically, the Dodd-

[1] The full text of the proposed rules is *available at* http://www.sec.gov/rules/proposed/2010/33-9153.pdf.
[2] Pub. L. No. 111-203 (July 21, 2010).
[3] Pub. L. No. 110-343 (October 3, 2008).

Frank Act added Section 14A(a) to the Securities Exchange Act of 1934,[4] which mandates that shareholder votes on executive compensation be held no less frequently than once every three years.[5] Under these rules public companies would be required to hold say-on-pay votes beginning with their first annual shareholders' meeting taking place after January 21, 2011.

The SEC proposal also would require enhanced disclosures to be included in the proxy statement for the annual meeting regarding the company's policies and procedures employed for the say-on-pay vote. As the say-on-pay vote is non-binding, the proposals call for companies to document how they have considered the results of previous say-on-pay votes in their Compensation Discussion and Analysis ("CD&A").[6]

Shareholder's Input on Frequency of Say-on-Pay Votes

The proposed rules require companies subject to the federal proxy rules to allow shareholders to vote on the frequency with which they would be able to cast a say-on-pay vote; (e.g., annually, every other year, or once every three years). Shareholders would be allowed to cast this non-binding "frequency vote" at least once every six years beginning with the first annual shareholders' meeting taking place on or after January 21, 2011. Additionally, and keeping with the SEC's theme of increased mandatory disclosure regarding executive compensation packages, companies would be required to provide information on the "frequency vote" in the annual meeting proxy statement.

"Golden Parachutes": Disclosure and Shareholder Approval Votes

Another aspect of the proposal call for companies issuing proxy or consent solicitations in connection with mergers, acquisitions or consolidations to provide additional information about the compensation arrangements with executive officers that would result from the proposed transaction. Under the proposal, acquiring and target companies would be required to disclose the details of "golden parachute" arrangements as they apply to the named executives of both companies. Such disclosure for these arrangements must be broad enough to encompass any "golden parachutes" resulting from going-private transactions and third-party tender offers. Accordingly, the required disclosures will increase transparency to shareholders by outlining important information regarding compensation arrangements, regardless of the structure of the transaction.

Vote Reporting and Recordkeeping for Institutional Investment Managers

Under the proposal, institutional investment managers must file their votes on say-on-pay, frequency of say-on-pay votes, and "golden parachute" arrangements with the SEC at least once per year no later than August 31st of each year. For purposes of this proposed rule, an institutional

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[4] Securities Exchange Act of 1934, 15 U.S.C. § 78a, et. seq.
[5] Shareholders would also be given a say in how often say-on-pay votes should be held, see discussion below.
[6] The SEC adopted rules in 2006, requiring public companies to issue Compensation Discussion and Analysis reports, *available at* http://www.sec.gov/rules/final/2006/33-8732a.pdf.

investment manager is defined as any institution which manages equity securities on a discretionary basis having an aggregate fair market value of $100 million or more.[7]

Such an investment manager would be required to identify securities voted, describe the executive compensation matters voted on, disclose the number of shares over which the manager held voting power and the number of shares voted, and indicate how the manager voted.

Conclusion

The say-on-pay, "golden parachute" and vote reporting for institutional investment managers rules issued by the SEC have been anticipated since the passage of the Dodd-Frank Act and will require many companies to reexamine their executive compensation policies and procedures in the near term. While the proposed rules call for non-binding votes, if a company were to receive a negative vote from shareholders, and yet go forward with the disapproved compensation package, it could cause increased scrutiny from both regulators and shareholders.

The SEC is currently seeking public comment on these proposals. The comment period will close on November 18, 2010. To submit a comment on these proposed rules, send an e-mail to: rule-comments@sec.gov and include File Number S7-31-10 in the subject line.

For more information about this topic and other legal services, please contact us at (619) 298-2880, info@jackolg.com or visit www.jackolg.com. Thank you.

Author: Brent M. Cunningham, Law Clerk; Editor: Michelle L. Jacko, Esq., Managing Partner, JLG. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds and banks on legal and regulatory compliance matters.

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[7] More specifically, "a person will become subject to the new reporting requirement if it meets two criteria: (1) the person is an institutional investment manager as defined in Section 13(f)(6)(A) of the Securities Exchange Act; and (2) the person is required to file reports under Section 13(f) of the Securities Exchange Act." Rule Proposal Release at pg. 8, *available at* http://www.sec.gov/rules/proposed/2010/34-63123.pdf.