

Securities

ADVISORY

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SEC NIXES BROKER VOTING IN DIRECTOR ELECTIONS

Also, Proposes New Compensation and Governance Disclosures

Today, the SEC approved an amendment to New York Stock Exchange (“NYSE”) Rule 452 to eliminate broker discretionary voting in elections of directors (except for registered investment companies). In addition, the SEC proposed a number of new proxy disclosure requirements regarding compensation and other corporate governance topics. Lastly, the SEC proposed rules to implement shareholder “say-on-pay” rules for institutions that are recipients of financial assistance under the Troubled Asset Relief Program (“TARP”). Below we summarize the highlights of these actions. This is based solely on the SEC’s press release and statements made at today’s public meeting. For more information, please refer to the full text of the rule proposals and amendment of NYSE Rule 452 which we expect to be posted on the SEC’s website within the next few weeks.

ELIMINATION OF BROKER DISCRETIONARY VOTING IN DIRECTOR ELECTIONS

Under NYSE Rule 452, NYSE member brokers holding shares as nominees on behalf of their customers may vote on “routine” proposals at shareholder meetings if the beneficial owner of the shares, i.e., the broker’s customer, has not instructed the broker how to vote the shares within a specified time. For purposes of Rule 452, a routine proposal is one that is not contested and does not involve a merger or any other matter which may substantially affect the rights or privileges of the shareholders. The rule also sets forth a list of specific matters that are considered non-routine. The amendment approved by the SEC today adds the election of directors to this list of non-routine matters (except for companies registered under the Investment Company Act of 1940). As a result, in the absence of instruction from beneficial owners, brokers will no longer be able to vote shares they hold on behalf of such beneficial owners in the election of directors. This amendment will be applicable to proxy voting for shareholder meetings held on or after January 1, 2010.

The elimination of broker discretionary voting in director elections is likely to have several consequences in next year’s annual meeting and proxy cycle. Indeed, two of the five Commissioners (Casey and Paredes) cited a number of these consequences as factors in explaining their votes against the amendment. Such consequences include, among other things, increased proxy solicitation fees as companies seek to generate a higher rate of response amongst retail shareholders, the potential for not obtaining a quorum at some companies’ meetings, uncertainty about how this change might affect director elections at companies that have adopted majority voting requirements, and the potential for greater influence in elections by proxy advisory firms such as RiskMetrics.

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PROPOSED NEW COMPENSATION AND GOVERNANCE DISCLOSURE REQUIREMENTS

The SEC voted to propose a number of new disclosure requirements relating to compensation and other governance matters. Based on public statements made at the SEC's open meeting, these proposals include the following:

- The scope of the Compensation Discussion and Analysis ("CD&A") accompanying executive compensation disclosure would be broadened such that it would need to address the company's overall policies and practices for employees generally (including non-executive officers), if the risks arising from such policies and practices could have a material effect on the company. Under current rules, the scope of the CD&A is limited to compensation practices and policies for named executive officers. The proposal is aimed, at least in part, at public companies with highly-paid employees, such as, for example, entertainers and brokers, whose compensation is not required to be addressed in the CD&A under current rules.
- In the Summary Compensation and Director Compensation tables, the value of stock awards and option awards made in a particular year would be presented based on the aggregate grant date fair value of such awards, as determined in accordance with applicable accounting standards, rather than the current approach of showing the compensation cost for financial statement reporting purposes during the year of all outstanding awards. The proposal would, effectively, represent a return to the approach first used when the executive compensation rules were substantially amended in 2006.
- Disclosures regarding the qualifications of directors and director nominees, required by Item 401 of Regulation S-K, would be revised to cover the particular experience, qualifications, attributes, or skills that qualify such persons, in light of the company's business, to serve on the company's board of directors and on any board committee that such person serves on or is chosen to serve on. This item would also be expanded to require disclosure of (i) other public company directorships held by the director or nominee during the previous five years, and (ii) disclosure of relevant legal proceedings involving the director or nominee during the prior 10, versus the current five, years.¹
- Item 407 of Regulation S-K would be amended to require additional disclosures regarding the company's leadership structure, including a discussion of why the company's particular leadership structure is appropriate, whether (and why) the company has chosen to combine or separate the chief executive officer and board chair positions, whether the board of directors has a lead independent director, and the role played by the board in overseeing the company's risk management.
- Disclosure regarding compensation consultants would be expanded beyond that already required. This would include:
 - disclosures about any services provided to the company by such consultants or their affiliates in addition to consulting services related to executive or director compensation,
 - whether the engagement of the consultant to provide such other services was recommended or made by management,
 - whether the board of directors or compensation committee approved such other services, and
 - fees paid to such consultants and affiliates for compensation-related services and for all such other services.

¹ The SEC is also soliciting comment on whether it should amend its rules to require disclosure about whether diversity is a factor a nominating committee considers when selecting someone for a board position, and whether the SEC should amend other rules to provide for additional or different disclosures related to diversity.

- Companies would be required to report voting results of shareholder meetings within four business days on Form 8-K. Currently, these results are contained in the Form 10-Q (or Form 10-K) covering the quarter in which such meeting was held.²

PROPOSED SAY-ON-PAY RULES FOR TARP RECIPIENTS

The SEC voted to propose new Rule 14a-20 under the Exchange Act and to amend Item 20 of Schedule 14A to require an annual non-binding shareholder vote on executive compensation for SEC registrants that have received financial assistance under TARP.³ The SEC's rules require TARP recipients that are SEC registrants to provide a separate, non-binding shareholder vote on the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K. The requirement applies only to annual meetings of shareholders (or special meetings in lieu of annual meetings) for which proxies will be solicited for the election of directors, and the requirement only applies for so long as the company has obligations arising from financial assistance under the TARP outstanding. The SEC's proposed rules would require companies to briefly explain the general effect of the shareholder vote, such as whether the vote is non-binding. Although the SEC's proposed rules do not mandate any specific form of shareholder proposal for TARP recipients to use, the SEC is asking for comment on whether a specific form of shareholder proposal should be required for the sake of consistency.

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SEC Chairman Mary Schapiro has been promising this rulemaking package since shortly after her Senate confirmation last winter. That the NYSE rule change came with less than unanimous approval reflects the controversy that has surrounded that issue for many years. That the disclosure proposals will add length to the already unwieldy annual meeting proxy statement is undeniable. Neither point, however, ranks high on the SEC's current agenda, which is that of enhancing its image as the investor's advocate and, in that process, contributing more generally to a restoration of investor confidence.

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² In addition, the SEC voted to propose a number of amendments to clarify certain aspects of the proxy solicitation rules.

³ TARP recipients are required to provide shareholders with a say-on-pay vote by Section 111(e) of the Emergency Economic Stabilization Act of 2008, as amended by the American Recovery and Reinvestment Act of 2009. The SEC is required to adopt rules implementing this requirement for public companies by February 17, 2010.