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Executive Compensation: Year-End Update

Law360, New York (December 11, 2009) -- As 2009 draws to a close, employers should consider a number of important executive compensation-related issues and developments.

Section 409A Compliance

All employers (public and private) should be aware that in recent months, the IRS has begun audits of employer 2006 and 2007 tax returns for Section 409A compliance.

Several companies have been reported to have received extensive information document requests (IDRs) relating to their nonqualified deferred compensation plans and Section 409A compliance procedures.

While the transition period for amending plan documents to comply with Section 409A closed at the start of this year, there is still an opportunity to amend plan documents on or before Dec. 31, 2009, to comply with Section 409A — to the extent amounts payable under the plans have not yet vested and will not vest in 2009.

In addition, operational defects may generally be corrected in accordance with the IRS's corrections program for Section 409A-covered plans.

In general, defects corrected in the same year in which they occur receive the most generous treatment under the corrections guidance.

Thus, employers should consider reviewing their nonqualified plan administration before Dec. 31, 2009, to try to capture any operational errors that may have occurred during 2009.

Section 162(m)

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For publicly traded employers with a calendar fiscal year, Dec. 31, 2009, marks the end of the transition period for complying with new IRS guidance under Section 162(m).

For performance periods starting after Jan. 1, 2009, incentive compensation arrangements that may pay out at "target" (or otherwise based on factors other than actual performance) on a covered employee's termination of employment (including involuntary termination other than for cause, good reason termination or retirement), will no longer qualify for the performance-based compensation exception to the $1 million deduction limitation under Section 162(m).

This is true regardless of whether or not the compensation is actually paid on the employee's termination.

In considering this issue, employers should be careful to examine employment agreements or other separate documents (other than the incentive compensation plan itself) that may provide for payment of the incentive compensation on a termination event.

Compensation Discussion & Analysis

While we are still waiting for the SEC to finalize the proposed enhancements to the executive and director compensation disclosures, publicly traded employers should take note of recent public statements made by Shelly Parratt, deputy director of the U.S. Securities and Exchange Division of Corporation Finance, that starting in the 2010 proxy season, proxy statements failing to meet the existing disclosure requirements for executive and director compensation will likely be required to be amended.

In the past three years, the SEC has taken a more generous approach of allowing registrants to promise to improve their executive and director compensation disclosures in future filings.

Regardless of whether or not the proposed enhancements to the executive and director disclosures are finalized in time for the 2010 proxy season, publicly traded employers can and should already be anticipating and building some of the expected enhancements into their current activities.

For example, compensation committees and executives should already be looking at the extent to which compensation policies and practices for employees generally (not just executive officers) pose material risks to the employer, and potential ways of adjusting such policies and practices to align with the employer's risk-management objectives.

The steps the company has taken to assess risk management issues as they relate to employee compensation policies will be a "best practice" disclosure for 2010 proxy statements regardless of what the SEC does.

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Increasing attention has also been focused on the adequacy of post-termination pay disclosures.

Commentators have begun encouraging companies to provide in one place in the proxy statement a summary of the total amount of post-employment compensation payable to named executive officers.

Some companies voluntarily provided such "walkaway numbers" disclosure last year, and while not addressed in the SEC's proposed disclosure enhancements, other companies are expected to do so this year.

A company wishing to provide such disclosure in 2010 should begin considering how to calculate walkaway numbers, how to present the numbers in the proxy statement, what assumptions should be explained, and how to describe the rationale for the various compensation arrangements underlying the walkaway numbers.

Identify and Address "Hot Button" Pay Practices

The economic downturn has resulted in increased criticism of certain pay practices that have traditionally been the subject of shareholder concern.

RiskMetrics Group, one of the leading proxy advisory firms, has identified a list of certain "problematic pay practices" that will cause it to issue "against" recommendations for say-on-pay proposals, and under some circumstances, advise against the reelection of compensation committee members.

Some of the pay practices singled out by RiskMetrics for such treatment include multiyear guarantees for salary increases, nonperformance-based bonuses and equity compensation; taking the value of long-term equity awards into account in computing supplemental retirement plan benefits or providing credit for additional years of service without justification; change in control agreements that provide for payments that exceed three times the executive's base salary and target bonus; and tax gross-ups for certain executive perquisites (such as personal use of corporate aircraft and executive life insurance).

In anticipation of the 2010 proxy season, companies should review all of their executive pay practices to determine whether any could be deemed problematic, and whether such arrangements should be eliminated or modified to address potential criticism.

What to Expect in 2010

A number of bills currently pending in Congress contain provisions that could impact executive compensation and corporate governance issues in 2010.

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For example, legislation that would require the SEC to develop requirements for the independence of compensation consultants and other compensation committee advisors are likely to be adopted in some form.

In addition, legislation requiring all publicly traded employers (not just those participating in the government's TARP program) to offer shareholders a nonbinding "say-on-pay" vote on the employer's executive compensation programs (including golden-parachute payments), appear likely to pass in 2010 as well.

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