

Dodd-Frank Wall Street Reform and Consumer Protection Act: Application to Public Companies

The U.S. Senate on July 15, 2010 approved the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), the financial reform legislation that addresses various aspects of the U.S. financial regulatory system, including regulatory oversight, derivative products, troubled "too big to fail" banks and enhanced consumer protection. The Act was previously approved by the U.S. House of Representatives on June 30, 2010, and President Obama is expected to sign the bill into law.

While the Act is largely focused on the regulation of banks and the financial services industry, certain provisions of the Act, specifically those included in Title IX of the Act entitled the Investor Protection and Securities Reform Act of 2010, apply generally to publicly-traded companies and modify the regulation of corporate governance, executive compensation and related disclosure obligations. The Act establishes new rules related to:

- shareholder "say on pay" voting;
- independence of compensation committees and their advisors;
- increased disclosure related to executive compensation;
- clawback requirements for incentive compensation;
- hedging disclosure;
- shareholder use of proxy materials to nominate directors; and
- restrictions on broker discretionary voting.

The following provides a brief summary of the key corporate governance and executive compensation provisions of the Act that apply to public companies.

Non-Binding Shareholder Vote on Executive Compensation ("Say-On-Pay") (Section 951)

The Act requires public companies to provide shareholders the opportunity to have a non-binding vote to approve the compensation of named executive officers at least once every three years. The vote will be advisory and apply generally to the overall compensation, rather than the compensation of each individual executive or program. In addition, at least once every six years, shareholders must be provided with a separate, non-binding vote on whether the say-on-pay vote should occur every one, two or three years.

The Act also requires that in connection with an acquisition, merger, consolidation or sale of all or substantially of all of a company's assets, the company must disclose in its proxy statement all compensation arrangements with named executive officers that may be triggered by such transaction ("golden parachute" payments). The shareholders must then be entitled to exercise a separate, non-binding shareholder vote to approve the disclosed compensation arrangements to the extent such arrangements were not previously subject to a shareholder say-on-pay vote.

The say-on-pay provisions will apply beginning at the first shareholder meeting that occurs more than six months after enactment of the Act. At the first such meeting of the shareholders, the shareholders will vote on whether (1) to approve the current compensation of named executive officers and (2) future say-on-pay votes will be every one, two or three years. Institutional investors who are subject to Section 13(f) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are required to report annually how they voted in any say-on-pay vote, unless such vote is otherwise required to be recorded publicly under the SEC rules.

Compensation Committee Independence (Section 952)

The Act requires the SEC to adopt rules to direct the national stock exchanges to require the compensation committee of each listed company to consist entirely of independent directors. For purposes of determining independence, the exchanges must take into account relevant factors, including (1) the source of all compensation paid to a member of the committee, including any consulting, advisory or other compensatory fees, and (2) whether the committee member is affiliated with the company.

The independence requirements for committees do not apply to (1) certain “controlled companies”, (2) limited partnerships, (3) companies in bankruptcy, (4) open-ended registered management investment companies, and (5) foreign private companies that disclose to shareholders annually why they do not have an independent compensation committee. The SEC is required to adopt these rules no later than 360 days after enactment of the Act.

Compensation Consultants and Other Advisors Independence (Section 952)

The Act also requires the SEC to adopt rules that would require that a company’s compensation committee have the authority to engage outside independent advisors, including compensation consultants, legal counsel or other advisors. The Act requires the SEC to identify factors to be considered in assessing the independence of the advisors, including other services performed by the advisor for the company, the fees paid to the advisor as a percentage of total revenue, the company’s procedures for selection of advisors, relationships

between the company and the advisor and any stock of the company owned by the advisor. The company’s proxy statement for any shareholder meeting occurring one year or more after the enactment of the Act must include disclosure of whether the committee retained a compensation consultant and whether any conflicts of interest may exist.

The rules relating to the use of independent advisors do not apply to certain “controlled companies”. The SEC is required to adopt these rules no later than 360 days after enactment of the Act.

Disclosure of Executive Compensation Compared to Performance and Median Employee Pay (Section 953)

The Act requires that the SEC adopt rules requiring additional disclosure in each company’s proxy statement. The company’s proxy statement must include a description of the relationship between the executive compensation actually paid and the financial performance of the company, taking into account any changes in the stock value and dividends paid. In addition, the company must disclose certain information on internal pay disparity, including (a) the median total compensation paid to all employees, excluding the company’s CEO, (b) the total compensation of the CEO, and (c) the ratio of the median employee total compensation to the CEO’s total compensation.

Clawback of Executive Officer Compensation (Section 954)

The Act requires the SEC to adopt rules to direct national stock exchanges to require listed companies to develop and implement policies that provide for (a) disclosure of the policy of the issuer on incentive-based compensation that is based on financial information required to be reported under the securities laws, and (b) the recovery of incentive compensation paid to all executive officers in the event of an accounting restatement required due to material noncompliance with financial reporting requirements. The clawback provision applies to current and former executive officers who received incentive compensation during the three-year period prior to the restatement in excess of what otherwise would have been paid to the executive officer under the restatement. Unlike current clawback provisions contained in the Sarbanes-Oxley Act of 2002

("Sarbanes-Oxley"), which only covers payments made to the company's CEO and CFO if noncompliance resulted from misconduct, the clawback provisions of the Act apply to all executive officers, regardless of whether any misconduct occurred.

Hedging Disclosure (Section 955)

The SEC is required to adopt rules requiring disclosure in a company's proxy statement as to whether directors or employees of the company are permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) to hedge against decreases in the market value of any equity security of the company held by or granted to a director or employee.

Proxy Access (Section 971)

The Act gives the SEC the authority to issue rules permitting shareholders to nominate directors within the company's proxy solicitation materials. While the Act does not require the SEC to take any action, the provisions give the SEC broad discretion to issue proxy access rules under such terms and conditions as it deems appropriate to ensure investor protection and the safeguard of shareholder interest. The SEC is permitted to exempt an issuer or class of issuers from this requirement and the Act directs the SEC to consider whether the requirement disproportionately burdens small issuers.

Enhanced Disclosure Regarding Chairman and CEO Structure (Section 972)

The SEC is required to adopt rules that would require companies to disclose in their annual proxy materials why the same person is serving as both the company's CEO and chairman of the board of directors. The SEC already requires similar disclosure relating to the board leadership structure pursuant to Item 407(h) of Regulation S-K. The SEC is required to adopt these rules no later than 180 days after enactment of the Act.

Restrictions on Broker Discretionary Voting (Section 957)

The Act requires national stock exchanges to adopt rules that prohibit broker discretionary voting with respect to the election of directors (other than in connection with uncontested elections), executive compensation or any other significant matter as determined by the SEC, unless brokers receive specific voting instructions from the beneficial owners of the securities. This provision follows the January 2010 amendment of the NYSE rules governing brokers that prohibited broker discretionary voting in all director elections.

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