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## Dodd-Frank Wall Street Reform and Consumer Protection Act Corporate Governance and Disclosure Provisions

The House of Representatives approved the Dodd-Frank Wall Street Reform and Consumer Protection Act on June 30. The Senate vote has been delayed until mid-July, with signing by President Obama expected thereafter. This Advisory describes the significant changes to corporate governance and executive compensation and disclosure applicable to publicly traded issuers, which are generally contained in Subtitle E—Accountability and Executive Compensation Sections 951-957 of [the bill](#). Of note is that the majority voting requirement, which would have required directors in uncontested elections to be approved by a majority of the votes cast, was dropped from the Senate version of the bill. Described below are some of the major corporate governance and executive compensation provisions of the bill and considerations for the 2011 proxy season.

### Corporate Governance

- **Say on Pay.** An issuer's first proxy statement or consent solicitation for a shareholder meeting occurring at least six months after enactment that includes compensation disclosure must include a separate non-binding shareholder vote on the compensation of executive officers. Such proxy statement must also include a proposal for a separate non-binding shareholder vote on whether the shareholders shall have a say on pay vote every one, two or three years. This requirement would be effective for the 2011 proxy season. The say on pay proposal must be presented to shareholders no less frequently than once every three years, and the separate resolution on the frequency of the say on pay resolution must be presented to shareholders at least once every six years. The SEC may adopt rules to exempt certain issuers and is required to consider disproportionate burdens on small issuers.
- **Shareholder Approval of Golden Parachutes.** Any proxy statement or consent solicitation for a shareholder meeting occurring six months after enactment relating to shareholder approval of an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all the assets of an issuer must include a separate non-binding shareholder vote on any golden parachute compensation. Under rules to be adopted by the SEC, the proxy statement shall clearly disclose any agreements with named executive officers concerning any type of compensation (present, deferred or contingent) that is related to the transaction subject to shareholder approval. Disclosure shall also include the aggregate total of all such compensation that may (and the conditions upon which it may) be paid to such executive officer. The SEC may adopt rules to exempt certain issuers and is required to consider disproportionate burdens on small issuers.

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- **Proxy Access.** The bill provides the SEC the explicit authority to adopt rules granting shareholders proxy access so that they can require their company to include the shareholder's director nominations in the company's proxy statement. This provision is meant to counter contentions to the effect that the SEC does not currently have the authority to mandate such access. The bill gives the SEC broad discretion to adopt implementing rules with no required ownership mandates for access rights.
  - **Compensation Clawbacks.** The SEC shall adopt rules directing the listing exchanges to prohibit the listing of companies that do not comply with rules to be adopted by the SEC requiring an issuer to implement policies and procedures (1) to disclose the policy for incentive-based compensation that is based on financial information required to be reported under the securities laws, and (2) to recover incentive-based compensation (including stock options awards) from any current or former executive in the event of an accounting restatement due to the material noncompliance with any financial reporting requirement under the securities laws. There will be a three-year look-back period from the date of the restatement for compensation paid. The amount of the clawback would be any excess paid to the executive over the amount that the executive would have been paid giving effect to the accounting restatement. Note that this provision is far broader than the Sarbanes-Oxley clawback provisions that apply only to the compensation of the chief executive and chief financial officers; only in the event of a restatement due to "material noncompliance of the issuer, as a result of misconduct..."; and provides for a 12-month look-back.
  - **Compensation Committee Independence.** The SEC must adopt rules directing stock exchanges to prohibit from listing any issuer that does not comply with additional independence requirements governing compensation committee members and consultants, legal counsel and other advisors to the compensation committee. The SEC rules will require that, for purposes of determining "independence," factors such as any consulting, advisory or other fees paid by the issuer to such director as well as the affiliations of the director with the issuer would need to be considered. The compensation committee would also be required to select compensation consultants, legal counsel or other advisors after determining the independence of such advisors under rules to be adopted by the SEC. The independence of such advisors would be based on factors including the other services provided to the issuer, the amount of fees received as a percentage of the total revenues of the advisor, policies of the advisor that are designed to prevent conflicts of interest, any business or personal relationships of the advisor with the compensation committee, and any equity ownership of the issuer by the advisor. In addition, the compensation committee must have sole discretion to retain a compensation consultant and independent legal and other advisors and will be directly responsible for the selection, compensation and oversight of such advisors. The SEC may permit the exchanges to exempt a category of issuers from these requirements and is required to consider the impact on smaller reporting issuers (issuers with less than \$75 million of public float).
  - **Broker Voting.** Listed exchanges are required to mandate that their member brokers are prohibited from voting shares held in street name with respect to director elections, executive compensation or "any other significant matter" as determined under SEC rules, unless the beneficial owner provides the broker with specific voting instructions. This provision codifies and expands the scope of New York Stock Exchange Rule 452, which the NYSE voluntarily enacted effective July 1, 2009.

## Additional Disclosure Requirements

- **Disclosure of Investor Votes on Executive Compensation and Golden Parachutes.** Every institutional investment manager required to file a Form 13F (beneficial ownership of \$100 million or more of exchange-traded shares) shall report at least annually how it voted with regard to say on pay and golden parachute compensation proposals described above.
- **Pay for Performance Disclosures.** The SEC is required to adopt rules requiring issuers to clearly disclose the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account the change in the value of the shares of stock, dividends and any distributions. The SEC rules will also require disclosure of (1) the median of the annual total compensation of all employees other than the CEO; (2) the annual total compensation of the CEO; and (3) the ratio of the median total compensation of all employees to the total compensation of the CEO. Total compensation is calculated as in the proxy statement summary compensation table.

- **Hedging.** Issuers are required to disclose in annual meeting proxy statements whether any director or employee (or their designee) is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities granted to employees or directors as compensation or otherwise directly or indirectly held.
- **Chairman and CEO Structures.** The SEC is to issue rules within 180 days of enactment requiring issuers to disclose why they have separated or combined the positions of CEO and chairman of the board. Under current SEC rules, issuers are now required to disclose their leadership structure and reasons for adopting such a structure.
- **Compensation Consultant and Conflict.** In any proxy solicitation materials for an annual meeting occurring one year after enactment, issuers would be required to disclose whether the compensation committee has retained a compensation consultant and whether the compensation consultant's services have raised any conflict of interest, and, if so, the nature of the conflict and how the conflict is being addressed.
- **Financial Institutions Executive Compensation.** Not later than nine months after enactment, federal regulators shall adopt regulations requiring "covered financial institutions" with assets greater than \$1 billion to disclose incentive compensation to their appropriate federal regulator. Disclosure is required of all incentive-based compensation arrangements in sufficient detail for the regulator to determine if the arrangement with the executive officer, employee, director or principal shareholder is excessive or could lead to a material financial loss. Within the same time frame, federal regulators are also required to prescribe regulations to prohibit any type of incentive-based compensation by "covered financial institutions" with assets greater than \$1 billion that is excessive or could lead to material financial loss. Covered financial institutions include depository institutions, depository institution holding companies, credit unions, registered broker-dealers and registered investment advisors, but are subject to the exemption if they have assets of less than \$1 billion.

## Other Corporate Compliance Matters

- **Auditor Attestation.** The bill provides a permanent exemption from the auditor attestation requirements of SOX 404(b) for smaller reporting companies.

## What to Consider Now

It has been reported that the bill will be approved by the Senate and signed into law by President Obama next week substantially in its current form. While many provisions require the SEC to implement rules that will be proposed and adopted over the course of 2010, we believe that these requirements will be effective for the 2011 proxy season if the bill is enacted as reported. Although issuers will not be able to finalize their plans to comply until the SEC finalizes the new rules, they can begin to assess and consider adjustments in their governance practices that will be required, including confirmation of compensation committee directors and consultant independence and formulation of clawback policies. Also, issuers who have not previously had a say on pay vote should begin to consider plans for managing shareholder relations and review their compensation disclosure in light of mandatory say on pay votes. Finally, we believe that the SEC will make exemptions available for smaller reporting companies where the bill directs the SEC to take issuer size into consideration.

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