Dodd-Frank Wall Street Reform and Consumer Protection Act
Executive Compensation and Corporate Governance Provisions

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. Although the Act is primarily designed to reform the U.S. financial system, it will also have a major impact on public companies in all industries. Many details remain uncertain, as the Act directs the SEC and the national securities exchanges and associations to issue numerous rules to implement the Act’s provisions, in most cases over the next year.

While the entire Act is approximately 2,300 pages in length, this alert summarizes only the corporate governance and executive compensation components of the legislation. There may be additional provisions that apply to your company, including enhanced whistleblower protections and mandated changes to Regulation FD as it relates to credit rating agencies.

Executive Compensation
Say on Pay and Golden Parachute Votes

Say on Pay
The Act directs the SEC to issue rules requiring public companies to hold a nonbinding shareholder vote on the compensation of executive officers at least once every three years. A company must include in its proxy statement a separate resolution for shareholder approval of the compensation of executive officers as disclosed in the proxy statement. Additionally, companies must include a separate shareholder resolution to determine whether the shareholder vote on executive compensation will occur every one, two or three years. A resolution to determine the frequency of the executive compensation resolution must be presented to the shareholders at least once every six years. Both votes must be held at the first shareholder meeting occurring after January 21, 2011.

Golden Parachutes
Under the Act, any proxy or consent solicitation materials for a shareholder meeting at which the shareholders are asked to approve an acquisition, merger, consolidation, sale, or other disposition of all or substantially all of the assets of the company must disclose, in accordance with SEC rules to be issued, any agreements or understandings that the company has with any executive officers concerning any type of compensation that is based on or otherwise related to the proposed transaction (i.e., golden parachute arrangements). In addition, the company must disclose the aggregate total of all such compensation that may be paid or become payable to the executive officers and the conditions upon which it may be paid. The company must also include a nonbinding shareholder resolution to approve such golden parachute arrangements, unless the agreements or understandings have already been subject to a shareholder say on pay vote as described above. This provision will apply to any shareholder meeting that occurs after January 21, 2011.
In issuing rules under this provision, the SEC is permitted to exempt an issuer or class of issuers from either the say on pay or golden parachute shareholder vote requirements. When drafting these rules, the SEC has been directed to consider whether the requirements are disproportionately burdensome to small issuers.

**Compensation Committee Rules**

The Act directs the SEC to issue rules requiring the national securities exchanges to de-list any issuer that fails to comply with the compensation committee rules described below. The SEC must adopt these rules by July 15, 2011, and the SEC rules may permit the national securities exchanges and associations to exempt a category of issuers from these requirements.

**Independence of Compensation Committee Members**

The SEC rules will require that all members of an issuer’s compensation committee be independent members of the board of directors. The rules will require that an issuer consider various factors in determining the independence of a member of the compensation committee, including: (1) whether the member was compensated by the company, including compensation for any consulting, advisory, or other compensatory fees, and (2) whether the member is affiliated with the issuer, subsidiary, or an affiliate of a subsidiary of the issuer. The SEC rules may exempt a particular relationship from the independence considerations.

**Compensation Committee Authority to Retain Compensation Consultants and Other Advisers**

Under the Act, the compensation committee has the authority to engage, compensate, and oversee compensation consultants, legal counsel, and other advisers and will be directly responsible for the appointment, compensation and oversight of such advisers. However, the committee is not required to act consistently with the advice or recommendations of the adviser. If the compensation committee employs a compensation consultant, the company must disclose in its proxy statement that it retained a compensation consultant and whether the work of the compensation consultant raised any conflict of interest. If the work of the consultant raised a conflict of interest, the company must also disclose the nature of the conflict and how the conflict is being addressed.

Companies are required under the Act to provide appropriate funding, as determined by the compensation committee, for reasonable compensation to compensation consultants, legal counsel, and other advisers engaged by the compensation committee.

**Independence of Compensation Consultants, Legal Counsel, and Other Advisers**

Under the Act, the compensation committee may engage compensation consultants, legal counsel, and other advisers only after considering the advisers’ independence. The Act directs the SEC to issue rules identifying independence factors that the compensation committee must consider when hiring an adviser, including other services provided to the company by the adviser’s employer; the amount of fees the adviser’s employer received from the company in relation to the total revenue of such employer; such employer’s policies and procedures designed to avoid conflicts of interest; any business or personal relationship between the adviser and a member of the compensation committee; and any stock of the company owned by the adviser.

**Executive Compensation Disclosures**

The Act directs the SEC to issue rules requiring public companies to provide certain additional executive compensation disclosure, but the Act does not set a deadline for issuance of the rules related to this disclosure.

**Pay Versus Performance Disclosure**

Under the Act, the SEC has been directed to require each issuer, in its proxy statement, to provide a clear description of the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends and any distributions. The company may use a graphic representation to disclose this information.

**Pay Equity Disclosure**

Under the Act, the SEC has also been directed to require each issuer to also disclose the median annual total compensation of all employees excluding the CEO, the annual total compensation of the CEO, and the ratio of the median annual total non-CEO compensation to the annual total CEO compensation. The median annual total compensation of all employees must be calculated in the same manner that the total compensation is calculated for
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the CEO in the summary compensation table of an issuer’s proxy statement. Presumably, the SEC will address in its rules which employees (e.g., subsidiary employees, part-time v. full-time, foreign, etc.) must be included in the calculation. Regardless of which employees must be included, we anticipate that many companies will have difficulties in adapting their systems to calculate compensation in this manner for all employees.

The location of this disclosure is unclear. As currently drafted, the Act would require the disclosure in a very wide range of filings, including registration statements under the Securities Act of 1933 and annual, quarterly and current reports under the Securities Exchange Act of 1934. We believe it is likely that the drafters intended to require the disclosure only in registration statements, proxy statements and other reports in which executive compensation disclosure is otherwise required, but we will have to await any technical corrections or rulemaking that may correct or address this matter.

Mandatory Claw Back
The Act directs the SEC to issue rules requiring public companies to develop and implement a policy that requires: (a) the disclosure of the issuer’s policy on incentive-based compensation that is based on financial information required to be reported under securities laws, and (b) that, in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, the issuer will recover from any current and former executive officer who received incentive-based compensation based on financial information (including stock options awarded as compensation) during the three-year period preceding the date on which the issuer is required to prepare the restatement. Notably, the Act does not require any misconduct on the part of the officer to initiate the claw back provision.

The SEC must direct the national securities exchanges to prohibit the listing of any issuer that fails to abide by the claw back provisions, but the Act does not set a deadline for issuance of the rules.

Director and Employee Hedging
The Act directs the SEC to issue rules requiring each public company to disclose in its proxy statement whether any employee or member of the board of directors, or any designee of an employee or director, is permitted to purchase financial instruments that are designed to hedge or offset decreases in the market value of equity securities. This disclosure includes not only equity securities granted to employees or directors as part of their compensation, but also those equity securities directly or indirectly held by employees or directors. The Act does not set a deadline for issuance of these rules.

Corporate Governance
Proxy Access
The Act authorizes, but does not require, the SEC to issue rules requiring public companies to include shareholder nominations for the board of directors in the company’s annual proxy materials. The SEC may exempt a company or class of companies from this requirement, and when determining whether to make an exemption, the SEC must consider whether the requirements are overly burdensome for small issuers. The SEC has proposed rules on proxy access that remain pending, and it seems likely that the SEC will adopt some version of proxy access very soon.

Chairman and CEO Disclosure
The Act also directs the SEC to issue rules requiring an issuer to disclose in its annual proxy statement whether it has chosen the same individual to serve as chairman and CEO, or different individuals, and the reasons why the company has chosen its structure. Although the Act requires the SEC to issue a rule implementing this provision within 180 days of enactment, the SEC already substantially requires this disclosure under Item 407(h) of Regulation S-K.

Broker Discretionary Voting
The Act requires the national securities exchanges to prohibit brokers from voting securities that they do not beneficially own for the election of directors, executive compensation, or any other significant matter, as determined under the SEC rules, unless the beneficial owner has instructed the broker how to vote on that matter. While NYSE Rule 452 currently prohibits broker discretionary voting on director elections, shareholder proposals, and equity-based compensation plans, the Act seemingly expands the rules to prohibit broker discretionary voting on management say on pay proposals.
Auditor Attestation for Non-Accelerated Filers

The Act amends section 404(b) of the Sarbanes-Oxley Act to permanently exempt from the auditor attestation requirements any issuer that is neither a "large accelerated filer" nor an "accelerated filer" as defined in Rule 12b-2 of the Exchange Act, effectively exempting non-accelerated filers and smaller reporting companies from these requirements.

Conclusion

The Act’s executive compensation and corporate governance provisions will have a significant impact on public companies and will require heightened disclosures in the 2011 proxy season. The SEC and national securities exchanges and associations will be issuing rules to effect the Act’s provisions over the next year, and we will continue to monitor the ongoing developments. Please do not hesitate to contact us if you have any questions regarding the new executive compensation and corporate governance requirements or your compliance program.

(Contributions to this update have also been made by our Summer Associates Kristin Boyle and Laura Hawkins.)