

# Dodd-Frank Corporate Governance



# The Dodd-Frank Wall Street Reform and Consumer Protection Act: Executive Compensation and Corporate Governance Reforms, SEC Disclosure and Proxy Access Implications for Corporate Counsel

Presented by:  
Frederick D. Lipman  
Jane K. Storero

# Highlights of the Dodd-Frank Act Corporate Governance Provisions

- The Dodd-Frank Act (the “Act”) contains (with exceptions) mandates new requirements, executive compensation, corporate governance and disclosure for all listed public companies, such as:
  - “Say-on-pay”, say on golden parachutes, and say “when” on pay
  - Compensation committee independence and use of consultants
  - Enhanced executive compensation disclosures, including pay vs. performance, CEO median pay ratio and hedging
  - Clawbacks
  - Disclosures concerning dual CEO/Chair roles
  - Discretionary broker voting and proxy access
  - Whistleblower benefits

# Application of the Corporate Governance Provisions of the Act

- Applies generally to issuers with an equity security listed on a national securities exchange or a national securities association.
- Also applies, in certain cases, to unlisted companies which are subject to the SEC proxy rules contained in Section 14 of the Securities Exchange Act of 1934.
- The term “listed companies”, in this presentation, generally refers to both categories.

# Today's Discussion

- **Dodd-Frank Act Corporate Governance Reforms**
  - Say on Pay Proposals
  - Elimination of Discretionary Voting by Brokers and Proxy Access Update
  - Additional Executive Compensation Disclosures
  - Claw Back Provisions
  - Enhanced Whistle Blower Provisions
- Action Items for Public Companies

# “Say-on-Pay” and Say “When” on Pay Proposals

(Title IX, Subtitle E, Section 951)

- A proxy or consent or authorization for an annual or other meeting of the shareholders for which compensation disclosure is required by the SEC’s proxy rules must include a separate, non-binding shareholder vote on executive compensation.
- The resolution must be included in a proxy or consent or authorization at least once every 3 years.

# “Say-on-Pay” and Say “When” on Pay Proposals

(Title IX, Subtitle E, Section 951)

- At least once every 6 years, companies must provide shareholders with a say on pay “frequency” vote on how often they want to vote on executive compensation:
  - *to determine whether vote on executive compensation required will occur every 1, 2 or 3 years*

**Effective Date:** Applies to votes that take place 6 months after July 21, will be in effect for most public companies for 2011; for the first year, there will be both a say on pay and frequency vote

# “Say-on-Pay” and Say “When” on Pay Proposals

## (Title IX, Subtitle E, Section 951)

- Say on Pay Requirements
- Required shareholder votes are not intended to be binding on the issuer or the issuer’s board of directors
- Shareholder votes are not to be construed to:
  - overrule the issuer or board
  - create or imply a change to board fiduciary duties
  - create or imply any additional fiduciary duties
  - restrict or limit shareholder ability to make proposals related to executive compensation
- Institutional investment managers must annually disclose to their shareholders how they voted on these proposals



# “Say-on” Golden Parachutes

(Title IX, Subtitle E, Section 951)

- Say on golden parachute pay applies to any proxy or consent solicitation at which shareholders are asked to approve
  - an acquisition, merger, consolidation or proposed sale
  - other disposition of all or substantially all of the assets of an issuer
- The person making the solicitation shall disclose
  - any agreements or understandings that such person has with any named executive officer concerning any type of compensation that is based on or relates to the subject transaction
  - the aggregate total of all compensation that may (and the conditions upon which it may) be paid or payable to or on behalf of such executive officer
  - the conditions upon which such compensation is payable

# “Say-on” Golden Parachutes

(Title IX, Subtitle E, Section 951)

- Exception – if previously approved in say on pay vote
- Companies incorporating the golden parachute vote in the say on pay vote may still be required to hold a separate vote where:
  - Material details previously disclosed and voted on have changed, or
  - The golden parachute compensation is to be paid to NEOs of buyer

# Say on Pay – Action Items

- **Address any lingering concerns about the executive compensation program**
  - Have investors or Board of Directors identified any problematic pay practice?
- Examine trends in incumbent CEO's year-over-year pay when 1- and 3-year total shareholder returns are less than peer group median
  - Is long-term CEO being rewarded despite lagging shareholder returns?
  - Is compensation sufficiently performance based?
  - Many ways to evaluate performance – Total Shareholder Return as a key indicator

# Say on Pay – Action Items

- Avoid excessive (non-performance based) and risk-incentivizing pay practices
  - Excessive tax gross ups (including excise tax gross up)
  - Guaranteed bonuses
  - Single performance metric for incentive program
- Also consider longer-term alignment between pay and shareholder returns
- Review current executive compensation disclosure to see whether it can be improved
  - Consider simplifying the Compensation Discussion and Analysis
  - The more transparency the better
  - Presentation and content are critical

# Say on Pay – Action Items (Continued)

- Become familiar with executive compensation policies of key shareholders and proxy advisory firms to identify “red flags” that may influence a “no” vote
  - Determine whether to “reach out” to these shareholders to address their possible concerns or make changes to program to avoid a negative vote recommendation from ISS
- Analyze shareholder base to determine whether the absence of broker voting will have any impact on vote
  - If so, determine how to ensure an adequate vote
  - Consider a proxy solicitor
- In formulating a Say When on Pay recommendation, consider the relationship with shareholders and future shareholder votes on compensation-related matters

# Say on Golden Parachutes – Action Items

- While vote is situational, companies should consider the following items when preparing for the “Say on Pay” vote for their overall executive compensation program
  - Make sure all change-in-control arrangements are identified – the definition of what’s covered as set forth in the Act is fairly broad
  - Consider enhancing disclosure of existing change-in-control arrangements in the proxy statement for the annual shareholders meeting (including a clear explanation of the rationale for the arrangement) so that there is no question that they are covered by the exception to the vote
  - Consider whether to expand disclosure in the annual proxy statement to cover all executive officers – the disclosure and advisory vote only cover named executive officers, but it’s unclear whether NEOs is based on last year’s or the current year’s determinations

# Elimination of Discretionary Voting by Brokers

(Title IX, Subtitle E, Section 957)

- National securities exchanges must prohibit brokers from voting any security for which they do not receive instructions from the beneficial owner in connection with:
  - the election of directors
  - executive compensation (i.e., “say on pay” votes)
  - “other significant matters” as determined by SEC Rule
- Exchanges may prohibit discretionary broker votes on other items not otherwise designated in the Act

# Elimination of Discretionary Voting By Brokers – Action Items

- Review quorum requirements for shareholders' meeting
- Determine vote required for specific proposals
- Allow extra time between meeting and mail dates, if possible
- Consider the retention of a proxy solicitor
- Be familiar with the company's shareholder base and voting policies



# Proxy Access

(Title IX, Subtitle G, Section 971)

- The Dodd-Frank Act authorizes the SEC to require by rule that:
  - a solicitation of proxy, consent or authorization is to include a nominee submitted by a shareholder
  - an issuer follow a certain procedure with respect to solicitations
- New Access Requirements:
  - 3% ownership threshold
  - 3 year continuous holding period
  - 1 or 25% of the board
  - Shareholder with the greatest ownership gets to include nominees
- **Effective Date:** NOT Applicable for 2011 proxy season. . . Final SEC Rules adopted August 25, 2010 delayed due to legal challenge

# Compensation Committee Independence

## (Title IX, Subtitle E, Section 952)

- Requires new stock exchange listing standards that require each member of a compensation committee to be independent
- SEC rules will require, in determining “independence”, consideration of the source of compensation of board members, including consulting, advisory, or other compensatory fees, and whether the board member is an affiliate.
- NYSE and NASDAQ currently have independence rules for the compensation committee, but new requirement is likely to be stricter
  - similar to the requirements currently in place for audit committee members pursuant to Sarbanes-Oxley
- **Effective Date:** Proposed Rules – December 2010; Final Rules – April – July 2011

# Compensation Committee Independence – Action Items

- While a comprehensive review will have to wait until the SEC and the exchanges complete their rulemaking, companies should consider the following items now:
  - Re-examine your compensation committee member relationships in light of the new standards
  - One item that could present problems for venture capital-backed companies is the prohibition on affiliates being independent
  - If you expect that you may not have enough independent committee members, consider increasing the size of the board of directors and recruiting new members

# Independence of Compensation Committee Consultants (Title IX, Subtitle E, Section 952)

- The independent Compensation Committee of a company may **only select** a compensation consultant, legal counsel, or other compensation advisor after taking into consideration factors identified by the SEC, such as:
  - The provision of other services to the company by the person that employs the advisor.
  - The amount of fees received from the company by the person that employs the advisor and the percentage of such fees to his or her total revenue.
  - The policies and procedures of the person that employs the advisor that are designed to prevent conflict of interests.
  - Any business or personal relationship of the advisor with a member of the compensation committee.
  - Any stock of the company owned by the advisor.
- **Effective Date:** Proposed Rules – December 2010; Final Rules – April – July 2011

# Independence of Compensation Committee Consultants

## (Title IX, Subtitle E, Section 952)

### Hiring Consultants

- Compensation committees
  - have sole discretion to retain or obtain the advice of a compensation consultant
  - are directly responsible for the appointment, compensation, and oversight of the work of a compensation consultant
- Compensation committees are not required to implement or act on the advice or recommendations of the compensation consultant
- Hiring a consultant does not affect ability or obligation of the committee to exercise its own judgment in the fulfillment of its duties
- The company must provide funding so the committee can pay reasonable compensation to a compensation consultant, independent legal counsel or any other advisor

# Executive Compensation Disclosures – Pay vs. Performance

(Title IX, Subtitle E, Section 953)

- SEC to issue rules requiring a clear description of any compensation required to be disclosed under the proxy rules, including relationship between:
  - Compensation actually paid; and
  - The financial performance of the issuer (total shareholder return).
  - Must take into account change in value of stock and dividends
- Definition of compensation appears to be different than in the Summary Compensation Table
- May include a graph
- **Effective Date:** No deadline specified for SEC rule; Proposed Rules - April – July 2011

# Executive Compensation Disclosures – Pay vs. Performance Action Items

- Several interpretive issues must be addressed:
  - How “compensation actually paid” is to be determined
  - How corporate financial performance is to be measured
  - Period for comparison
- Review past disclosures of incentive compensation arrangements and consider providing greater disclosure about compensation policies and alignment to financial performance
- Add an executive summary to Compensation Discussion and Analysis that addresses this relationship
- In the absence of SEC rules, consider presenting graphic disclosure showing the relationship between aggregate named executive officer compensation and corporate financial performance (for example, TSR) over an extended period of time (for example, five years)

# Executive Compensation Disclosures – Median Pay (Title IX, Subtitle E, Section 953)

- SEC to require disclosure regarding:
  - The **median of the annual total compensation** of all employees, except the CEO, of the company.
  - The **annual total compensation** of the CEO of the company.
  - The **ratio** of the median of the annual total compensation of all employees of the company to the annual total compensation of the CEO of the company.
- Total compensation is determined as in the Summary Compensation Table
- Requires clarification by the SEC in implementing regulations:
  - Several interpretive issues must be addressed
  - Issuers have many questions about how to determine median employee pay
- **Effective Date:** No deadline specified for SEC rule; Proposed Rules
  - April – July 2011



# Executive Compensation Disclosures – Median Pay

- Several interpretive issues must be addressed:
  - Specific filings to include this disclosure
  - How median employee total compensation is to be determined
  - Rule for determining total compensation



# Disclosures Regarding Chairman and CEO Structures

(Title IX, Subtitle G, Section 972)

- The SEC shall issue rules that require a company to disclose in the annual proxy statement sent to investors the reasons why the company has chosen:
  - The same person to serve as chairman of the board of directors and CEO; or
  - Different individuals to serve as chairman of the board of directors and CEO.
- Current SEC rule addressing this disclosure requirement

# Chairman and CEO Structure – Action Items

- Review structure currently utilized
- Re-evaluate combination of roles or provide additional support for continuing the combination of these two critical positions



# Clawbacks

(Title IX, Subtitle E, Section 954)

- Listed companies will be required to develop and implement a policy regarding clawbacks of incentive-based compensation paid based on inaccurate financial statements
  - **When:** Triggered by an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws
  - **What:** Applies to incentive-based compensation (including stock options) in “excess” of the amount that would have been received under the accounting restatement
  - **Who:** All current and former executive officers
  - **How Long:** For compensation paid during the three year period preceding the date the company is required to prepare the accounting restatement

# Clawbacks

(Title IX, Subtitle E, Section 954)

- Much broader than Sarbanes requirements:
  - three-year look back vs. one-year look back
  - accounting restatement vs. proof of misconduct
  - all current and former executive offices vs. CEO and CFO
- **Effective Date:** No deadline specified for SEC rule;  
Proposed Rules – April – July 2011

# Clawback Policies – Action Items

- While many of the details about this policy will require SEC rulemaking, companies should consider the following items now:
  - If a company does not currently have a compensation recovery policy, it should decide whether the scope of the mandated policy is sufficient – for example, the triggering events may be too narrow – this may involve going beyond the scope of the new provision
  - If a company already has a compensation recovery policy, it needs to compare its policy against the specifics of the mandated policy to see if any changes or modifications will be necessary
  - Also, should review current outstanding compensation arrangements, including incentive compensation plans, model agreements and employment agreements to determine whether any modifications are needed
  - Consider enhancing disclosure of compensation recovery policy, both in the Compensation Discussion and Analysis and in connection with the advisory vote on executive compensation – shareholders are likely to want to know how your policy stacks up against the mandated policy

# Benefits for Whistleblowers

(Title IX, Subtitle B, Section 922)

- SEC authority to pay whistleblowers who:
  - Provide “original” information; and
  - Such information leads to enforcement action where sanctions recovered exceed \$1.0 million.
- The SEC has discretion to pay whistleblower 10-30% of monetary sanctions collected.
- **Effective Date:** Proposed Rules – November 2010

# Whistleblower – Action Items

- Revise policy to include employees of the public company's subsidiaries and affiliates whose financial information is included in the company's consolidated financial statements.





# Preparing for the 2011 Proxy Season

- Flurry of SEC rule makings in the works.
  - New Say on Pay Proposals
  - No proxy access
  - New disclosure requirements
- Action items for public companies discussed.

