

Corporate Governance and Executive Compensation Provisions of the Financial Reform Act

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). The Act was passed largely in response to the 2008 financial crisis with the goals of restoring stability within the financial system, increasing corporate transparency and accountability to shareholders, and providing new consumer protections. Towards the goal of greater accountability, the Act imposes new corporate governance and executive compensation rules on public companies. This e-alert summarizes the key provisions applicable to those areas. Future e-alerts will address other areas of the Act.

Topic	Summary of the Act	Effective Date
<p>Say-on-Pay: Shareholder Advisory Vote on Executive Pay</p> <p>Section 951, adding new Section 14A to the Securities Exchange Act of 1934</p>	<p>Requires that reporting companies include in their annual proxy statement, at least every three years, a nonbinding say-on-pay vote with respect to the compensation of named executive officers.</p> <p>Shareholders have the right to vote at least once every six years on the frequency of the say-on-pay votes.</p>	<p>Proxy statement for the first annual meeting held on or after January 22, 2011 (six months after enactment) must provide for (1) an nonbinding say-on-pay vote, and (2) a vote on the frequency of subsequent say-on-pay votes (every one, two or three years).</p>
<p>Advisory Shareholder Vote on Golden Parachutes</p> <p>Section 951, adding new Section 14A to the Exchange Act</p>	<p>Requires a nonbinding shareholder vote on payments to named executive officers in connection with a change-of-control transaction of the company. The related proxy statement must contain clear and simple disclosure based on rules to be promulgated by the SEC. Does not apply to a golden parachute payment previously approved by shareholders under the say-on-pay voting provision.</p>	<p>Proxy statement related to a change of control that is subject to a shareholder vote held on or after January 22, 2011 (six months after enactment) must provide for such a vote.</p> <p>Note: No deadline is set for the SEC rules related to “clear and simple” disclosure and the effectiveness of the shareholder approval requirement does not appear dependant on those rules.</p>
<p>Potential Exemption from Advisory Shareholder Voting Requirements</p> <p>Section 951</p>	<p>Authorizes the SEC to exempt a company or class of companies from the advisory compensation votes, and specifically notes that the SEC can consider whether the advisory vote requirements will disproportionately burden smaller companies.</p>	<p>No deadline is specified.</p>

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<p>Compensation Committee Independence</p> <p>Section 952, adding new Section 10C to the Exchange Act</p>	<p>Requires the SEC to issue rules directing each national securities exchange to require the following:</p> <p>(a) each member of a listed company's compensation committee must be (i) a director and (ii) independent under a definition of independence to be established by the SEC; and</p> <p>(b) compensation committees must have authority to engage and oversee independent compensation consultants, legal counsel or other advisors. Additionally, the company must disclose in its annual proxy statement whether the compensation committee used a compensation consultant and whether that use raised any conflicts of interest and how the conflicts were addressed.</p>	<p>SEC rules must be issued no later than July 16, 2011 (360 days after enactment). The effective date of those rules is not yet clear.</p> <p>Disclosure regarding the use of a compensation consultant and whether that use raised any conflicts of interest must be included in a proxy statement for an annual meeting occurring on or after July 22, 2011 (one year after enactment).</p>
<p>Pay for Performance Disclosures</p> <p>Section 953(a), adding new Section 14(i) to the Exchange Act</p>	<p>Requires the SEC to adopt rules for disclosure in annual meeting proxy statements of executive compensation information showing the relationship between a company's financial performance (taking into account changes in the value of its stock price and payment of dividends) and the compensation paid to its executives. The disclosure may include a graphic representation of the relationship.</p>	<p>There is no specified deadline for the SEC to issue the required rules.</p>
<p>Compensation Ratio Disclosures</p> <p>Section 953(b)</p>	<p>The SEC must amend its compensation disclosure rules to require companies to disclose (1) the median annual total compensation for all employees (except the CEO), (2) the annual total compensation of the CEO, and (3) the ratio of the two.</p>	<p>No specified deadline for the SEC adopt the required amendments.</p>

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<p>Clawback Requirements</p> <p>Section 954, adding new Section 10D to the Exchange Act</p>	<p>Requires the SEC to issue rules directing each national securities exchange to require listed companies to develop a policy requiring:</p> <p>(a) disclosure of incentive-based compensation that is based on financial information; and</p> <p>(b) the company to recoup incentive compensation that was paid on the basis of erroneous data from any current or former executive officer during the three-year period preceding the restatement.</p> <p>Significantly, this compensation claw-back policy goes beyond the existing Sarbanes-Oxley provision in that it must apply to all instances when financial statements are restated not just when financial statements are restated due to misconduct, covers all executive officers rather than only the CEO and CFO, and has a three-year look back rather than one year.</p>	<p>No specified deadline for the SEC to adopt the required rules. Likely to be adopted before the 2011 proxy season.</p>
<p>Employee and Director Hedging</p> <p>Section 955, adding new Section 14(j) to the Exchange Act</p>	<p>Requires the SEC to issue rules requiring companies to disclose in their annual proxy statement whether their employees or directors (or their designees) may purchase financial instruments designed to hedge equity securities of the company that the employee or director holds.</p>	<p>No specified deadline for the SEC to adopt the required rules.</p>
<p>Financial Institutions and Excessive Compensation</p> <p>Section 956</p>	<p>Requires the SEC and federal banking regulators to issue rules applying enhanced reporting and regulation of incentive-based compensation structures to financial institutions. The rules must prohibit incentive compensation arrangements that encourage inappropriate risks by providing “excessive compensation, fees or benefits” to an insider or which could lead to material financial loss to the institution.</p>	<p>Rules must be issued no later than April 22, 2011 (nine months after enactment). The effectiveness of those rules is not yet clear.</p>

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<p>Broker Discretionary Voting</p> <p>Section 957, amending Section 6(a) of the Exchange Act</p>	<p>Each national securities exchange is required to adopt rules prohibiting brokers from voting uninstructed shares (e.g., discretionary voting) in connection with a shareholder vote on the election of directors, executive compensation or any other significant matter (as determined by the SEC).</p>	<p>July 22, 2010 (the date of enactment); however, there is no specified deadline for when the SEC or the exchanges must adopt the final rules. Note that effective January 1, 2010, new NYSE rules already prohibit brokers from voting uninstructed shares in director elections without explicit voting instructions.</p>
<p>Proxy Access</p> <p>Section 971, amended Section 14(a) of the Exchange Act</p>	<p>The SEC may, but is not required to, issue rules permitting shareholders to include their nominees for the board of directors in a company's proxy materials.</p>	<p>Not applicable. The provision is permissive so the SEC may or may not issue any rules</p>
<p>Board Leadership Structures</p> <p>Section 972, adding new Section 14B of the Exchange Act</p>	<p>Requires the SEC to issue rules that will require a company to explain in its annual proxy materials why it has either chosen to combine or separate its chairman and CEO positions.</p>	<p>SEC rules must be issued no later than January 17, 2011 (180 days after enactment). The effective date of those rules is not yet clear. Note that effective Feb 28, 2010, new rules issued by the SEC already require disclosure on this topic.</p>
<p>Sarbanes Oxley Section 404 Exemption for Smaller Reporting Companies</p> <p>Section 989G, amending Section 404 of the Sarbanes-Oxley Act of 2002</p>	<p>Since the Sarbanes-Oxley Act was adopted in 2002, the SEC has repeatedly delayed the application to companies that are not accelerated filers (generally, those with market caps of less than \$75 million) of the costly requirement in Section 404(b) for an audit of internal control over financial reporting. The Act creates a permanent exemption from the requirements of Section 404(b) for non-accelerated filers and directs the SEC to study the burden of complying with Section 404(b) for companies with a market capitalization of between \$75 million and \$250 million.</p>	<p>July 22, 2010 (the date of enactment).</p>

If you have any questions regarding these provisions, please contact John Henry (jhenry@millermartin.com | 423.785.8208), Beth Sims (bsims@millermartin.com | 615.744.8490) or any Member of [Miller & Martin's Financial Reform Act Task Force](#).