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Impact of Dodd-Frank on Corporate Governance & Executive Compensation

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") is the most sweeping act of regulatory reform of the financial sector since the Great Depression. Numerous provisions of the Act impact financial and public companies in myriad ways. This memorandum will summarize key provisions of the legislation which impact corporate governance policies and executive compensation requirements of listed companies and covered financial institutions.

Corporate Governance Provisions:

I. Proxy Access

Section 971 of the Act amends Section 14(a) of the 1934 Act to give the SEC the authority to require a listed company to (i) include in its solicitation of proxy, a director nominee submitted by a shareholder and (ii) follow a certain procedure regarding the solicitation. Section 971 authorizes the SEC to issue rules allowing shareholders to use proxy solicitation materials supplied by a company for the purpose of nominating individuals to serve on the board of directors.

II. Disclosures Regarding Chairman and CEO Structures

Section 972 of the Act amends Section 14B of the 1934 Act and requires the SEC to issue rules requiring a listed company to disclose in the annual proxy statement the reasons why the company has chosen (i) the same person to serve as chairman of the board of directors and chief executive officer, or (ii) different individuals to serve as chairman of the board and chief executive officer. This provision does not require that separate individuals serve as chairman and CEO, but rather requires disclosure of the reasons for leadership structure. The Act requires the SEC to issue such rules within 180 days of enactment.

III. Risk Committees

Section 165 of the Act directs the Board of Governors to require publicly traded bank holding companies with assets of more than $10 billion and non-bank financial companies supervised by the Board of Governors to establish a risk committee. Such risk committees would be required to: (i) oversee the enterprise-wide risk management practices of the bank holding company or non-bank financial company supervised by the Board of Governors; (ii) include a number of independent directors determined by the Board of Governors, based on the nature of operations, size of assets and other criteria; and (iii) include at least one risk management expert with experience in identifying, evaluating and managing risk exposure of large, complex firms.

Executive Compensation Provisions:

I. Shareholder Vote on Executive Compensation Disclosures

Section 951 of the Act amends the 1934 Act by inserting Section 14A requiring every public company to hold a shareholder advisory vote to approve the compensation of executives as disclosed pursuant to the executive compensation requirements of Section 229.402 of title 17. The issuer must provide shareholders with a non-binding vote to approve the compensation of executives at least once every 3 years starting with any annual meeting, or other shareholder meeting, beginning 6-months after the Act's enactment. The issuer must also provide a separate non-binding vote at least once every 6 years to determine whether the non-binding executive compensation vote should be held every 1, 2, or 3 years, beginning with any annual meeting, or other shareholder meeting, beginning 6-months after the Act's enactment. Finally, the issuer must provide shareholders with a non-binding vote to approve golden parachute payments made to executives if shareholders are presented with a vote to approve a merger transaction.

II. Compensation Committee Independence

Section 952 of the Act adds Section 10(C) to the Exchange Act, requiring the SEC to direct the securities exchanges to prohibit the listing of any security of an issuer that does not comply with the compensation committee independence requirements. The Act also requires that the SEC rules permit a securities exchange to exempt certain types of companies based on the size of the issuer and any other relevant factors. The Act provides that the SEC must make such rules no later than one year after the Act's enactment.

(a) Independence of Compensation Committees

Section 10(C)(a) requires that each member of a board's compensation committee be independent according to a definition of independence determined by the exchanges. This definition of independence must take into account (i) the sources of compensation paid to members of the compensation committee (including any consulting or advisory fee) and (ii) whether the members are affiliates with the company or any subsidiary or affiliate of the company.

(b) Independence of Compensation Consultants and Other Compensation Committee Advisors

Section 10(C)(b) provides that a compensation committee may only select a compensation consultant, legal counsel or other advisor after considering the following factors: (1) the provision of other services to the issuer by the person that employs the consultant; (2) the amount of fees received from the issuer by the person that employs the compensation consultant, as a percentage of the total revenue of the person that employs the compensation consultant; (3) the policies of the person that employs the consultant which are designed to prevent conflicts of interest; (4) any business or personal relationship of the compensation consultant with a member of the compensation committee; and (5) any stock of the issuer owned by the compensation consultant.

(c) Compensation Committee is Authorized to Retain a Compensation Consultant

Section 10(C)(c) provides that the compensation committee of an issuer shall be directly responsible for the appointment, compensation and oversight of the work of a compensation consultant. This provision does not require the compensation committee to implement or act consistently with the advice of the consultant, and the compensation committee must exercise its own judgment in the fulfillment of its duties. According to the Act, in any proxy or consent solicitation material for an annual meeting of shareholders, a company must disclose whether (i) the compensation committee retained a compensation consultant; and (ii) whether the work of the compensation consultant has raised any conflict of interest, and if so, how the conflict is being addressed.

(d) Authority to Engage Independent Legal Counsel

Section 10(C)(d) also authorizes the compensation committee to retain independent legal counsel and other advisors once the committee has considered the independence factors under 10(C)(b)(2). Similar to the requirements for obtaining a compensation consultant, the compensation committee would be responsible for the appointment, compensation and oversight of independent legal counsel but would not be obligated to implement the advisor's recommendations.

(e) Compensation of Compensation Consultants, Independent Legal Counsel & Other Advisors

Pursuant to Section 10(C)(e) of the Act, the company must provide for appropriate funding, as determined by the compensation committee for payment to (i) a compensation consultant and (ii) independent legal counsel or any other advisor to the compensation committee.

III. Executive Compensation Disclosures

Section 953 of the Act amends Section 14 of the 1934 Act by requiring the SEC to issue rules requiring each listed company to disclose in its proxy statement for annual shareholder meetings a clear description of any compensation that must be disclosed under Item 402 of Regulation S-K. The disclosure must include information regarding the relationship between executive compensation actually paid and the financial performance of the company, taking into account any change in the value of the stock and dividends of the company and any distributions. The Act would require the SEC to amend Item 402 of Regulation S-K to require each listed company to disclose: (i) the median annual total compensation of all employees of the company, except the CEO; (ii) the annual total compensation of the CEO; and the ratio of these amounts.

Section 955 of the Act would amend Section 14 of the 1934 Act to require the SEC to issue rules requiring each listed company to disclose in its annual proxy statement whether any employee or director, or any designee, is permitted to purchase financial instruments designed to hedge or offset any decrease in the market value of equity securities (i) granted to the employee or director as part of their compensation, or (ii) other securities held by the employee or director. Such instruments would include prepaid variable forward contracts, equity swaps, collars and exchange funds.

IV. Recovery of Erroneously Awarded Compensation Policy

Section 954 adds Section 10C of the 1934 Act requiring the SEC to issue rules directing national exchanges to prohibit the listing of any company that does not implement policies to recover compensation from executive officers under particular circumstances. Listed companies must develop policies providing (i) for disclosure of the company's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws, and (ii) that, if the company must prepare an accounting restatement because of material noncompliance with any financial reporting requirement, the company will recover from any current or former executive officer who received incentive-based compensation during the three-year period preceding the accounting restatement, based on erroneous data, compensation in excess of what would have been paid under the accounting restatement.

V. Enhanced Compensation Structure Reporting

Section 956 of the Act requires the prudential regulators to jointly promulgate regulations prohibiting as an unsafe and unsound practice any compensation plan of a covered financial institution that (i) provides an executive officer or director with excessive compensation, fees or benefits or (ii) could lead to material financial loss to the covered financial institution. This provision does not apply to covered financial institutions with less than $1 billion in assets

VI. Voting by Brokers

Section 957 of the Act would amend Section 6(b) of the 1934 Act to prohibit any member that is not the beneficial owner of an issuer's shares registered under Section 12 from granting a proxy to vote the shares in connection with a shareholder vote on certain proposals, unless the beneficial owner has given the member voting instructions. This provision applies to shareholder votes with respect to (i) election of directors, (ii) executive compensation or any other significant matter as determined by the SEC.