JONES WALKER

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SUMMARY OF EXECUTIVE COMPENSATION AND CORPORATE GOVERNANCE PROVISIONS OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") into law. Although the primary purpose of this legislation was to overhaul the financial industry, the Act contains a broad array of provisions affecting companies subject to regulation by the Securities & Exchange Commission (the "SEC"). Some of the most notable provisions include a mandatory say-on-pay vote, the imposition of new independence rules on compensation committees and their advisers, and an explicit delegation to the SEC of authority to implement rules governing shareholder access to an issuer's proxy statement. This E*Bulletin briefly discusses some of the more significant corporate governance and executive compensation provisions of the Act applicable to companies subject to SEC regulation. For a copy of the full Act, click here.

Say-on-Pay Vote. The Act requires each public company to include a say-on-pay resolution for a non-binding vote by shareholders in its proxy statement every one, two, or three years. The vote would seek shareholder approval of executive compensation as disclosed in both the compensation tables and accompanying narrative description of the executive compensation program (the "Compensation Discussion and Analysis"), and is applicable to any proxy statement containing such disclosure. Shareholders would be asked to vote at least every six years to select the frequency of the say-on-pay vote.

A company may also be required to hold a say-on-pay vote on certain executive compensation arrangements if it is seeking shareholder approval of a corporate transaction such as an acquisition, merger, consolidation, or sale of assets. As discussed in greater detail below, in any proxy statement soliciting shareholder approval of such a transaction, the company will now be required to make certain disclosures regarding compensatory agreements and understandings with the company's named executive officers if those are based on, or relate to, the transaction for which shareholder approval is sought. In addition, if those agreements and understandings were not previously subject to the periodic say-on-pay vote described above, the proxy statement must also contain a non-binding say-on-pay vote for those agreements and understandings.

The Act expressly provides that these say-on-pay votes are not binding on the company and its board of directors. A say-on-pay vote may not be construed as overruling a decision by the company or its board, or as creating or implying any changes in the fiduciary duties of the company or its board. The enactment of these mandatory say-on-pay proposals does not restrict shareholders from making other executive compensation proposals for inclusion in the company's proxy materials.

Say-on-pay is effective for meetings occurring on or after January 21, 2011. In its first proxy statement to which this provision applies, the company is required to include both the frequency and the say-on-pay proposals. Although the

statute by its terms applies to all companies with securities registered under the Securities Exchange Act of 1934 (the "Exchange Act"), the SEC is explicitly authorized to create exemptions, such as for small issuers.

New Disclosure Requirements. The Act contains a variety of new disclosure requirements, some of which are largely duplicative of current SEC disclosure requirements. Each will require SEC rulemaking, and some will also require rulemaking by the stock exchanges.

> *Merger Proxies— Golden Parachutes*. Any proxy statement for a shareholder meeting occurring on or after January 21, 2011, at which shareholders are asked to approve an acquisition, merger, consolidation, or sale of assets must disclose any agreements or understandings with the named executive officers of the issuer (or of the acquiring issuer) concerning any type of compensation that is based on or relates to the transaction, as well as the aggregate total of all such compensation that may be paid or become payable to those officers. The SEC will need to issue rules implementing this disclosure requirement and may create exemptions, such as for small issuers.
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> If these "golden parachute" agreements or understandings have not been subject previously to a periodic say-on-pay vote, the proxy solicitation for shareholder approval of the transaction must also include a specific non-binding say-on-pay vote on those agreements or understandings.
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> *Section 13(f) Reporting Companies*. Institutional investment managers subject to Section 13(f) of the Exchange Act will have to report at least annually on how they voted on these say-on-pay votes. Although this provision is effective upon enactment, SEC rulemaking will be required to detail the form and timing of the disclosure.
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> *Compensation Consultants*. An issuer must disclose in its annual meeting proxy statement whether its compensation committee retained or obtained advice of a compensation consultant, whether the consultant's work raised any conflict of interest, and, if any conflict was raised, how that conflict is being addressed. Although this provision will require rulemaking by both the SEC and the stock exchanges, this provision is effective for the issuer's first annual meeting occurring on or after July 21, 2011.
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> *Pay-for-Performance*. Public companies will now have to disclose information showing the relationship between executive compensation actually paid and the company's financial performance, as determined by change in stock value and dividends and distributions. This disclosure must be included in the annual meeting proxy statements and may be presented graphically. SEC rulemaking will be required to determine the method and coverage of this new requirement.
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> *CEO Pay Ratio*. The SEC is directed to require each public company to disclose in its SEC filings:
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> - the median of the annual total compensation of all employees except the company's chief executive officer,
> - the chief executive officer's annual total compensation, and
> - the ratio of the median annual compensation of all employees to the total annual compensation of the CEO.
>
> In this context, total annual compensation is calculated based on the SEC's proxy disclosure rules for determining total compensation for an executive officer.

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Hedging Policy. A public company will be required to disclose in its annual meeting proxy statement whether any of its employees or directors (or a designee) is permitted to engage in hedging transactions with respect to equity securities granted to the employee or director as compensation or that the employee or director holds, directly or indirectly. This provision will require SEC rulemaking, especially given that the text of the statute does not limit equity securities to those issued by the company or its affiliates.

Chairman and CEO. The SEC is required to issue rules within 180 days of enactment requiring an issuer to disclose in its annual meeting proxy statement why the issuer has chosen either the same person or different persons to serve as chairman and CEO. This provision duplicates recent proxy rule changes by the SEC that require narrative disclosure of the company's board leadership structure.

Clawback Requirement. Exchange-traded issuers will be required to develop, implement, and disclose a clawback policy with regard to incentive-based compensation. At a minimum, the policy must provide that if the issuer is required to make an accounting restatement due to material noncompliance with any financial reporting requirement, the issuer will recover from any current or former executive officer who received incentive-based compensation during the three years prior to the restatement date the excess of what he or she would have received under the accounting restatement.

This clawback differs from the Sarbanes-Oxley clawback provision in that it is not limited to restatements due to misconduct, it covers a more expansive period (three years prior to restatement rather than 12 months following the first erroneous filing), and it covers all current and former executive officers (rather than just the issuer's chief executive and financial officers). The implementation of this provision will require SEC and exchange rulemaking.

New Compensation Disclosures and Prohibitions Specific to Covered Financial Institutions. The Act requires that certain federal regulators (the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the SEC, and the Federal Housing Finance Agency) issue joint regulations or guidance on incentive-based compensation arrangements applicable to banks, bank holding companies, registered broker-dealers, credit unions, investment advisers, and Fannie Mae and Freddie Mac ("covered financial institutions"). The Act provides an exemption from these requirements for covered financial institutions with less than $1 billion in assets.

Specifically, these regulators must require covered financial institutions to disclose to their regulator all of their incentive-based compensation arrangements. In addition, the regulators will jointly issue regulations or guidelines to prohibit incentive-based payment arrangements they determine either encourage inappropriate risks by providing an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits; or could lead to material financial loss to the covered financial institution.

On June 21, 2010, all but three of these regulators issued joint final guidance on incentive compensation for financial institutions ("Guidance on Sound Incentive Compensation Policies"). Under the Act's new statutory provision, the expanded group of federal regulators (including the National Credit Union Administration Board, the SEC, and the Federal Housing Finance Agency) is to issue joint guidance within nine months of enactment (by April 20, 2011).

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Although it is unclear whether the recently-issued guidance will be supplemented or replaced by the guidance mandated by the Act, the current regulatory guidance remains in effect for financial institutions.

Independence of Compensation Committees. The exchanges will require that listed companies have compensation committees composed entirely of "independent" directors. In defining "independence," the exchanges must consider relevant factors including the source of a director's compensation and whether the director is affiliated with the issuer, a subsidiary, or an affiliate of a subsidiary of the issuer. These factors are similar to those required by Sarbanes-Oxley for independent audit committee members, although these criteria are presented as factors to be considered rather than as requirements.

The Act exempts certain types of listed companies from this independence requirement (e.g., controlled companies, limited partnerships, companies in bankruptcy), while directing the SEC to permit the exchanges to make other appropriate exemptions, including exemptions based on size. This provision will require both SEC and exchange rulemaking, and the SEC is expected to provide an appropriate cure period for exchange-traded issuers not currently in compliance.

Independence of Compensation Committee Advisers. Prior to selecting compensation consultants, legal counsel, or other advisers (collectively referred to below as "advisers"), an issuer's compensation committee must take certain factors into consideration that, as identified by the SEC, could affect the independence of those advisers. At a minimum, these factors must include: (1) the provision of other services to the issuer by the adviser's employer, (2) the amount of fees received by the adviser's employer (as a percentage of total revenue of the adviser's employer), (3) the policies and procedures of the adviser's employer intended to prevent conflicts of interest, (4) any relationship (business or personal) between an individual compensation committee member and the adviser, and (5) any stock of the issuer owned by the adviser. Under this new provision, a compensation committee has sole discretion to retain these types of advisers, and is directly responsible for their appointment, compensation, and oversight. The issuer must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to these committee advisers.

Unlike the provision regarding independence of compensation committees themselves, this provision contains only one statutory exemption, for controlled companies (greater than 50% threshold); however, the exchanges are permitted to make other appropriate exemptions, including exemptions based on size. In addition, this provision refers more broadly to "issuers," rather than exchange-traded issuers—therefore, SEC rulemaking will be needed to clarify whether this provision will apply to companies whose securities are not traded on the exchanges.

Similar to the provision regarding compensation committee independence, this provision will be enforced by the exchanges—the SEC is to direct exchanges to prohibit listing of issuers who do not comply, and there will be an opportunity to cure defects before de-listing.

Broker vs. Beneficial Owner Voting. The Act places limitations on discretionary voting by banks, brokers, and other nominees ("brokers") who hold exchange-traded securities for the benefit of an underlying beneficial owner. This provision of the Act amends the Exchange Act to require that national stock exchanges prohibit their member brokers

from voting in director elections (except registered investment companies) and on executive compensation or "any other significant matter" as determined by the SEC.

NYSE rules already classify certain matters on which shareholders are asked to vote as "non-routine," with the effect that brokers are currently prohibited from casting a discretionary vote in director elections and on such matters as merger transactions and equity compensation plans. The real impact of this provision will be felt in its application to the newly-enacted say-on-pay vote requirement and in the SEC's ability to eliminate discretionary voting in other categories by designating those matters as "significant."

Proxy Access. The Act expressly authorizes the SEC to adopt rules and regulations that require proxy solicitations by an issuer to include shareholder nominees for director and to establish procedures for such a solicitation. The SEC may issue rules allowing shareholder access to the issuer's proxy solicitation materials for this purpose, and is permitted to exempt an issuer or class of issuers from this requirement.

—*Margaret F. Murphy* and *Hope M. Spencer*

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, contact:

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