PUBLICATION

Dodd-Frank Wall Street Reform And Consumer Protection Act, Part 5

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On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). The Act contains several provisions that will affect compensation practices and disclosure of public companies. A summary of the key provisions of the Act relating to compensation practices and disclosure is below.

Compensation Practices

Nonbinding Shareholders' Vote on Compensation. The Act amends the Securities Exchange Act of 1934 (Exchange Act) by adding Section 14A. Section 14A requires that a non-binding shareholder vote on executive compensation is included in a proxy statement at least every three years. At least once every six years, such proxy statement must include a separate resolution allowing a shareholder vote to determine whether the say-on-pay votes will occur every one, two or three years. An issuer must include both resolutions in the proxy statement for the first shareholder meeting held more than six months after the date of enactment of the Act. Thus, the provision will go into effect for meetings held during the 2011 proxy season.

Section 14A also requires any proxy solicitation material for a shareholder meeting occurring more than six months after enactment of the Act at which shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all the assets of a company to disclose any agreements or understandings with any named executive officer concerning any type of compensation that is based on, or otherwise relates to, the transaction and the aggregate total of all such compensation that may (and the conditions upon which it may) be paid or become payable to, or on behalf of, such executive officer. The Act also requires any proxy relating to the foregoing to include a separate resolution allowing for a non-binding shareholder vote to approve such agreements or understandings and compensation as disclosed, unless they have been subject to a say-on-pay vote as discussed above.

The shareholder votes discussed above will not bind the issuer or the board and do not override any decision by the issuer or the board.

Adoption of Clawback Policies. The Act adds Section 10D to the Exchange Act which requires that the national securities exchanges must adopt listing rules that address clawback policies. Each issuer listed on a national securities exchange will be required to develop and implement a policy (i) providing for disclosure of the issuers policies on incentive-based compensation that is based on financial information required to be reported under securities laws; and (ii) that, in the event 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 or former executive officer of the issuer who received incentive-based compensation (including stock options awarded as compensation) during the three-year period preceding the restatement based on the erroneous data, the amount in excess of what would have been paid to the executive officer under the accounting restatement. The Act does not specify a timeframe in which the SEC must adopt rules. When adopted, the rules will be broader than the clawback provision in the Sarbanes-Oxley Act.

Compensation Committees

The Act adds Section 10C to the Exchange Act, which directs the SEC to adopt rules within 360 days after enactment requiring the national securities exchanges to enhance compensation committee requirements of listed issuers.

Independence of Compensation Committees. The SEC's rules must require that each member of the compensation committee be an "independent" director. In determining the meaning of "independence," the national securities exchanges rules must enumerate certain relevant factors including, (i) the sources of compensation of the director, including any consulting, advisory or other compensatory fee paid by the issuer to the director and (ii) whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer. The Act expands current listing requirements of national securities exchanges to require examination of the source of compensation of the director and whether the director is affiliated with the issuer (by stock ownership or otherwise).

Independence of Advisers. The compensation committee will be allowed to select a compensation consultant, legal counsel or other adviser to the committee only after taking into consideration certain factors that affect the independence of the adviser. These factors include: (i) the provision of other services to the issuer by the person that employs the adviser; (ii) the amount of fees received from the issuer by the person that employs the adviser, as a percentage of that employer's total revenue; (iii) the policies and procedures of the employer of the adviser that are designed to prevent conflicts of interest; (iv) any business or personal relationship of the adviser with a member of the compensation committee; and (v) any stock of the issuer owned by the adviser.

Authority to Retain Advisers. The compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of an adviser. The committee is directly responsible for the appointment, compensation and oversight of the work of such adviser. The committee is not, however, required to implement or act consistently with the advice or recommendations of the adviser, and nothing in the provision affects the committee's ability or obligation to exercise its own judgment in fulfillment of its duties. In any proxy solicitation materials for an annual shareholder meeting occurring on or after one year following enactment of the Act, the issuer must disclose, (i) whether the committee retained or obtained the advice of a compensation consultant and (ii) whether the work of the consultant raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. The issuer will be required to provide appropriate funding for payment of reasonable compensation to the adviser.

Executive Compensation Disclosures

In addition to the disclosures described above, the Act requires the SEC to adopt rules to effect additional disclosure requirements described below related to executive compensation. The Act does not specify the timeframe in which the SEC must adopt rules under the Act.

Pay Versus Performance. The Act amends Section 14 of the Exchange Act to require the SEC to adopt rules that require issuers to disclose, in annual meeting proxy solicitation materials, a clear description of any compensation that is required to be disclosed by the issuer under Item 402 of Regulation S-K. Further, the new subsection requires the SEC to expand Item 402 disclosure to include information that shows 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 of the issuer and any distributions.

Pay Equity. The Act requires the SEC to amend Item 402 of Regulation S-K to require disclosure of the median of the annual total compensation of all employees of the issuer, except its CEO, the annual total compensation of the CEO and the ratio of the median employee compensation (less CEO compensation) to CEO compensation. This disclosure would be required in filings described in Item 10(a) of Regulation S-K,

which includes proxy statements, registration statements and other documents. The Act provides that the "total compensation" of employees shall be calculated in the same manner as that for named executive officers under Item 402(c)(2)(x) of Regulation S-K, which will require additional effort by most issuers to determine.

Hedging. The Act amends Section 14 of the Exchange Act to require the SEC to adopt rules that will require issuers to disclose in their annual meeting proxy materials whether any employee or board member (or any designee) is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities that are either granted to the employee or director as compensation or held, directly or indirectly, by the employee or director.

If you have questions about this or any other securities-related issues, please contact your Baker Donelson attorney.

Baker Donelson is pleased to present a series of Alerts related to the Dodd-Frank Wall Street Reform and Consumer Protection Act. To read the complete series, click here.