



**WINSTEAD**

# **Dodd-Frank: What You Don't Want to Know but Probably Should**

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**Dallas, Texas**



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*"We can give you enough medication to alleviate the pain but not enough to make it fun."*

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# Recent Sweeping Securities-Related Legislative and Regulatory Changes

2001-2002: Major Corporate and Accounting Scandals . . .  
Enron, Tyco International, Adelphia and Worldcom

**2002: Sarbanes-Oxley Act**

2003-2006: Significant Economic Growth; Significant Executive  
Compensation Increases

**2007: Proxy Reform: Executive Compensation Disclosure**

2008-2009: Economic Turmoil; Banking Scrutiny

**2010: Dodd-Frank Wall Street Reform and Consumer  
Protection Act**

# Overview: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Signed into Law on July 21, 2010

- Focuses on Financial Regulatory Reform
- Additional Coverage includes
  - Corporate Governance
  - Executive Compensation

# Overview: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Today's Topics are Applicable to Most Public Companies

- **Corporate Governance**

- Whistleblower Incentives and Protection
- Proxy Access
- Compensation Committee Independence
- Disclosure of Board Leadership Structure
- Restrictions on Broker Discretionary Voting

- **Executive Compensation**

- “Say-on-Pay” Vote
- Clawback
- Disclosures
  - Executive Pay vs. Financial Performance
  - Internal Pay Equity

- **Don't Know What We Don't Know**

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*"You know how to whistle, don't you? Just pick up the phone and call the S.E.C."*

# Whistleblower Incentives and Protection

- Protects Whistleblowers from Retaliation
  - New Cause of Action against Anyone Subjecting Whistleblowers to Harassment or Demotion
- Payments for *Original Information* Leading to Successful Action
  - Monetary Sanctions must Exceed \$1 Million
  - Award of 10% to 30% for *Collected* Sanctions
- SEC Regulations Expected by April 2011

## **Dodds: Whistleblower Incentive and Protection**

- Protects Whistleblowers and Creates Bounty
- May Cause More Employees to Whistleblow Externally because More Incentive
- May Provide even More Incentive to Disgruntled Employees

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# Proxy Access

- Act Grants SEC Authority to Adopt Rules:
  - Issuers Required to Include Shareholder Director Nominees in Issuer Proxy at Issuer's Expense
  
- SEC Adopted Previously Proposed Proxy Access Rules on August 25, 2010
  - Effective: November 15, 2010

## Proxy Access

- Eligibility Test Requirement includes:
  - Shareholder or Group must hold 3% of Outstanding Voting Shares of Issuer
  - Shares must be Held Continuously for 3 Consecutive Years and held through Meeting Date
- Generally, can Nominate Greater of 1 Nominee or 25% of Total Directors, rounded down
- Nominee must meet Exchange's Objective Independence Requirements and NOT Issuers' Qualifications
- Notice Requirements must be Met

## Dodds: Proxy Access

- Dramatic Shift in Theory
  - Eliminates Cost of Nominating even a Single Director
- Gives Activist Shareholders more Leverage
- Expect more Contested Elections
  - May Deter Qualified Nominees from Serving
- Companies Must Get to Know Shareholders and Engage Them
  - Advisory Firms more Important
- Companies Need to Consider Bylaws, Committee Charters and Corporate Governance Policies
- “What have you done for me lately?” Mentality

## Update: Proxy Access

- October 4, 2010: SEC granted Stay of Proxy Access Rules Pending Resolution of Business Roundtable and Chamber of Commerce Petition for Review with DC Circuit Court of Appeals
  - Seeking Expedited Review by Court
  - SEC does not address Merits of Case
- SEC also Stayed an Amendment designed to Allow Shareholders to File Bylaw Proposals that allow more Permissive Access Procedures
- Case Expected to Take at least a few Months
  - Proxy Access likely Dead for 2011 Proxy

## Compensation Committee Independence

- **Listing Exchanges:**
  - Must require Compensation Committee Members' Independence as Listing Condition
    - Factors:
      - Source of Compensation
      - Affiliation to Company and its Affiliate
- **Issuers must Disclose in Proxy**
  - Independence of Compensation Consultants, Legal Counsel and other Advisors
    - Similar to Factors for Compensation Committee Members
- **Does NOT require Consultant Independence**
- **SEC Regulations Expected by Year-end 2010 (likely effective for 2011 Proxy)**

# Dodds: Compensation Committee Independence

- Goal is Independence of Compensation Committee and Advisors
- Rules for Compensation Committee Expected to be Similar to Audit Committee Independence Standards
- SEC May Provide Exemptions
- Similar to SEC's Recently Revised Executive Compensation Rules
- May Cause Issues for Long-Term Advisor Relationships

## **Disclosure: Board Leadership Structure**

- Required to Disclose in Proxy Reasons for choosing Same or Different People for Chairman and CEO roles
- Disclosure in addition to Current Disclosure regarding Chairman Independence and Board Leadership Structure
- SEC Regulations Expected by Year-end 2010 (likely effective for 2011 Proxy)

## **Dodds: Disclosure: Board Leadership Structure**

- Consider SEC's efforts to Separate Roles
- Consider External View of Company's Structure (including advisory services)
- Determine if your Company Wants to be Pro-active or Reactive

## Restrictions on Broker Discretionary Voting

- Exchanges must Prohibit Broker Discretionary Voting on any Director Election, Executive Compensation (including “Say-on-Pay”) and other significant matters
  - Specific Shareholder Instructions required
- SEC Regulations expected by July 2011 (likely not effective for 2011 Proxy)

## Dodds: Broker Discretionary Voting

- Get to Know Shareholders
- Likely to have Fewer Shares Voted
- Advisory Services will likely have Greater Impact on Results
- May need Proxy Advisors to get to Retail Votes
- Consider using Full Delivery of Proxy Materials rather than Notice Only to Increase Retail Participation
- Consider including One Routine Item (ratification of auditors) so Broker Votes are Counted for Quorum

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*“His vote doesn’t count, but at least he gets a sense of being part of the process.”*

## “Say-on-Pay” Vote

- Shareholders must have Advisory Vote on Executive Compensation Once every 3 Years
  - Non-binding Vote that Does Not Overrule Board Executive Compensation Decisions
- Vote on whether “Say-on-Pay” Vote will be Held every 1, 2 or 3 Years must be Held every 6 Years
- No SEC Rule-Making Required to be Effective, but SEC May Add Rules

## Say on Change in Control Pay

- Proxy Statement to Approve a Merger or Similar Transactions Must
  - Disclose
    - Golden Parachutes
    - Total Golden Parachute Pay and Applicable Conditions
  - Provide Non-binding Vote on these Arrangements
- No SEC Rule-making necessary; Generally Effective by Year-end 2010

*Approved*



*Disapproved*



## Dodds: “Say-on-Pay” Vote

- Significant Recent Movement toward “Say-on-Pay” Vote
- Consider “Say-on-Pay” Vote Seriously even though Non-binding
- Study Recent Examples (Key Bank, Occidental Petroleum, Motorola)
- Get to know Shareholders and Consider Using Proxy Advisors
- Review and Consider changing Executive Compensation
- Consider “Say-on-Pay” in drafting 2011 Proxy Disclosure
- Consider Third-Party Recommendations on Directors based on “Say-on-Pay” Vote

# Clawback

- SEC to Require Listing Exchanges to Require
  - Disclosure: Company's Clawback Policies for any Incentive-based Compensation Paid Out based on Erroneous Financial Information
  - Recovery of Incentive-based Compensation from Executive Officers if Accounting Restatement due to Non-compliance with Financial Reporting Requirements
- SEC Regulations Expected by July 2011 (likely not effective for 2011 Proxy)

## **Dodds: Clawback**

- Applies to Compensation Received in Three-year Period Preceding date Requiring Restatement
- May Cause even More Careful Disclosure
- Revisit Existing Clawback Policies
- Determine Clawback “Enforcer”

## Disclosure: Executive Pay vs. Financial Performance

- Issuers must Include a Comparison of Executive Pay to the Company's Financial Performance
  - Compares Executive Compensation Actually Paid
  - Measures Include "Value of Shares of Stock"  
Dividends and Distributions
- SEC Regulations Expected by July 2011 (likely not effective for 2011 Proxy)

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## **Dodds: Disclosure Executive Pay vs. Financial Performance**

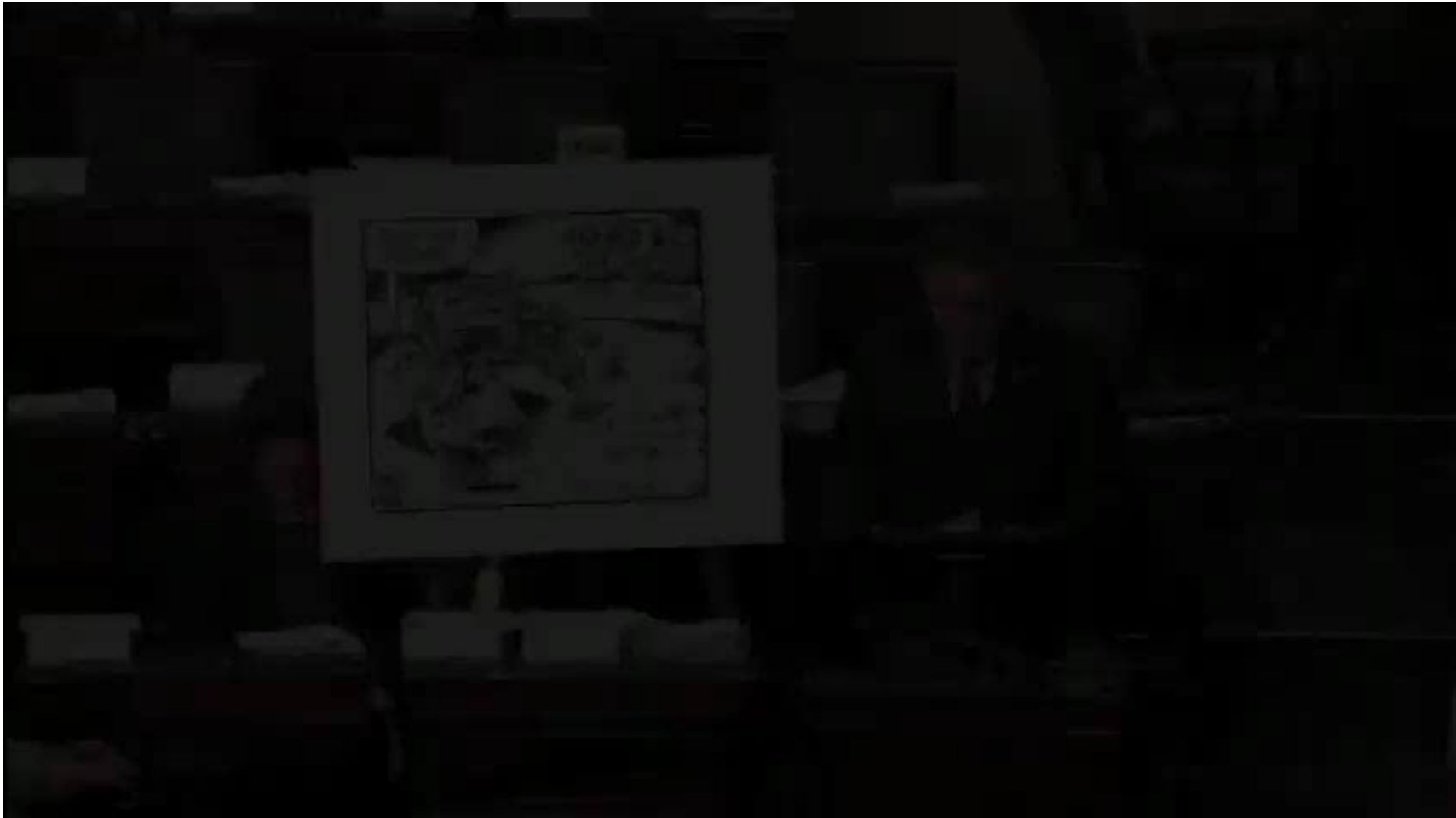
- Start Early even if Not Immediately on Radar
- Should Estimate Results Now
- Consider External View of Analysis
- Consider Changes to Executive Compensation Program

## Disclosure: Internal Pay Equity

- Issuers must Disclose:
  - CEO's Total Annual Compensation
  - Median Total Annual Compensation of All other Employees
  - Ratio of the Two Amounts
  
- SEC Regulations expected by July 2011 (likely not effective for 2011 Proxy)

## Dodds: Internal Pay Equity

- Start Early even if Not Immediately on Radar
- Put Procedures in Place to Make Calculations (especially larger issuers)
- Consider External View of Analysis
- Consider Changes to Executive Compensation Program



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# Credit Rating Agencies

- Annual Internal Controls and Procedures Exams for Agencies
- Increased Transparency
- Eliminates Exemption for Expert Consent and Liability Provisions for Credit Agencies
- Eliminates Regulation FD Exemption
- Holds Credit Agencies Liable for Quality of Rating

# Dodds: Credit Rating Agencies

- Initially froze Asset-Backed Securities Market
  - Already Fragile Market
- SEC Agreed to 6 Months Moratorium on Credit Rating Requirement
- Still Shaking Out

# Asset-Backed Securities Risk Retention

- Applies to Issuer, and any Organizer or Originator of Asset-backed Securities
- Risk Retention Requirement, generally 5%
- SEC Regulations expected by April 2011

# Dodds: ABS Risk Retention

- Requires “Skin in the Game”
- Could Improve ABS Market or Could Further Stagnate Market
- Too Soon to Know

## Summary of Key Dodds

- Be Cognizant of Whistleblower Incentive
- Prepare for Proxy Access and Consider Shareholder (may now have more time to prepare)
- Take “Say-on-Pay” Seriously and again Consider Shareholders
- Start Early on Executive Pay vs. Financial Performance and Internal Pay Equity even though Not Immediate Requirements

# Conclusion

- Options
  - Go Private
  - Deal with Dodd-Frank

Good Luck!

# Questions & Discussion

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Rangers!**