

The Impact of The Dodd-Frank Act on Public Company Executive Compensation

Oct 13 2010

Posted By: Kenneth A. Hoogstra

Practice Area: Securities Law

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), signed into law by President Obama on July 21, 2010, contains several provisions that will affect public companies' future proxy statements, policies and relationships concerning executive compensation. Although many of the rules relating to how these provisions will be implemented have yet to be written, public companies and their advisors should become familiar with the changes that will take effect in 2011 and beyond.

MANDATORY SAY-ON-PAY VOTING

Beginning in 2011, public companies will be required to conduct non-binding advisory votes seeking shareholder approval of executive compensation. Three separate types of these so-called "say-on-pay" votes are mandated by the Act. First, at the first shareholder meeting that occurs on or after January 21, 2011, a company must seek shareholder approval of the prior year's compensation of its CEO, CFO and three other most highly compensated executive officers ("Named Executive Officers"). Second, at this same meeting and at least once every six years thereafter, a company must allow shareholders to decide whether the vote approving Named Executive Officers will be held every one, two or three years. Third, if shareholders are asked to approve a merger, acquisition, consolidation or other significant corporate transaction that would trigger "golden parachute" payments to the Named Executive Officers compensation, the company must submit such golden parachute payments to a separate nonbinding vote, and must include in its proxy statement clear and simple disclosures of the golden parachute arrangements and the amounts payable.

The SEC has not yet issued proposed or final rules detailing how these votes are to be conducted. For example, with respect to the vote regarding the frequency of the say-on-pay vote, it is unclear whether a company will be permitted to recommend a frequency or whether shareholders will be permitted to choose from among all three options. Until such rules are issued, public companies may wish to review the results of shareholder votes of prior years, particularly with respect to executive compensation plans that required shareholder approval, to anticipate the likely outcome of the say-on-pay vote. To the extent that a company is aware of shareholder dissatisfaction with its compensation practices, it may wish to evaluate and revise the particular elements of compensation that are problematic. In addition, companies may wish to reevaluate the description of their compensation philosophies and policies in their most recent proxy statements, and ensure that the Compensation Discussion and Analysis tells a clear, consistent story on how the compensation of the Named Executive Officers was determined.

CLAWBACK POLICIES

The Act also requires national securities exchanges and national securities associations to amend their listing standards (in accordance with rules that will be written by the SEC) to require listed companies to develop and implement clawback policies. Under such policies, if a listed company is required to prepare an accounting restatement due to material noncompliance with the securities laws, the company must recover certain incentive-based compensation received by current or former executives within the three-year period preceding the date of the accounting restatement. The amount to be recovered is the excess incentive-based compensation that was paid as a result of the material noncompliance – that is, the amount that would not have been paid had the initial financial statements been correct. The new listing rules will also require listed companies to disclose their clawback policies in filings with the SEC.

COMPENSATION COMMITTEE INDEPENDENCE

The Act also requires national securities exchanges and national securities associations to develop listing standards aimed at enhancing the independence of a listed company's compensation committee, as well as the independence of the compensation consultants, legal counsel or other advisors engaged by the compensation committee.

With respect to compensation committee members, the Act mandates that each such member be a member of the board of directors. The Act also provides that the listing standards "shall consider relevant factors" in defining the member's independence, such as the source of the member's compensation and whether the member is affiliated with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company. Compensation committees must also have the authority to engage and pay independent legal counsel.

With respect to compensation consultants, legal counsel and other advisors, the Act provides that a company's compensation committee may only select a consultant, counsel or advisor that is independent under the listing standards applicable to the company. In defining "independence" for this purpose, the Act lists several relevant factors that must be considered in the listing standards of national securities exchanges and associations, including:

- the provision of other services to the company by the person that employs the compensation consultant, legal counsel, or other adviser;
- the amount of fees received from the company by the person that employs the compensation consultant, legal counsel, or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel, or other adviser;
- the policies and procedures of the person that employs the compensation consultant, legal counsel, or other adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee; and
- any stock of the company owned by the compensation consultant, legal counsel, or other adviser.

The Act gives the SEC 360 days to issue rules regarding these independence requirements, which the national securities exchanges and national securities associations must then follow in amending their listing standards. At this point, it is unclear whether these independence requirements will be effective at any point in 2011.

NEW COMPENSATION DISCLOSURES

The Act will also require public companies to include new information in their proxy statements relating to executive compensation. The Act directs the SEC to adopt rules mandating disclosure of the ratio of the total annual compensation of a company's CEO to the median annual compensation of all employees of the company except the CEO, and to disclose the total annual compensation numbers used in such ratio. The Act also directs the SEC to adopt rules requiring public companies to disclose the relationship of compensation actually received by their Named Executive Officers to the company's financial performance. In addition, the SEC must develop rules mandating disclosure of whether any employees or directors are permitted to trade in any financial instruments that are designed to hedge against the market value of equity securities granted as compensation to, or held directly by, the employee or director.

von Briesen & Roper Legal Update is a periodic publication of von Briesen & Roper, s.c. It is intended for general information purposes for the community and highlights recent changes and developments in the legal area. This publication does not constitute legal advice, and the reader should consult legal counsel to determine how this information applies to any specific situation.