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What Public Companies Need to Know Now About the Dodd-Frank Wall Street Reform and Consumer Protection Act

July 21, 2010

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law, implementing changes in everything from federal standards on home mortgages to reforming the Federal Reserve. This client alert provides a summary of the key provisions that we believe will impact public companies.

CHANGES TO YOUR PROXY DISCLOSURE

New Section 14B of the Securities Exchange Act of 1934 (the “**Exchange Act**”) instructs the Securities and Exchange Commission (the “**SEC**”) to adopt or amend the following rules regarding the disclosure in a public company’s proxy materials for an annual meeting of shareholders.

Executive Compensation:

- **Pay Versus Performance.** Issue a new rule requiring a “clear description” of any compensation disclosed under Item 402 of Regulation S-K and a discussion of the relationship between the executive compensation paid and the financial performance of the issuer, including any change in the value of the issuer’s shares, dividends, and distributions. *No timeframe specified.*
- **Pay Disparity.** Amend Item 402 of Regulation S-K to require disclosure

of (a) the median annual total compensation of all employees except the chief executive officer, (b) the annual total compensation of the chief executive officer, and (c) the ratio of (a) to (b). *No timeframe specified.*

- **For Covered Financial Institutions.** In conjunction with other federal financial regulators, issue regulations (a) requiring reporting of all incentive-based compensation arrangements and (b) prohibiting arrangements that encourage inappropriate institution risk by providing excessive compensation, fees or benefits, or leading to material financial loss. *Due by April 21, 2011.*

Employee and Director Hedging:

- Issue a new rule requiring disclosure of whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities. Current SEC proxy rules already require specific hedging transactions by executive officers or directors to be disclosed in an issuer's proxy statement. *No timeframe specified.*

Chairman and CEO Structure:

- Issue a new rule requiring disclosure of why the issuer has chosen to either have or not have the same person serve as both chief executive officer of the issuer and chairman of the board of directors. Current SEC proxy rules already require disclosure of the issuer's board leadership structure and policies. *Due by January 17, 2011.*

CHANGES TO YOUR PROXY PROCEDURES

Proxy Access. Section 14(a) of the Exchange Act was amended to grant the SEC authority to adopt rules governing the procedures by which shareholder nominees for director must be included in the issuer's proxy materials. This grant of authority does not specify any standards for such rules. *No timeframe specified.*

Shareholder Advisory Votes. New Section 14A was added to the Exchange Act to require issuers, unless exempted by the SEC, to seek a shareholder vote on the following compensation resolutions. *Effective for the first shareholder meeting held after January 21, 2011.*

- **Vote on Pay.** Approval of the compensation of the issuer's executives, as disclosed pursuant to Item 402 of Regulation S-K and determination of whether shareholder approval of executive compensation should be sought every 1, 2 or 3 years thereafter (which itself must be determined at least once every 6 years).
- **Vote on Golden Parachutes.** If the proxy materials relate to an acquisition, merger, consolidation, sale or disposition of all or substantially all of the assets of an issuer, the proxy must disclose and seek shareholder approval of any executive officer compensation (present, deferred, or contingent) paid by the issuer and relating to the contemplated transaction, including the aggregate total of such

compensation and the conditions upon which it may be paid, if any (unless the arrangement was previously approved under the advisory vote on executive compensation outlined above).

The advisory votes will not be binding and are not intended to overrule company or director decisions or create additional fiduciary duties. Every institutional investment manager subject to Section 13(f) will be required to report at least annually how it voted in these advisory votes.

Broker Voting. Section 6(b) of the Exchange Act was amended to prohibit any broker from granting a proxy to cast a vote regarding an election of directors, executive compensation or any other matter the SEC determines is significant without first receiving voting instructions from the beneficial owner. *Effective immediately.*

CHANGES TO YOUR CORPORATE GOVERNANCE

Compensation Committee Matters. New Section 10C of the Exchange Act instructs the SEC to adopt a rule directing the national securities exchanges to require listed issuers to comply with the following new compensation committee requirements. *Due by July 21, 2011.*

- **Independence.** Each member of an issuer's compensation committee must be a member of the issuer's board of directors and independent.[1] For these purposes, the definition of "independence" will consider any compensation paid to the director and any affiliations between the director and the issuer, the issuer's subsidiaries and any affiliates thereof.
- **Advisers.** The compensation committee will be directly responsible for the appointment, compensation, and oversight of any compensation consultant or independent legal counsel. Each issuer will be required to provide appropriate funding — as determined by the compensation committee — to pay the compensation committee's advisers. The compensation committee will be permitted to select an adviser only after considering certain factors, identified by the SEC, which may affect the adviser's independence. These factors will include the following:
 - If the adviser's employer provides other services to the issuer;
 - The fees received by the adviser's employer from the issuer, as a percentage of the employer's total revenue;
 - The adviser's employer's policies to prevent conflicts of interest;
 - Any business or personal relationships of the adviser and any member of the compensation committee; and
 - Any issuer stock owned by the adviser.
- **Disclosure.** An issuer's proxy or consent solicitation materials must disclose:
 - Whether the compensation committee obtained the advice of a compensation consultant; and
 - Whether the compensation consultant's work raised any conflicts of interest and, if so, the nature of the conflict and how it was addressed.

Incentive-Based Compensation Clawback. New Section 10D of the Exchange Act instructs the SEC to direct, by rule, the national securities exchanges to require every issuer to develop, implement, and disclose a policy providing for the recovery of any excess incentive-based compensation granted to any current or former executive officers during the three years prior to any accounting restatement due to the issuer's material noncompliance with any financial reporting requirements. *No timeframe specified.*

ADDITIONAL MATTERS

Resource Extraction Disclosure. Section 13 of the Exchange Act was amended to instruct the SEC to issue rules requiring any issuer who files an annual report with the SEC to include the following disclosures in that annual report. *Rules due by April 17, 2011, compliance required by first annual report filed one year after rules issued.*

- **Payments.** If the issuer engages in the commercial development of oil, natural gas or minerals, the type and total amount of any payments made by any entity in its corporate family to any government for the commercial development of oil, natural gas or minerals. This information must be disclosed on a per project and per government basis.
- **Sourcing.** If conflict minerals, as defined by the Secretary of State and published in the federal register, are necessary to the functionality or production of one of the issuer's products, whether the materials came from the Democratic Republic of Congo or an adjoining country and, if so:
 - A description of the measures taken to verify the source and chain of custody of the minerals, which measures shall include an independent private sector certified audit of such report; and
 - A description of the products that are not Democratic Republic of Congo conflict free, the entity that conducted the independent private sector audit, the facilities used to process the conflict minerals, the conflict minerals' country of origin and the efforts to determine the mine or location of origin with the greatest possible specificity.

Exemption from SOX Internal Control Attestation Requirements. New Section 404(c) of the Sarbanes-Oxley Act of 2002 permanently exempts non-accelerated filers from the requirement to have an external auditor attest to internal control over financial reporting. Additionally, the SEC was instructed to determine how to reduce the burden of complying with the external auditor attestation requirement for issuers whose market capitalization is between \$75 million and \$250 million. *Exemption effective immediately; report due by April 21, 2011.*

Securities Violations Reporting. New Section 21F of the Exchange Act instructs the SEC to adopt rules providing any whistleblower who voluntarily provides original information to the SEC that leads to a successful enforcement or related action with an award equal to 10%-30% of the sanctions imposed. Additionally, whistleblowers should be protected against retaliation and have the option of bringing a private action against any

employer who does retaliate. *Due by April 17, 2011.*

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If you have any questions regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act and its impact on your company, please contact the authors of this Client Alert, any of O'Melveny's Corporate Finance partners or, as to aspects of the rules related to executive compensation matters, any of O'Melveny's Executive Compensation and Employee Benefits partners.

[1] Controlled companies, limited partnerships, companies in bankruptcy proceedings, open-ended management investment companies registered under the Investment Company Act of 1940, and foreign private issuers that provide annual disclosures to shareholders of the reasons that the foreign private issuer does not have an independent compensation committee are exempted. Further, the SEC rule may permit the national securities exchanges to exempt certain issuers.

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