

# ClientAlert

## Financial Markets Developments

Capital Markets  
November 2011

### Dodd-Frank Act Corporate Governance and Executive Compensation Provisions Checklist and SEC Rulemaking Timeline



#### Effective and Proposed Rules

Provision	Summary	Effectiveness/ SEC Rulemaking Timeline	Other Regulations/ Additional Comments
<p><b>Whistleblower Incentives</b> <b>[Section 922]</b></p>	<p>Instructs the SEC to pay monetary awards of between 10 and 30 percent to persons who voluntarily provide original information to the SEC that leads to successful enforcement actions resulting in monetary sanctions over US\$1 million.</p>	<p>On <b>May 25, 2011</b>, the SEC adopted rules implementing Section 922 of the Dodd-Frank Act. The rules became effective <b>August 12, 2011</b>.</p>	<p>The Sarbanes-Oxley Act already provided protection for whistleblowers at public companies, mandated that corporations establish procedures to allow for confidential reporting of accounting or auditing irregularities and prohibited a company from taking any retaliatory action against a whistleblower. However, the Sarbanes-Oxley Act did not provide for a financial reward to a whistleblower or otherwise incentivize parties to provide information to outside authorities.</p> <p>In light of the increased incentives afforded to whistleblowers under the Dodd-Frank Act whistleblower program, companies should reexamine and heighten the visibility of their internal compliance programs, and position themselves to respond effectively and efficiently to internal reports of potential wrongdoing. Examples of initiatives to consider include: evaluate, update and educate employees about internal compliance programs to ensure they provide effective reporting mechanisms; consider internal reporting incentives; conduct regular training; and develop formal procedures for senior managers to rapidly respond to the SEC in the event of a whistleblower complaint.</p> <p>Large bounties are available to encourage whistleblowers to report violations of US securities laws by foreign private issuers. Information relating to a possible violation of foreign securities laws will not qualify for a whistleblower award.</p>

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<p><b>Say-on-Pay and Say-on-Frequency</b></p> <p><b>[Section 951]</b></p>	<p>Not less frequently than once every three years, at any annual or other meeting of shareholders for which the SEC requires compensation disclosure, companies must seek a nonbinding shareholder vote to approve the compensation of the named executive officers, as disclosed under Item 402 of Reg. S-K.</p> <p>Not less frequently than once every six years, companies must seek a nonbinding shareholder vote to determine whether the say-on-pay vote will occur every one, two or three years.</p>	<p>On <b>January 25, 2011</b>, the SEC adopted rules implementing Section 951 of the Dodd-Frank Act.</p>	<p>The final rules confirm that say-on-pay and say-on-frequency votes will not trigger a requirement to file a preliminary proxy statement.</p> <p>Item 402 of Reg. S-K: CD&amp;A transformed into a disclosure and an investor communication/marketing document in light of the say-on-pay regime; most companies opted to include an executive summary as part of their CD&amp;A disclosures.</p> <p>Does not apply to foreign private issuers.</p> <p>2011 Results:</p> <ul style="list-style-type: none"> <li>■ Nearly three-quarters of companies passed say-on-pay votes with more than 90 percent shareholder approval</li> <li>■ Approval of say-on-pay has been high across industries</li> <li>■ Most proxy statements filed in the 2011 proxy season included a say-on-frequency recommendation, with the majority of those recommendations favoring say-on-pay votes every year <ul style="list-style-type: none"> <li>– Proxy advisory firms ISS and Glass Lewis will only recommend voting for an annual say-on-pay vote frequency.</li> </ul> </li> </ul>
<p><b>Say-on-Golden-Parachutes</b></p> <p><b>[Section 951]</b></p>	<p>Required a nonbinding shareholder vote on golden parachute payments to named executive officers in connection with a change-of-control transaction of the company (unless previously approved by say-on-pay vote).</p>	<p>On <b>January 25, 2011</b>, the SEC adopted rules implementing Section 951 of the Dodd-Frank Act.</p>	<p>Does not apply to foreign private issuers.</p>

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<p><b>Compensation Committee Independence</b></p> <p><b>[Section 952]</b></p>	<p>Requires the SEC to issue rules directing each national securities exchange to require each member of a listed company's compensation committee to be independent, taking into account factors such as advisory, consulting or other compensatory fees and affiliate status. The compensation committee has authority to engage a compensation advisor, and the company must disclose the use of an advisor in its annual proxy statement and address any conflicts.</p>	<p>Disclosure regarding the use of a compensation consultant and any conflicts raised must be included in a proxy statement for an annual meeting occurring on or after <b>July 21, 2011</b> (one year after enactment).</p> <p>On <b>March 30, 2011</b>, the SEC proposed rules that would begin the process of implementing Section 952 of the Dodd-Frank Act.</p> <p>The proposed rules direct the national securities exchanges to adopt listing standards relating to the independence of compensation committee members, the compensation committee's authority to retain compensation advisors and the compensation committee's responsibility for the appointment, compensation and work of any compensation advisor and propose amendments to related disclosure requirements in the proxy materials. It is expected that the SEC and the exchanges will work together on adopting the final listing standards in the second half of 2011.</p> <p>As with the adoption of corporate governance listing standards following the Sarbanes-Oxley Act, it is expected that the SEC will encourage as much uniformity as possible in the listing standards adopted by the exchanges.</p> <p>The SEC expects to adopt (1) exchange listing standards regarding compensation committee independence and factors affecting compensation advisor independence and (2) disclosure rules regarding compensation consultant conflicts by December 2011.</p>	<p>Item 407(e) of Reg. S-K already requires disclosure of the role of compensation consultants in determining or recommending the amount or form of executive or director compensation and whether such consultant was retained directly by the compensation committee. It also requires certain disclosure of fees for additional services in excess of US\$120,000.</p> <p>Compensation committee independence requirements apply to foreign private issuers unless the foreign private issuer provides annual disclosure to shareholders of the reasons why it does not have an independent compensation committee. Application of compensation advisor and proxy disclosure provisions is unclear. Securities exchanges may propose exemptions to the listings standards. The SEC sought comments on whether Form 20-Fs and 40-Fs should be amended to require foreign private issuers to provide annual disclosure of the type required under Section 952.</p>

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<b>Proxy Access— “Private Ordering” Permitting Shareholder Proxy Access Proposals Under Rule 14a-8</b>  <b>[Section 971]</b>	<p>The SEC may, but is not required to, issue rules permitting shareholders to include their nominees for the board of directors in a company’s proxy materials.</p>	<p>On September 29, 2010, the Business Roundtable and the US Chamber of Commerce filed a lawsuit challenging the final rules issued by the SEC. On October 4, 2010, the SEC granted the stay. On July 22, 2011, the US Court of Appeals for the DC Circuit held in a unanimous three-judge ruling that the SEC failed to provide sufficient data showing how the rule would improve board performance and increase shareholder value through the election of dissident nominees. On September 7, 2011, the SEC announced that it would not seek a rehearing of the US Court of Appeals for the DC Circuit decision vacating the SEC’s proxy access rules, nor appeal the decision to the US Supreme Court.</p>	<p>The rules adopted by the SEC on August 25, 2010 also enabled shareholders to submit proposals for inclusion in a company’s proxy statement pursuant to Rule 14a-8(i)(8) seeking to amend provisions in the company’s organizational documents relating to proxy access. As a result, shareholders will still have the opportunity to establish proxy access standards on a company-by-company basis through the Rule 14a-8 process. Companies may see an increase in proposals from shareholders eligible to rely on Rule 14a-8(i)(8) seeking to institute a shareholder nomination regime via binding bylaw amendments.</p>

## Pending Rules

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<b>Pay for Performance</b>  <b>[Section 953(a)]</b>	<p>Requires the SEC to issue rules requiring a company to include in its annual proxy statement a clear description of any executive compensation, including information that shows the relationship between executive compensation paid and the financial performance of the company, taking into account any change in the value of the shares of stock and dividends of the company and any distributions. This disclosure may be presented graphically or in narrative form.</p>	<p><b>No specified deadline</b> for the SEC to issue the required rules.</p> <p>Proposed rules to be issued for comment before the end of 2011.</p>	<p>Does not apply to foreign private issuers.</p>
<b>Internal Pay Equity: Compensation Ratios</b>  <b>[Section 953(b)]</b>	<p>Requires the SEC to amend Item 402 of Reg. S-K to require a company to disclose: (1) the median of the annual total compensation of all employees of the issuer, except the CEO; (2) the annual total compensation of the CEO; and (3) the ratio of its CEO’s compensation to the median compensation of all other employees.</p>	<p><b>No specified deadline</b> for the SEC to amend Item 402 of Reg. S-K.</p> <p>Proposed rules to be issued for comment before the end of 2011.</p>	<p>Debate has continued in Congress on the question of whether this provision should be repealed or modified, although no significant legislative action has been taken to date.</p> <p>Does not apply to foreign private issuers.</p>

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<b>Clawback Policies</b> <b>[Section 954]</b>	Requires the SEC to issue rules directing each national securities exchange to amend listing standards to require that companies adopt a policy providing that, if a company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, it will recover from any current or former executive officer who received incentive-based compensation during the three-year period preceding the date on which the company is required to prepare an accounting restatement, amounts based on the erroneous data, in excess of what would have been paid under the restatement. Additional disclosure will be required of a company's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws.	<b>No specified deadline</b> for the SEC to adopt the required rules.  Proposed rules to be issued for comment before the end of 2011.	Section 304 of the Sarbanes-Oxley Act requires both the CEO and CFO of a public company to reimburse the issuer for bonuses, incentive or equity compensation, and sale of issuer stock received during the 12-month period following the issuance of financial statements that are restated due to material noncompliance as a result of misconduct.  Application to foreign private issuers is unclear; final rules are subject to exchange listing standards which may exempt foreign private issuers from the requirements of Section 954.
<b>Employee and Director Hedging</b> <b>[Section 955]</b>	Requires the SEC to issue rules requiring companies to disclose in their annual proxy statement whether their employees or directors (or their designees) may purchase financial instruments, such as prepaid variable forwards, equity swaps, collars and exchange funds, designed to hedge equity securities of the company that the employee or director holds.	<b>No specified deadline</b> for the SEC to adopt the required rules.  Proposed rules to be issued for comment before the end of 2011.	Application to foreign private issuers is unclear; the SEC has authority to exempt foreign private issuers from the requirements of Section 955.

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<b>Broker Discretionary Voting</b>  <b>[Section 957]</b>	Each national securities exchange is required to adopt rules prohibiting brokers from voting uninstructed shares (e.g., discretionary voting) in connection with a shareholder vote on the election of directors, executive compensation or any other significant matter (as determined by the SEC).	<b>July 21, 2010</b> (the date of enactment); however, there is <b>no specified deadline</b> for when the SEC or the exchanges must adopt the final rules.	On September 9, 2010, the SEC approved (with accelerated effectiveness) the NYSE's amendment to Rule 452 to prohibit broker discretionary voting on matters "relating to executive compensation" including say-on-pay, say-on-frequency, and say-on-golden-parachutes.  The SEC has not yet specified other matters for which brokers may not use discretionary authority to vote uninstructed shares and the SEC's future rules may focus on "significant matters" beyond executive compensation.
<b>Board Leadership Structures (i.e., CEO and Chair)</b>  <b>[Section 972]</b>	Requires the SEC to issue rules that will require a company to explain in its annual proxy materials why it has either chosen to combine or separate its chairman and CEO positions.	SEC rules must be issued no later than <b>January 17, 2011</b> (180 days after enactment). <b>No proposed rules have been published.</b> The SEC amended its disclosure rules in December 2009 to require a discussion of this topic, and it appears that no further SEC rulemaking will be completed on this topic. The SEC has not indicated a timeline or whether current disclosures satisfy this requirement.	Item 407(h) of Reg. S-K already requires disclosure whether it has separated or combined the positions of chairman and CEO and why such structure is appropriate.  Application to foreign private issuers is unclear, but likely will not apply.

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