

# Executive Compensation and Corporate Governance Provisions in the Dodd-Frank Act

Ron Mueller, Amy Goodman, Steve Fackler and Sean Feller  
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# Overview

- What does the Dodd-Frank Act mean for corporate governance and executive compensation
- Major Provisions
  - Say-on-Pay and Broker Discretionary Voting
  - Disclosure/Vote on Golden Parachute Compensation
  - Compensation Committee Independence
  - Compensation Consultants and Advisors
  - Mandatory Clawback
  - Disclosure of Relationship of Pay to Financial Performance
  - Disclosure of Internal Pay Ratio
  - Other Executive Compensation Provisions
  - Corporate Governance Provisions
  - Other Items
- Final bill signed by President on July 21, 2010
- Many provisions require or will be informed by SEC or exchange rulemaking



## What Does the Dodd-Frank Act Mean for Corporate Governance and Compensation?

- Greater role for shareholders
- Tilts the balance to activist investors' influence
- Increases influence of proxy advisory firms
- Pressure on compensation committees to use independent advisors
- Increased scrutiny by activist investors and the media regarding design and amount of compensation
- Pressure on companies and compensation committees to choose appropriate performance metrics
- Will require year round shareholder engagement



## Say-on-Pay

- Overview
  - Non-binding vote on compensation of named executive officers every one, two or three years
  - Separate vote at least every six years to determine how often say-on-pay vote will occur
  - Effective for shareholder meetings occurring on or after January 21, 2011
- Steps to consider
  - Thorough review of executive compensation disclosure for clarity and ease of understanding
  - Review ISS (formerly RiskMetrics) and other guidelines for “red flags” in compensation policies
  - Engage with key shareholders
- Broker Voting: Stock exchanges must adopt rules to prohibit brokers from granting proxies for director elections, executive compensation and other “significant matters” (determined by SEC rules)



## Disclosure and Non-Binding Vote on Golden Parachute Compensation

- Disclosure of named executive officer compensation that is based on or related to a merger, sale of assets or similar transaction
- Required in proxy materials for vote on transaction
- Non-binding vote required unless previously subject to say-on-pay vote
- Voting requirement effective for shareholder meetings on or after January 21, 2011
- SEC rulemaking required to determine content of golden parachute disclosures



## Compensation Committee Independence/Compensation Consultants and Advisors

- Compensation Committee Independence
  - Requires SEC within 360 days to direct exchanges to enact rules regarding compensation committee independence for listed companies
  - Exchanges must consider relevant factors including sources of compensation paid to compensation committee members (e.g., consulting, advisory or other compensatory arrangements) and whether members are affiliates of the issuer or its subsidiaries



## Compensation Committee Independence/Compensation Consultants and Advisors

- Compensation Consultants, Counsel and Advisors
  - Must be selected after consideration of independence factors to be established by SEC
  - Compensation Committee must be directly responsible for appointment, compensation and oversight of its consultants and advisors
  - Compensation Committee must have authority and funding to retain legal counsel and other advisors



## Mandatory Clawback

- SEC required to direct exchanges to require listed companies to adopt and implement clawback policies
- Additional disclosure to be required regarding a company's policy on incentive compensation that is based on financial information required to be reported under the securities laws
- Rules will require adoption of clawback policy to recoup payments of incentive compensation to current and former executive officers:
  - if accounting restatement required based on erroneous data due to material noncompliance with financial reporting requirements
  - regardless of culpability
- If triggered, recoupment is required for all incentive compensation (which may include stock options) received based on the erroneous data during the three-year period preceding the date of the restatement
- Steps to consider: Be aware that any existing clawback policy will need to be revised. Companies likely should wait for final rules before amending policies.



## Disclosure of Relationship of Pay to Financial Performance

- SEC required to adopt rules requiring companies to disclose a clear description of relationship of executive compensation “actually paid” and the issuer’s financial performance
- Steps to consider
  - Analyze how compensation will compare with financial performance metrics, such as stock performance and net earnings
  - ISS currently includes a similar metric in its reports regarding CEO compensation and stock performance
  - Consider alternative (graphical) presentations that may most effectively present the relationship between pay and performance
  - Actual presentation will depend on final SEC rules



## Disclosure of Internal Pay Ratio

- SEC must amend executive compensation rules to require disclosure of
  - the median of annual total compensation of all employees other than the CEO
  - the annual total compensation of the CEO
  - the ratio of these amounts
- Total compensation must be disclosed in accordance with SEC rules for disclosure of NEO compensation in the Summary Compensation Table, as in effect before the Act's enactment
- Determining total compensation of all employees is likely to be very burdensome
- No timeline for adoption of rules specified



## Other Executive Compensation Provisions

- Hedging: SEC must adopt rules requiring disclosure of policy re: employee, executive officer and director hedging
  - Review current insider trading policy re: hedging policy
- Executive Compensation disclosures and prohibitions for regulated financial institutions



## Corporate Governance Provisions

- Proxy Access: SEC may, but is not required to, adopt rules regarding shareholder proxy access for nomination of directors
- Disclosure of Board Leadership Structures: SEC required to adopt rules within 180 days requiring disclosure re: company's decision regarding separation (or not) of chairman and CEO roles.
  - Unlikely to result in significant changes from recently adopted SEC rules on this subject



## Other Items

- Beneficial ownership and short-swing profit reporting
- Regulation FD and disclosure of credit ratings
- Extractive industries, mine safety and “conflict minerals” disclosures
- Whistleblowing to the SEC
- SEC funding



## Issuer Input Essential as Implementation of Act Unfolds

- 243 rulemakings
- Opportunity to inform SEC staff even before rulemaking
- How to write effective comment letters



## Today's Presenters

**Ron Mueller**

(202) 955-8671

[RMueller@gibsondunn.com](mailto:RMueller@gibsondunn.com)

**Steve Fackler**

(212) 351-2392

(650) 849-5385

[SFackler@gibsondunn.com](mailto:SFackler@gibsondunn.com)

**Amy Goodman**

(202) 955-8653

[AGoodman@gibsondunn.com](mailto:AGoodman@gibsondunn.com)

**Sean Feller**

(213) 229-7579

[SFeller@gibsondunn.com](mailto:SFeller@gibsondunn.com)

# Our Offices

## Brussels

Avenue Louise 480  
1050 Brussels  
Belgium  
+32 (0)2 554 70 00

## Century City

2029 Century Park East  
Los Angeles, CA 90067-3026  
310.552.8500

## Dallas

2100 McKinney Avenue  
Suite 1100  
Dallas, TX 75201-6912  
214.698.3100

## Denver

1801 California Street  
Suite 4200  
Denver, CO 80202-2642  
303.298.5700

## Dubai

The Exchange Building 5, Level 4  
Dubai International Finance Centre  
P.O. Box 506654  
Dubai, United Arab Emirates  
+971 (0)4 370 0311

## London

Telephone House  
2-4 Temple Avenue  
London EC4Y 0HB  
England  
+44 (0)20 7071 4000

## Los Angeles

333 South Grand Avenue  
Los Angeles, CA 90071-3197  
213.229.7000

## Munich

Widenmayerstraße 10  
D-80538 München  
Germany  
+49 89 189 33-0

## New York

200 Park Avenue  
New York, NY 10166-0193  
212.351.4000

## Orange County

3161 Michelson Drive  
Irvine, CA 92612-4412  
949.451.3800

## Palo Alto

1881 Page Mill Road  
Palo Alto, CA 94304-1125  
650.849.5300

## Paris

166, rue du faubourg Saint Honoré  
75008 Paris  
France  
+33 (0)1 56 43 13 00

## São Paulo

Rua Funchal, 418, 35° andar  
Sao Paulo 04551-060  
Brazil  
+55 (11)3521.7160

## San Francisco

555 Mission Street  
San Francisco, CA 94105-2933  
415.393.8200

## Singapore

One Raffles Quay  
Level #37-01, North Tower  
Singapore 048583  
+65.6507.3600

## Washington, D.C.

1050 Connecticut Avenue, N. W.  
Washington, D.C. 20036-5306  
202.955.8500