



Dodd Frank Update

The SEC has been slow to pass new regulations implementing the Dodd-Frank Act. This memorandum provides an update on the status of recently enacted regulations and timetable expected for additional regulations.

Fully Implemented Rules

The following governance and disclosure rules are in effect:

- Shareholder approval of executive compensation (say on pay).
- Whistleblower incentives and protections.
- Disclosures concerning board leadership and structures (i.e. separation of Chairman and CEO roles).

Say on Pay (Section 951)

Through rules adopted by the SEC that became effective in April 2011, the Dodd-Frank Act requires companies to seek non-binding shareholder advisory votes on:

- Executive compensation arrangements (say on pay), at least once every three years.
- Whether a say on pay vote should be held every one, two or three years (frequency of say on pay), at least once every six years.
- Certain golden parachute arrangements.

While public companies were concerned that say on pay would increase shareholder proposal activity, the rules actually led to a *decrease* in shareholder proposal activity because companies increased efforts to communicate and engage with shareholders. According to Manhattan Institute's Proxy Monitor, fewer shareholder proposals went to vote in the 2011 proxy season on average per Fortune 100 company than in any of the past three years, and the average number of proposals fell 16% from 2010. In addition, the percentage of shareholder proposals receiving majority support at Fortune 100 companies continued to decline:

- In 2009, 10.8% of shareholder proposals received majority support.
- In 2010, 8.4% of shareholder proposals received majority support.
- In 2011, 7.3 % of shareholder proposals received majority support.

(See [*Manhattan Institute Proxy Monitor Finding 7, 2011 Proxy Season Review*](#).)

Notably, shareholders supported say on pay in significant numbers, with average support of over 88% at S&P 500 companies. Management's say on pay proposals failed to receive majority support at only a very small percentage of companies. (See [*Say on Pay in the 2011 Proxy Season: Lessons Learned and Coming Attractions for U.S. Public Companies*](#), The Conference Board, July 2011).

Whistleblower Incentives and Protections (Section 922)

In May 2011, the SEC adopted final rules to implement a bounty program for whistleblowers who provide original information leading to a successful enforcement action with monetary sanctions exceeding \$1 million. Eligible individuals may receive a cash award between 10% and 30% of the monetary sanctions recovered by the SEC. Given the new rules, we recommend that public companies consider ways to strengthen the culture of ethics, compliance and communication internally.

Board Leadership Disclosures (Section 972)

Under the Dodd-Frank Act, the SEC issued rules requiring companies to disclose in annual proxy statements the rationale for separating or combining the chairman and CEO positions. These rules became effective on February 28, 2010.

Implementation Incomplete

The SEC has failed to implement a significant number of key governance and disclosure provisions under the Dodd-Frank Act. The SEC's current timetable is reflected at the end of this memo.

Broker Discretionary Voting (Section 957)

In September 2010, the SEC approved exchange rules prohibiting broker voting on director elections and executive compensation. Dodd-Frank requires that the SEC consider and provide guidance on prohibiting broker voting on other "significant matters" as determined by the SEC. The SEC has not proposed any guidance or provided an expected timetable for doing so.

Compensation Committee and Adviser Independence (Section 952)

The SEC has proposed rules regarding:

1. Heightened independence standards for compensation committee members, which take into account factors such as a member's receipt of consulting and advisory fees and status as an affiliate,
2. Authority of the committee to retain, compensate and oversee compensation consultants, legal counsel and other advisers to the committee,
3. Requirement to consider the independence of those advisers, and
4. Disclosures regarding a compensation consultant's conflicts of

interest. If you have not already done so, we recommend an analysis of the Compensation Committee's charter and existing composition to determine if any changes are appropriate. We also recommend that the Compensation Committee involve its securities counsel with respect to any

hiring of compensation consultants so that it can assist in ensuring compliance with the new rules.

Executive Compensation Disclosures (Section 953)

The Dodd-Frank Act requires that the SEC issue rules requiring companies to describe with clarity in annual proxy statements the relationship between executive compensation actually paid and the company's financial performance. The SEC must also issue rules requiring disclosure of:

- The median of the annual total compensation of all the company's employees except the CEO.
- The annual total compensation of the CEO.
- The ratio of the median employee annual total compensation to the CEO's annual total compensation.

The SEC expects to propose rules on these executive compensation disclosures by the end of 2011, and to adopt final rules by the end of June 2012. In the meantime, we recommend public companies gather this information so that the Compensation Committee has time to consider it in future decisions regarding compensation.

Clawback of Incentive Compensation (Section 954)

Under the Dodd-Frank Act, the SEC must instruct the national securities exchanges to require that companies develop, implement and disclose a "clawback" policy. Under the mandated policy, if a company is required to restate financial statements due to material noncompliance with relevant reporting requirements, it must recover from current and former executive officers any excess incentive compensation paid based on erroneous data for the preceding three years. The SEC intends to propose rules to implement the clawback provision by the end of 2011, and to adopt final rules by the end of June 2012.

Hedging by Employees and Directors (Section 955)

The Dodd-Frank Act calls for the SEC to issue rules requiring companies to disclose in their annual proxy statements whether any employee or director is permitted to purchase financial instruments to hedge against losses on their company stock (including stock received as part of compensation). The SEC plans to propose rules to implement this provision of the Dodd-Frank Act by the end of 2011, and to adopt final rules by the end of June 2012. We recommend a review of existing insider trading policies and consideration of whether any changes are appropriate.

SEC Proxy Access Rule (Section 971) - Vacated

The Dodd-Frank Act gave the SEC express authority to adopt rules mandating that board nominees proposed by certain shareholders be included in the company's own proxy solicitation materials. This proxy access was intended to significantly lower the cost for a shareholder to run one or potentially more board candidates against those nominated by the board.

In August 2010, the SEC approved a proxy access rule (Rule 14a-11) that would allow one or more shareholders who held at least 3% of the voting power of the company for at least three years to have nominees for up to 25% of board seats included in the company's proxy materials. The SEC also approved a related amendment to the proxy rules requiring a company to include

in its proxy materials shareholder proposals that seek to establish more liberal procedures for including a shareholder's nominee in the company's proxy materials (Rule 14a-8(i)(8)). Before proxy access could become effective, the Business Roundtable and the US Chamber of Commerce challenged the SEC rule on First Amendment and Administrative Procedure Act grounds. The SEC stayed the rule's effectiveness, as well as the effectiveness of Rule 14a-8(i)(8), pending the outcome of the case. In July 2011, the US Court of Appeals for the District of Columbia vacated Rule 14a-11, finding that the SEC failed to fully evaluate the costs and benefits of the rule, and whether the rule might disproportionately favor certain shareholders (such as union and public pension funds) over others.

After this decision, the SEC put mandatory proxy access on hold and lifted the stay on Rule 14a-8(i)(8), making it effective on September 20, 2011. This rule requires public companies to include shareholder proposals for procedures to nominate directors in their proxy materials. We recommend that public companies consider implementing advance notice provisions under their Bylaws if not already in effect and review and consider any appropriate changes to existing policies and procedures for shareholders to propose director nominees.

SEC Timetable for Future Dodd-Frank Rulemaking

In late July 2011, the SEC published the following timetable for implementing the following rules under the Dodd-Frank Act that will be relevant to most public companies:

Year-End 2011

§951: Adopt rules regarding disclosure by institutional investment managers of votes on executive compensation.

§952: Adopt exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; adopt disclosure rules regarding compensation consultant conflicts.

§§953 and 955: Propose rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors.

§954: Propose rules regarding recovery of executive compensation.

January-June 2012

§§953 and 955: Adopt rules regarding disclosure of pay-for-performance, pay ratios, and hedging by employees and directors.

§954: Adopt rules regarding recovery of executive compensation.

July-December 2012

§952: Report to Congress on study and review of the use of compensation consultants and the effects of such use.

Dates still to be Determined

§911: Create new Investor Advisory Committee (pending appointment of Investor Advocate). §§915 and 919D: Create and staff Office of Investor Advocate (pending reprogramming approval by appropriators).

§957: Issue rules defining "other significant matters" for purposes of exchange standards regarding broker voting of uninstructed shares.

Schuchat, Herzog & Brenman lawyers have closely followed the Dodd-Frank Act and regulations implementing the Act. Our lawyers represent public companies, investment companies and investment advisers impacted by the Act.

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