



Dodd Frank Update

After our last update in October 2011, the SEC has continued to lag on passing rules to implement the Dodd-Frank Act. The SEC's progress in recent months is inconsequential and its timetable for enacting planned regulations has been pushed backwards. An updated version of that timetable can be found at the end of this memorandum.

Fully Implemented Rules

As discussed in the October update 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)

The say on pay provisions became effective in April 2011 and require companies to seek non-binding shareholder advisory votes on executive compensation arrangements (say on pay) at least once every three years, the frequency of say on pay votes at least once every six years and certain golden parachute arrangements.

As mentioned in October, this provision led to fewer shareholder proposals going to vote in the 2011 proxy season on average per Fortune 100 company than in any of the past three years. However, this may not be the case during the 2012 season, particularly in the financial sector. Companies that have experienced severe hardship in 2011, causing dramatic drops in the workforce, are prepared for an active 2012 proxy season as investors organize to challenge firm's pay practices. ([Wall Street Journal, Business](#)).

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.

Amidst concerns that the Whistleblower Program would undermine internal compliance systems, in late December 2011 the House Capital Markets Subcommittee approved a bill that would require whistleblowers to take their information to internal compliance officers before handing it over to the SEC. (Fund Action, *Bill Cramps Whistleblower Efforts*). This provision was heavily

debated before the passage of the Dodd-Frank Act and the bill will now go to the House Financial Services Committee.

We will continue to keep a watchful eye on these developments. Given the current rules and possible future changes to the Whistleblower Program, 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. Rules on this topic became effective on February 28, 2010; passed as Item 407(h) of Regulation S-K. Therefore, no material action was necessary after the passage of the Dodd-Frank Act.

Implementation Incomplete

The SEC has failed to implement a significant number of key governance and disclosure provisions under the Dodd-Frank Act in accordance with its 2011 timetable. The unsuccessful regulations planned originally to go into effect in 2011 are now poised for implementation in 2012. The SEC's current timetable is reflected at the end of this memo. The following regulations are still incomplete:

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 June 2012, and to adopt final rules by year's end. 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 June 2012, and to adopt final rules by the end of the year.

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 June 2012, and to adopt final rules by the end of the year. 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 December 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:

January –June 2012

§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: 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.

About Schuchat, Herzog & Brenman LLC: Experienced. Effective. Practical. Reasonable. These characteristics define us and have guided our firm in providing diverse clients with exceptional lawyering since 2003.

Our updates are general information that may not apply in all situations. Please contact us for specific legal advice based on particular situations rather than relying on any of our updates. We'd be happy to help.

For more information, please contact:

Julie Herzog, Partner
Schuchat, Herzog & Brenman, LLC
1900 Wazee Street, Suite 300, Denver, CO 80202
303-295-9707 | 303-295-9700 (general office)
jherzog@shblegal.com
www.shblegal.com