

Summary of Corporate Governance Changes in the Dodd-Frank US Financial Regulatory Reform Act

July 2010

BACKGROUND

On July 21, 2010, President Obama signed into law the 2300-page Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). This memorandum summarizes the key corporate governance and executive compensation provisions of the Act applicable to most public companies (the other major sections of the Act that apply more specifically to the banking industry, derivatives, hedge funds and private equity, the insurance industry, and consumer and investor protection are not discussed in this memorandum). As the SEC and other regulatory agencies adopt the rules required by the Act, more detail will be forthcoming. It is important to note that many companies have already adopted versions of certain of these requirements, due to pre-existing SEC requirements, exchange requirements, or their own corporate governance values. However, the new rules will now result in consistent procedures and disclosure across a broader spectrum of public companies.

Corporate Governance/Executive Compensation Changes with Potentially Large Impact

1. **Proxy access.** The Act authorizes the SEC to require companies to include in their proxy solicitation materials nominees submitted by shareholders and also to follow certain procedures in relation to these proxy materials. We expect the SEC to adopt new rules that will go into effect for the 2011 proxy season, which will in part increase the power of more well-organized stockholders and those stockholders who have a specific agenda item that they would like to bring to a stockholder vote. Hedge funds are an example of this type of stockholder. While the rules are not likely to make hedge funds any more or less effective in their campaigns, the rules should lower the costs to hedge funds of doing so. Public employee, union and social activist funds will be the primary beneficiaries of proxy access, and many already have assembled lists of potential directors candidates.
2. **Majority voting for director elections.** The Act does not require majority voting for uncontested director elections and otherwise leaves in place the plurality voting that governs most companies. However, we expect public pension funds and union funds to continue to press issuers to voluntarily adopt majority voting because it is a relatively inexpensive, reasonably effective mechanism of leverage by such investors. To use the majority voting tool requires very little in terms of stock holding periods, minimum ownership requirements, responsible alternative candidates, alternative visions or business plans. We predict that issuers will successfully counter arguments for majority voting with the argument that proxy access obviates the need for – and is a more responsible approach than – majority voting. Nonetheless, the proxy access power may be so significant in particular cases that shareholders are able to negotiate a majority voting concession from Management and the Board.
3. **Say-on-pay.** The Act requires that at least once every three years, a company's proxy statement must include a separate non-binding shareholder vote to approve the company's executive compensation as disclosed in the proxy statement. At least once every six years, the shareholders must vote by separate resolution on how frequently to have the say-on-pay vote (every year, every two years or every three years). More frequent voting should keep companies in better touch with investors, reduce the likelihood of pent up shareholder anger over compensation and make the compensation issue "routine," but issuers may be subject to other circumstances (e.g. cost constraints, labor union negotiations, etc.) that press for less frequent voting.
4. **Pay ratio disclosure.** Under the Act, companies will be required to disclose the median annual total compensation of all employees other than the CEO, the annual total compensation of the CEO and the ratio of the two. It has been argued that these three data points, standing only in relation to each other and without context, are meaningless, will be misinterpreted and are potential flashpoints. Therefore, it will be important for companies to provide appropriate context – such as the depth, scope and complexity of the business, the number of employees, revenue, earnings, assets, and geographic expanse - to support the compensation level of the CEO. The compensation discussion and analysis portion of, and the new executive summaries in, proxy statements will need to be revised accordingly to comply with the new rules.

More Moderate Impact Corporate Governance/Executive Compensation Changes

5. **Board leadership and CEO disclosures.** The Act orders the SEC to require issuers to disclose in their annual proxy statements the reasons why the company has chosen to combine or separate the Board chairman and CEO positions.
6. **Broker discretionary voting.** Stock exchanges must prohibit broker discretionary voting in connection with the election of directors, executive compensation or any other significant matter, as determined by the SEC. NYSE requirements already prohibit such voting in connection with the election of directors and share compensation plans. Adding additional areas of prohibition

is not expected to make a large difference in the outcome of these votes.

7. **Say-on-golden parachutes.** Proxy statements seeking shareholder approval of an acquisition, merger, consolidation or proposed sale of all or substantially all of a company's assets must disclose "golden parachute" payments and, in the unlikely event this compensation was not previously voted upon under the regular say-on-pay votes, must include a separate nonbinding shareholder resolution to approve such agreements.
8. **Compensation committee composition.** Stock Exchanges are to require compensation committees to meet new "independence" standards that include consideration of the source of compensation for the director (such as consulting, advisory or other compensatory fees paid by the company) and whether the director is affiliated with the company.
9. **Compensation Committee Consultant Standards.** Compensation committees will be required to consider certain independence factors (to be determined by the SEC) with respect to their consultants, legal counsel and other advisors. Companies will be required to disclose the performance and possible conflicts of interest of compensation consultants.
10. **Compensation Committee Authority.** The Act grants compensation committees the power of hiring and overseeing compensation consultants, legal counsel and other committee advisors and requires companies to provide appropriate funding for these advisors. These practices are already in place for many compensation committees.
11. **Pay-for-performance disclosure.** The Act requires companies to disclose in their annual proxy statements the relationship between executive compensation and the company's financial performance, basically as measured by total shareholder return.
12. **Compensation clawbacks.** Companies must develop, implement and disclose policies with respect to the clawback of incentive-based compensation paid to

current or former executive officers following a restatement.

13. **Hedging disclosure.** Issuers must disclose in their annual proxy statements whether employees or directors of the company are permitted to hedge any company equity securities granted as compensation or otherwise held. Many companies have already adopted anti-hedging policies, and this new rule may encourage other companies to do so.

Changes Affecting Certain Classes of Companies

14. **Financial institution compensation restrictions.** Bank holding companies and certain other financial institutions will be prohibited from providing executive officers, employees, directors or principal shareholders with compensation that is excessive or that could lead to material financial loss to the financial institution. The SEC already requires disclosure of such compensation but does not prohibit providing such compensation.
15. **Disclosure of say-on-pay and say-on-golden parachute votes by institutional investors.** Institutional investment managers subject to Section 13(f) of the Securities Exchange Act of 1934 must disclose their say-on-pay and say-on-golden-parachute voting records annually. Mutual funds already make these disclosures. The Act has broadened the list to include other institutional investors (e.g., banks).
16. **Board of director requirements for nationally recognized statistical rating organizations.** The Act substantially increases the oversight, liability, disclosure obligations and procedural requirements for credit rating agencies. For example, at least one half of the Board (and no fewer than two directors) must be "independent" as described in the Act, and some of them must be users of the ratings provided by the credit rating agencies either individually or through other companies for which they serve as officers or Directors. Director compensation must not be linked to corporate performance and must otherwise be structured to "ensure" independence of judgment. The maximum term of board service is a non-renewable five years. Among their

duties, directors are required to oversee policies and procedures for determining credit ratings, conflicts of interest and the effectiveness of internal controls for credit rating.

17. **Smaller public companies permanently exempt from Sarbanes-Oxley internal control requirements.** The Act exempts smaller public companies from compliance with the internal control auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act. This is good news for these companies, who had previously benefited from the SEC's discretion in continuously postponing the effective date but never formally eliminating the requirement. It is now eliminated.

This Securities Update was written by C. Russel Hansen, Jr., Of Counsel in Burns & Levinson's Securities Law Group.

Explanatory Notes:

This update is intended to provide a general summary and to call your attention to a number of rule changes which may be of possible interest and relevance to you. It is not intended to constitute a legal opinion or definitive summary of all changes that could be material to you or to serve as a substitute for legal advice.

Please contact a member of the Securities Law Group at Burns & Levinson if you have any questions about these rule changes or want to learn more about our expertise in this area.

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In the securities compliance area, we advise our clients on corporate governance/Sarbanes-Oxley and SEC and stock exchange reporting and compliance. Specifically, we assist our clients in fulfilling their ongoing SEC and stock exchange reporting obligations, managing sensitive disclosure issues internally and with industry analysts, preparing proxy statements and handling stockholder meetings, structuring employee benefit plans and executive compensation packages under the SEC's "short-swing profit" reporting and liability rules, effecting resales of securities in the public trading markets under

the SEC's Rule 144, and advising boards of directors and board committees concerning the requirements and restrictions imposed on their actions by the securities laws and corporate governance laws such as Sarbanes-Oxley. We have served as special securities counsel to the Boards and Audit Committees of publicly traded companies looking for opinions or advice of counsel other than their regular outside counsel.

We have counseled clients both domestic and international, from emerging growth companies to large public companies, and are positioned to provide clients with timely, expert, efficient and cost effective advice that they need to meet their business objectives. We take a practical and proactive approach to the rapidly changing securities disclosure and corporate governance laws, providing our clients with timely updates, identifying specific situations in which the new laws will impact particular clients either operationally or structurally, and working with clients to implement the changes that are either required or advisable to comply with the new regulatory schemes and investor sentiment.

Underwriters and Investment Banks

Our attorneys also represent underwriters in initial and follow-on public offerings and investment banks in private placements and mergers and acquisitions.