O L S H A N
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Client Alert

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The Dodd-Frank Act: Overview of Impact on Public Companies

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The Act is meant to overhaul the United States financial oversight regime and is considered to effect the most sweeping change to financial sector regulation since the reforms following the Great Depression. The Act touches on a broad range of topics, including responsibilities of public companies under the securities acts, registration requirements for hedge fund and private equity fund advisers, banks and other financial institutions, regulation of securities, over-the-counter derivatives and credit rating agencies, and modification of the regulatory structure under which the Federal Reserve and the Securities and Exchange Commission (the "SEC") operate.

This Client Alert provides an overview of the principal provisions of the Act that will have a significant impact on public companies.

In many cases, the SEC is directed to implement the requirements of the Act by adopting rules or directing the national securities exchanges to adopt rules. The Act also authorizes the SEC or securities exchanges to exempt certain categories of issuers, such as smaller issuers or foreign issuers, from certain requirements of the Act. As a result, many of the details and much of the impact of the Act may not be known until such rules are adopted.

Shareholder Voting

Non-Binding "Say-On-Pay" and "Say-On-Golden Parachutes" Vote

In an effort to expand shareholders' rights and adjust the transparency of public company decisions regarding executive compensation, the Act mandates that at least once every three years, publicly traded companies have a non-binding shareholder vote on the compensation paid to any executives whose compensation must be disclosed under SEC rules. The Act requires that once every six years such public companies have a non-binding shareholder vote on whether the "say-on-pay" vote should occur every one, two or three years.

The Act includes a similar provision regarding golden parachute compensation. Any proxy statement subject to SEC regulation seeking shareholder approval of an acquisition, merger, consolidation, proposed sale or other disposition of all or substantially all of the assets of the issuer must include a statement by the person making such a solicitation disclosing any "parachute payments" to any named executive officers of the issuer (or of the acquiring issuer, if such issuer is not the acquiring issuer). The Act also requires that such proxy statements include a separate non-binding proposal to approve these payments, unless the payments have already been subject to a "say-on-pay" vote.

These requirements are effective six months after the effective date of the Act. The Act also gives the SEC the authority to exempt certain issuers or classes of issuers and specifically directs the SEC to consider whether the requirements would disproportionately burden small issuers.

Broker Discretionary Voting

The Act amends the Securities Exchange Act of 1934 (the "Exchange Act") to require stock exchanges to prohibit any member (i.e., brokers) that is not a beneficial holder of a registered security from voting the security in connection with the election of directors, executive compensation, or other significant matter as determined by the SEC, unless such member has received approval from the beneficial holder of the security. In response, the New York Stock Exchange (the "NYSE") issued an information memorandum on August 4, 2010 stating that it intends to file an amendment to NYSE Rule 452 to prohibit its members from voting on matters related to executive compensation, including "say-on-pay" proposals, without prior shareholder instruction at shareholder meetings held after July 21, 2010. While the amendment to NYSE Rule 452 has not yet been filed, the prohibition on broker discretionary voting on executive compensation is effective immediately. The information memorandum also states that NYSE Amex and NYSE Arca will file identical amendments to their rules.

Proxy Access

The Act authorizes (but does not require) the SEC to adopt rules allowing shareholders to use an issuer's proxy solicitation materials for the purpose of nominating individuals to the issuer's board and gives the SEC wide latitude in prescribing applicable procedures. As authorized by the Act, on August 25, 2010, the SEC adopted mandatory proxy access for all U.S. public companies. Under the new rules, any shareholder or group of shareholders holding at least 3% of a company's voting stock for at least three years will have the right to have nominees for director (up to a maximum of 25% of the entire board) included in the company's proxy materials. The new rules do not apply to foreign private issuers or to companies that are subject to reporting requirements solely because they have registered debt. The new rules also provide for a three-year delay in effectiveness for "smaller reporting companies" (companies that have a public float of less than $75 million). New Rule 14a-11 will become effective 60 days from publication in the Federal Register (which is expected shortly), in time for the 2011 proxy season.

Disclosure Concerning the Chairman and Chief Executive Officer Positions

In an effort to provide investors with increased transparency in relation to a company's corporate governance, the Act requires the SEC to establish rules that would obligate an issuer to disclose to investors in its annual proxy statements the reasons behind combining or separating the chairman of the board and chief executive officer positions (or any equivalent positions). As the SEC's 2009 amendments to the proxy rules already require similar disclosure, it is unclear whether this provision of the Act will result in any additional disclosure requirements.

Executive Compensation

Pay for Performance Disclosure and Comparison of Total Annual Compensation

The Act requires an issuer to disclose in clear terms (graphic or otherwise) in its proxy statement the relationship between executive compensation actually paid and the issuer's financial performance. Current SEC rules already require issuers to disclose such information in their filings. Thus, it is unclear what additional disclosure will be required by these provisions.

The Act includes other executive compensation disclosure requirements, such as requiring issuers to describe (i) the median annual total compensation of all employees of the issuer, excluding the chief executive officer, (ii) the annual total compensation of the chief

executive officer and (iii) the ratio of the median annual total compensation of the issuer's employees to that of the chief executive officer.

Disclosure of Employee and Director Hedging

The Act directs the SEC to require issuers to disclose in their proxy materials for an annual meeting of shareholders whether employees or directors are permitted to purchase financial instruments designed to hedge or offset a decrease in the market value of equity securities either (i) held directly or indirectly by such employees or directors or (ii) granted as part of their respective compensation as employees or directors.

Compensation Committee Independence

The Act directs the SEC to adopt rules instructing the national securities exchanges to prohibit the listing of issuers that do not have independent compensation committees. Under the Act, the SEC's rules must require the national securities exchanges to consider the following factors in defining independence for compensation committee members: (i) the source of compensation for directors (such as consulting, advisory or other compensatory fees paid by the issuer) and (ii) whether the directors on the committee are affiliated with the issuer.

However, the Act provides that national securities exchanges may exempt issuers from these requirements at their discretion, taking into consideration an issuer's size and any other relevant factors. Further, the Act does not require all listed companies to form compensation committees; it only states that once formed, independence of a compensation committee is required.

Compensation Committee Adviser Independence

The Act provides that a company's compensation committee may only select a compensation consultant, legal counsel or other adviser after taking into consideration competitively neutral independence factors to be identified by the SEC. These factors are to include (i) the provision of other services to the issuer by the compensation consultant, legal counsel or other adviser, (ii) the amount of fees received from the issuer by the compensation consultant, legal counsel or other adviser, (iii) the policies and procedures of the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest, (iv) any business or personal relationship the compensation consultant, legal counsel or other adviser has with any member of the compensation committee and (v) any stock of the issuer owned by the compensation consultant, legal counsel or other adviser. The SEC is directed to require the national securities exchanges to enforce these provisions no later than 360 days after the date of enactment, although controlled companies (i.e., companies where 50% of the voting power is held by an individual, a group or another company) and foreign private issuers are exempt. The Act's provisions also grant national securities exchanges the authority to exempt other categories of issuers at their discretion, taking into account the impact on smaller reporting companies. The Act does not require that compensation advisers be independent, nor does the Act require that compensation committees hire outside advisers at all.

Executive Compensation Clawback Policies

The Act requires that the SEC enact rules directing the national securities exchanges to require listed companies to adopt policies providing (i) for disclosure of a company's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws and (ii) that, in the event a company is required to prepare an accounting restatement due to its material noncompliance with any financial reporting

requirement under the securities laws, the company will recover from any current or former executive officer who received incentive-based compensation (including stock options) during the preceding three-year period based on the erroneous data, the amount that is in excess of what would have been paid to the executive officer under the restated financial information. The SEC is further required to direct the national securities exchanges to prohibit the listing of companies which do not comply with those rules. This clawback requirement is significantly broader than the clawback contained in the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), which, among other things, had a one-year look back, only applied to restatements that resulted from misconduct and only applied to chief executive officers and chief financial officers.

Other Relevant Provisions

Exemption for Smaller Public Companies from Certain Sarbanes-Oxley Internal Control Requirements

The Act exempts non-accelerated filers and smaller reporting companies (i.e., companies with a public float of less than $75 million) from Section 404(b) of the Sarbanes-Oxley Act, which requires that a company's independent accounting firm provide an attestation report on the company's internal control over financial reporting. These companies will still be required to maintain internal control over financial reporting and assess the effectiveness of their internal controls on an annual basis. Previously, the SEC had temporarily delayed the application of this requirement to non-accelerated filers several times. In addition, the Act instructs the SEC to conduct a study within nine months after the passage of the Act to determine how to reduce the burden of complying with Section 404 for companies whose market capitalization falls between $75 million and $250 million, while maintaining appropriate investor protections.

Whistleblower Protection

The Act modifies both the Commodity Exchange Act and the Exchange Act to protect and provide incentives for individuals who supply information relating to a violation of securities laws. The Act provides for monetary awards for whistleblowers of 10-30% of the total monetary sanctions imposed in an enforcement action resulting in a sanction of at least $1,000,000. The Act also provides protection against employers who retaliate - employees may be entitled to back pay owed, litigation costs and attorneys' fees, and reinstatement of employment if they had been terminated for whistleblowing.

Regulation D Eligibility

The Act modifies the eligibility standard of Regulation D under the Securities Act of 1933 (the "Securities Act") to prevent certain "bad actors" from enjoying the benefits of Regulation D exemptions from registration. Under the Act, such persons are defined as those who (i) have been convicted of a felony or misdemeanor in connection with the purchase or sale of any security or false filing with the SEC, (ii) are subject to a final order (within 10 years of the filing of an offering or sale) based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct, or (iii) are subject to a final order barring them from associating with regulated entities, from engaging in the business of securities, insurance or banking, or from engaging in savings association or credit union activities. The Act requires that the SEC issue rules incorporating such definitions no later than one year after enactment.

The Accredited Investor Standard

The Act modifies the definition of "accredited investor" to provide that the value of a person's primary residence is to be excluded in the determination of whether a person's net

worth exceeds $1 million. The Act permits the SEC to revisit this definition in its discretion, in consideration of appropriate investor protection, the public interest and in light of the economy, and requires the SEC to conduct this review four years after the date of enactment and at least once every four years thereafter.

Aiding and Abetting Liability Standard

The Act expands the scope of liability under the Securities Act and the Investment Company Act of 1940 (the "Investment Company Act") by permitting government enforcement actions against persons who "knowingly or recklessly" provide substantial assistance in violation of either act. The Act similarly expands the scope of liability under the Investment Advisers Act of 1940 (the "Investment Advisers Act") by permitting government enforcement actions against persons who "knowingly or recklessly" aided, abetted, counseled, commanded, induced or procured a violation of such act.

Strengthening of SEC Enforcement Powers

The Act grants the SEC three significant additions to its enforcement powers. First, the Act allows the SEC to impose monetary penalties against individuals, as opposed to regulated entities, in cease and desist proceedings under the Securities Act, the Exchange Act, the Investment Company Act and the Investment Advisers Act. Second, the Act expands federal court jurisdiction by permitting the SEC to bring enforcement actions against individuals who have violated the Securities Act, the Exchange Act and the Investment Advisers Act through (i) conduct within the U.S. that constitutes significant steps in furtherance of such a violation, even if the securities transaction occurs outside the U.S. and involves only foreign investors, or (ii) conduct occurring outside the U.S. that has a foreseeable substantial effect within the U.S. Third, the Act expands the scope of control liability under Section 20(a) of the Exchange Act to apply to SEC enforcement actions, in addition to private actions.

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Please feel free to contact any of the partners listed below or any Corporate Partner with whom you work if you would like to discuss the Act and its potential ramifications.

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