

THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT **By Sarika Shah**

The Dodd-Frank Wall Street Reform and Consumer Protection Act is a federal statute signed into law by President Obama on July 21, 2010. A direct result of the financial crisis, the Act is primarily designed to help reform the US financial system, which has significant impact on public companies.

The Act was originally proposed in late 2009 by Senate Banking Committee Chair Chris Dodd and in the House by Representative Barney Frank, and is the most extensive financial regulation passed into law since the Great Depression.

The following summarizes sections of the Act that directly affect US public companies.

Say on Pay

“Say on Pay” is designed to improve board accountability and better align compensation with long term value creation for shareholders. The movement resulted from the perception by activist shareholders that executive compensation was/is excessive, specifically when executive compensation policies reward failure. Executive compensation rose sharply in the 1980's and increased continuously through the years. Say on Pay is a relatively new trend in the US, with AFLAC becoming the first US Corporation to voluntarily give shareholders an advisory vote on executive compensation in 2007. The UK became one of the first countries to enact Say on Pay legislation in 2002.

Some highlights of Say on Pay include:

- the SEC is authorized to require non-binding Say on Pay votes for all public companies;
- companies must include a proxy resolution on shareholder approval of executive compensation; and
- companies must also include a shareholder resolution to determine the frequency of executive compensation approval by shareholders, either every one, two, or three years.

Independence of Compensation Committees

Under the Dodd-Frank Act, companies can have only independent directors on their compensation committees. Committee members must meet independence standards similar to audit committee members under Sarbanes-Oxley, and the definition of “independence” will be issued by the national securities exchanges and associations.

The following will be considered:

- the source of a director's compensation, including any consulting, advisory, or other compensatory fee paid by the company to the director; and
- whether the director is affiliated with the company, a subsidiary, or an affiliate of a subsidiary.

Clawbacks

Under the Act, public companies must disclose any policies on incentive-based compensation that are based on financial information required to be reported under securities laws. If the company is required to prepare an accounting restatement due to its material noncompliance with any such financial reporting requirement, the company

has the right to recover the excess portion of any incentive-based compensation payments made during the three-year period preceding the restatement date to current or former executive officers (including stock options awarded as compensation) based on the erroneous data.

CD&A Pay Comparisons

Along with many other requirements passed into law are mandatory disclosures within the Compensation and Discussion Analysis (“CD&A”) section of the proxy. Along with Say on Pay, other disclosures include:

- pay vs. performance – the relationship between executive compensation actually paid and the financial performance of the company, taking into account any change in the value of shares of stock and dividends and any distributions (this disclosure may include a graphic);
- a comparison of the CEO’s pay to the median pay of all employees, disclosed in the form of a ratio;
- the median of the total annual compensation of all employees, except the CEO; and
- the CEO’s total annual compensation.

The Act’s executive compensation provisions will have significant impact on public companies, requiring heightened disclosures in the 2011 proxy season. As the season approaches, watch for interesting developments.

Sarika Shah is Senior Compensation Specialist at Sunoco.