

# Opinion

## FINANCIAL REFORMS

*Influencing a “New Normal” in Corporate Governance*



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In her regular column on corporate governance, Holly Gregory examines the likely impact of the Frank and Dodd Bills’ mandated governance reforms on public companies and their relationships with shareholders.

### MANDATED GOVERNANCE REFORMS

In late April 2010, the short Republican filibuster of the Restoring American Financial Stability Act of 2010 (S. 3217) (Dodd Bill) gave way to debates on the Senate floor and a wave of over 200 amendment proposals. The Dodd Bill passed in the Senate on May 20, 2010. Both the Dodd Bill and The Wall Street Reform and Consumer Protection Act of 2009 (H.R. 4173) (Frank Bill), which passed in the House on December 11, 2009, are primarily focused on recasting the financial regulatory structure. However, both bills also include a number of governance reforms that have long been on the wish list of shareholder activists, and if enacted will accelerate changes in corporate relationships with shareholders, as shareholders will gain a significantly greater voice in corporate governance (see *Box, Frank and Dodd Bills: Selected Governance Provisions Compared*).

The reforms would mandate governance practices that until now have been the basis of negotiation and “private ordering” by shareholders and boards at individual companies. In other words, decisions by individual companies whether to adopt these governance practices

will be replaced by strict federal mandate, operating through SEC regulation and the listing rules of national securities exchanges like the New York Stock Exchange and NASDAQ.

The governance reform provisions that appear in the Frank and Dodd Bills were narrowed down from the various proposals that appeared in about a dozen bills introduced in Congress in 2009 and 2010 that sought to impose significant governance regulations on public companies. The process of reconciling the Dodd and Frank Bills must now proceed, with expectations that President Obama will have legislation to sign this summer.

>> For up-to-date information on the status of these regulatory reforms, search [Financial Regulation Reform Initiatives](#) on our website.

### MORE SHAREHOLDER POWER

Proponents believe that the governance reforms in the Frank and Dodd Bills will reinvigorate board accountability to shareholders. Others believe that boards will be distracted from their governance tasks and directors will be impeded in their ability to form their own fiduciary judgments. The reality is likely to

## FRANK AND DODD BILLS: SELECTED GOVERNANCE PROVISIONS COMPARED

PROVISION	FRANK BILL (H.R. 4173)	DODD BILL (S. 3217)
<i>Proxy access</i>	SEC given express authority (but not required) to issue rules relating to the inclusion, in an issuer's proxy solicitation materials, of shareholder nominees to an issuer's board of directors.	SEC given express authority (but not required) to issue rules relating to the inclusion, in an issuer's proxy solicitation materials, of shareholder nominees to an issuer's board of directors.
<i>Majority voting in uncontested director elections</i>	Not addressed.	SEC instructed to issue rules requiring that directors of issuers listed on a national securities exchange who fail to receive a majority of votes cast in an uncontested election tender their resignations. Board would not be required to accept resignation, but would have to act by unanimous vote and make public within 30 days why resignation was not accepted and why decision was in issuer's best interests.
<i>Shareholder advisory vote on executive pay: "say on pay"</i>	SEC required to issue rules giving shareholders non-binding vote on executive pay packages for the issuer's named executive officers as disclosed in the proxy statement filed in connection with an annual meeting (or special meeting in lieu thereof) for which proxies or consents are solicited.	Exchange Act to be amended to provide shareholders non-binding vote on the compensation for the issuer's named executive officers as disclosed in the proxy statement filed in connection with any shareholder meeting for which the SEC's proxy rules require such disclosure.
<i>Shareholder advisory vote on severance compensation: "say on severance"</i>	SEC required to issue rules giving shareholders non-binding vote on "golden parachute" compensation disclosed in proxy or consent solicitation materials relating to a merger, acquisition or other transaction that may involve a change of control of the issuer.	Not addressed.
<i>Heightened compensation committee independence standard, retention of advisers by compensation committee and related disclosure</i>	SEC required to issue rules directing national securities exchanges to prohibit listing of issuer if: <ul style="list-style-type: none"> <li>(a) compensation committee members are not "independent" under a heightened standard: i.e., who do not receive consulting, advisory or other fees from the issuer, <b>except</b> compensation for services rendered to the issuer as a member of the board and/or a committee thereof;</li> <li>(b) compensation committee does not have authority to retain independent compensation consultants, counsel and other advisers and maintain responsibility for their oversight, with appropriate funding for retention of advisers provided by issuer; and</li> <li>(c) issuer does not disclose in all proxy statements for annual meetings (or special meetings in lieu of disclosure) whether the compensation committee retained and obtained the advice of a compensation consultant.</li> </ul>	SEC required to issue rules directing national securities exchanges to prohibit listing of issuer if: <ul style="list-style-type: none"> <li>(a) compensation committee members are not "independent" under a heightened standard: i.e., who do not receive any compensation from the issuer other than in their capacity as board or committee members <b>and</b> who are not affiliated with the issuer or its subsidiaries;</li> <li>(b) compensation committee does not have authority to retain independent compensation consultants, counsel and other advisers and maintain responsibility for their oversight, with "reasonable" compensation for advisers provided by issuer; and</li> <li>(c) issuer does not disclose in all proxy statements for annual meetings (or special meetings in lieu of disclosure) whether the compensation committee retained a compensation consultant, whether the work performed by that consultant raised a conflict of interest, the nature of the conflict and how it is being addressed.</li> </ul>
<i>Standards for adviser independence</i>	SEC required to issue rules directing national securities exchanges to prohibit listing if advisers to compensation committee do not meet SEC standards of independence (to be promulgated by regulation).	SEC required to issue rules directing national securities exchanges to prohibit listing if the compensation committee does not consider specific factors identified by SEC before selecting advisers (to be promulgated by regulation).
<i>Additional executive compensation disclosures</i>	Not addressed.	SEC required to issue rules requiring clear description of the relationship between compensation and the issuer's financial performance for named executive officers in the issuer's annual proxy statement, taking into account "any change in the value of the shares of stock and dividends of the issuer and any distributions." This disclosure may include a graphic representation of the required information.

## ASSESSING SHAREHOLDER RELATIONS CHECKLIST

A board should consider the following questions when assessing the company's approach to shareholder relations:

### CULTURE AND ATTITUDE

- Are we cultivating the appropriate culture and attitude for healthy and productive shareholder engagement?
- Do the senior management team and the board understand the new reality of pending changes and heightened pressures?

### GOVERNANCE STRUCTURES

- Have we undertaken an assessment of our board composition and our governance structures and practices in light of the emerging changes in governance regulation and do we know what we may need to change should it be enacted?
- Are there any changes that make sense to make now to get out ahead of the curve?

### KEY SHAREHOLDERS

- Do we know who our top 25 to 30 shareholders are and what governance issues they are most interested in and concerned about? Of these top shareholders:
  - Do we know how they tend to vote and do we know which proxy advisory services they rely on?
  - Do we know what guidelines they use in voting on shareholder matters?
  - Do we know what activist campaigns they have engaged in?
- Outside of our largest shareholders, do we have any shareholders who regularly bring shareholder proposals at our company or at other companies or otherwise engage in active shareholder strategies? (For example, consider ownership by public and union pension funds.)

### SHAREHOLDER OUTREACH

- What kind of shareholder outreach does the company engage in?
- Do we have a significant number of small shareholders who do not participate in voting, and if so, what can we do to encourage them to vote?
- Is the company devoting appropriate resources to shareholder communication and engagement issues, including adequate staff and advisors?
- What is the role of investor relations and our corporate secretary/ chief governance officer in these efforts, and how do they interact on these issues? Does the company need more focused outreach and interaction with both traditional analysts and their governance-focused colleagues?
- Do we have a creative, credible and capable team in place?

### GOVERNANCE COMMUNITY INVOLVEMENT

- Are we linked in to the range of groups who influence thinking in the governance area, from the Council of Institutional Investors to the Society of Corporate Secretaries and Governance Professionals

to the Business Roundtable and National Association of Corporate Directors?

- Is the corporate secretary/ chief governance officer or other member of the management team engaged in local chapters of these groups where possible and, in particular, working at building informal relationships with thought leaders in the shareholder community?

### LAWS AND REGULATIONS

- Are we prepared to involve independent directors in shareholder communications on key issues when appropriate (for example, involving the lead director and the chairs of the compensation and governance committees in meetings with key shareholders based on the particular issue)?
- Have we adopted a clear policy about shareholder and other communications by individual directors to address securities law and fiduciary duty concerns about the disclosure of confidential information? In addition:
  - Have we reminded individual directors that they should not engage in ad hoc communications about the company with shareholders, the media or others?
  - Are the board leader and counsel involved in the coordination of all these communications?

### PROXY ADVISORS

- Do we regularly review information available from proxy advisors concerning their views, including any policy guidance that informs their vote recommendations?
- Where our practices deviate from the views promoted by proxy advisors, have we articulated our rationale for our practice and have we communicated to shareholders why we believe it is the better approach for our company?
- Has the corporate secretary/ chief governance officer or other appropriate member of management cultivated a positive relationship with proxy advisors?

### INFORMATION TO SHAREHOLDERS

- Do we view the company's public filings as an opportunity to communicate with shareholders or merely as a regulatory compliance burden?
- Are we doing all that we can to provide transparent, relevant information to shareholders and avoid boilerplate?
- In instances where board decisions (whether related to company strategy or governance matters) diverge from the known priorities of a significant segment of the company's shareholders, are we doing all we can to explain the rationale for the decisions, particularly where the long-term benefits associated with certain decisions may not be immediately clear?
- Have we considered what other information shareholders may need to understand the situation the way the board views it?
- What else should we be doing to address the challenges of the "new normal" in governance?

be somewhere in the middle, with variation on the spectrum dependent on how both shareholders and boards approach the “new normal” in each company.

Companies already operate in an environment of intense and increasing scrutiny from regulators, shareholders, the media and the public at large. Shareholder power has increased over the past decade as shareholders have become more active, vocal and engaged in coordinated activity (with proxy advisors playing a significant role in this coordination). If the provisions for greater shareholder proxy access and shareholder advisory votes on executive compensation included in the Frank and Dodd Bills are enacted into law, board decisions concerning board composition and executive compensation are likely to come under even more intense scrutiny. Governing under that new regulatory scheme will require boards and senior management to attend to more effective communication and engagement with shareholders.

## IMPROVING SHAREHOLDER RELATIONS

Many companies have reacted to shareholder pressure by voluntarily adopting revised governance practices and engaging in discussions with their large shareholders about particular governance issues. For example, a significant number of the largest US publicly traded companies have already adopted aspects of the proposed governance reforms. It is estimated that approximately 70% of S&P 500 companies have already adopted majority voting in the uncontested election of directors. In addition, a growing number of S&P 500 companies are providing shareholders with an advisory vote on executive compensation.

Several companies, such as Pfizer, UnitedHealth and Home Depot, have engaged creatively with significant shareholders, for example, inviting them to discuss their concerns about executive compensation, board composition, and social and environmental issues. These efforts can supplement other attempts at quiet diplomacy with shareholders that often occur in the context of proxy season. Some companies, including Schering Plough and Prudential Financial, have also experimented with shareholder surveys and web-based communications as means of obtaining insights on shareholders’ concerns. These experiences can provide guidance for the much broader array of companies that will be subject to the legislative mandate.

Should the legislation pass, we can expect corporations to intensify efforts to engage with shareholders. Creative efforts to engage with shareholders will be key to peaceful and supportive relationships with shareholders in the new governance environment. For a list of issues boards should consider when evaluating their approach to shareholder relations, see *Box, Assessing Shareholder Relations Checklist*.

In general, many companies will need to devote greater time, energy, attention and corporate resources both at the management and board level to understanding the key concerns of the company’s shareholder base and to improve company disclosures and communications. In addition to identifying the concerns of significant shareholders, boards and corporate management will need to explore ways to encourage shareholders to make company-specific decisions and understand the board’s long-term view of the company.

>> For additional ways boards can improve their relationship with shareholders, search [Shareholder Communications: A Focus for the 2010 Board Agenda](#) on our website.

*The views stated above are solely attributable to Ms. Gregory and do not reflect the views of Weil, Gotshal & Manges LLP or its clients.*