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Congressional Watch: Senate Passes Financial Stability Bill Calling for SEC Proxy Access Authority and Other Governance and Executive Compensation Reforms

On May 20, 2010, the Senate passed The Restoring American Financial Stability Act of 2010 (the "Dodd Bill"), which was introduced by Senator Christopher J. Dodd (D-CT), Chairman of the Senate Banking Committee, in March 2010 and amended in several respects.[1] The Dodd Bill's corporate governance and executive compensation reform proposals are similar in important respects to those contained in The Wall Street Reform and Consumer Protection Act of 2009 introduced by Representative Barney Frank (D-MA), Chairman of the House Financial Services Committee, and passed by the House on December 11, 2009 (the "Frank Bill").[2]

The Dodd Bill must now be reconciled with the Frank Bill. Chairman Dodd and Chairman Frank, who will lead the reconciliation effort, have been reported as saying that they are confident that a final bill could be ready for signature by President Barack Obama by July 4, 2010.

This Briefing contains a chart comparing the governance and compensation-related provisions adopted by the Senate in the form of the Dodd Bill with those already adopted by the House in the form of the Frank Bill. It also discusses the Dodd Bill's provisions relating to the SEC and to Regulation D offerings.

The key corporate governance and executive compensation changes in the final Dodd Bill compared with the draft that was introduced into the Senate in March 2010 are in the areas of broker discretionary voting and disclosure of the ratio of the median of total compensation of all employees (except the CEO) to total CEO compensation. Additional amendments relate to Regulation D offerings.

Please note that the provisions described below account for only a relatively small proportion of the 1500+ page Dodd Bill. The Dodd Bill would also (among other things):

- create a Consumer Financial Protection Bureau (within the Federal Reserve) with a mandate to protect consumers from unfair, deceptive, and abusive lending practices;[3]
- create a Financial Stability Oversight Council, composed of the heads of the various regulatory agencies (including the Chairman of the SEC), to address emerging risks posed by large, complex financial companies and by products and activities in the financial sector;[4]
- attempt to prevent large financial companies from becoming "too big to fail" by heightening capital, leverage and liquidity requirements and requiring such companies to prepare and submit contingency plans for an orderly wind-down of insolvent operations;[5]

- make permanent the Investor Advisory Committee, established by the SEC on June 3, 2009 to advise the SEC on matters of concern to investors;[6] and
- impose significant new regulations over financial institutions, credit rating agencies, hedge fund advisers, issuers of securitized products, and dealers and other participants in the over-the-counter market for swaps and other derivative securities.[7]

Comparison of the Frank and Dodd Bills

GOVERNANCE/ COMPENSATION PROVISION	FRANK BILL, H.R. 4173 (PASSED BY THE HOUSE ON DECEMBER 11, 2009)	DODD BILL, S. 3217 (PASSED BY THE SENATE ON MAY 20, 2010)
Proxy access	SEC given express authority to adopt rules and procedures relating to the inclusion, in an issuer's proxy solicitation materials, of shareholder nominees to an issuer's board of directors, but is not required to do so. (§ 7222)	SEC given express authority to adopt rules and procedures relating to the inclusion, in an issuer's proxy solicitation materials, of shareholder nominees to an issuer's board of directors, but is not required to do so. (§ 972)
Majority voting in uncontested director elections	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 must 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 its analysis as to why the resignation was not accepted and why its decision was in the best interests of the issuer and its shareholders.[8] (§ 971)
Disclosure of Chairman and CEO structure	Not addressed.	SEC instructed to issue rules requiring issuers to disclose the reasons why the positions of Chairman of the Board and CEO have been combined or not combined.[9] (§ 973)
Shareholder advisory vote on executive pay	SEC required to issue final rules permitting shareholders to cast 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. Proxy statements for shareholder meetings occurring more than six months after enactment must include such resolution. (§ 2002)	Exchange Act to be amended to permit shareholders to cast non-binding advisory votes 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 compensation disclosure.[10] Proxy statements for shareholder meetings occurring more than six months after enactment must include such a resolution. (§ 951)
Broker discretionary voting	Not addressed.	SEC required to issue rules directing national securities exchanges to prohibit broker discretionary voting in connection with director elections, executive compensation "or any other significant matter" as determined by the SEC by rule. (§ 957) (*Note: This provision was added to the version of the Dodd Bill that was introduced on March 15, 2010.*)

Shareholder advisory vote on severance compensation	SEC required to issue final rules permitting shareholders to cast separate 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. Such disclosures must be in clear and simple tabular form based on rules to be promulgated by the SEC. (§ 2002)	Not addressed.
Investment manager vote reporting	SEC required to issue final rules requiring investment managers to report annually on how they voted re: executive compensation and “golden parachute” compensation. (§ 2002)	Not addressed.
Independence of compensation committee members	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities of an issuer whose compensation committee members are not “independent” under a heightened standard: i.e., who do not receive consulting, advisory or other fees from the issuer, *except* compensation for services rendered to the issuer as a member of the board and/or a committee thereof. (§ 2003)	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities of an issuer whose 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 *and* who are not affiliated with the issuer or its subsidiaries.[11] (§ 952)
Retention of advisers by compensation committee	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities of an issuer whose compensation committee does not have authority to retain independent compensation consultants, counsel and other advisers and maintain responsibility for their oversight. The issuer must provide appropriate funding for retention of advisers. (§ 2003)	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities of an issuer whose compensation committee does not have authority to retain independent compensation consultants, counsel and other advisers and maintain responsibility for their oversight.[12] The issuer must provide “reasonable” compensation for advisers. (§ 952)
Disclosure of retention of compensation consultants	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities if issuer does not disclose, in all proxy statements for annual meetings (or special meetings in lieu thereof) occurring one year after date of enactment, whether the compensation committee retained and obtained the advice of a compensation consultant. (§ 2003)	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities if issuer does not disclose, in all proxy statements for annual meetings (or special meetings in lieu thereof) occurring one year or later after the date of enactment, whether the compensation committee retained a compensation consultant, whether the work performed by such consultant raised a conflict of interest, the nature of such conflict, and how it is being addressed. (§ 952)
Standards for adviser independence	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities if advisers to the compensation committee do not meet SEC standards of independence (to be promulgated by regulation). (§ 2003)	SEC required to issue rules directing national securities exchanges to prohibit the listing of any class of securities if the compensation committee does not consider specific factors identified by SEC before selecting advisers. SEC standards of independence are to be promulgated by regulation.[13] (§ 952)

Exemptions from independence and other requirements for certain issuers	SEC may exempt certain categories of issuers from certain requirements, including (1) the requirement to have independent compensation committees (including the right to exempt specific relationships), compensation consultants, and independent counsel and other advisers, (2) the requirement to authorize the compensation committee to retain compensation consultants, independent counsel and other advisers, (3) the requirement to provide funding for such advisers and (4) disclosure requirements, in each case where "appropriate in view of the purpose" of this section. The SEC must take into account the potential impact on smaller reporting issuers when determining appropriate exemptions. (§ 2003)	SEC rules must permit national securities exchanges to exempt certain issuers from certain requirements including (1) the requirement to have independent compensation committees (including the right to exempt specific relationships), compensation consultants, independent counsel and other advisers, (2) the requirement to authorize the compensation committee to retain compensation consultants, independent counsel and other advisers, (3) the requirement to provide funding for such advisers and (4) disclosure requirements, in each case as the national securities exchange deems appropriate, taking into consideration the size of an issuer and other relevant factors. (§ 952)
Additional executive compensation disclosures	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." Such disclosure may include a graphic representation of the required information. SEC also required to issue rules requiring disclosure in the Form 10-K or proxy statement of (a) the median of the annual total compensation of all employees of the issuer, except the CEO, (b) the annual total compensation of the CEO and (c) the ratio of (a) to (b). (§ 953) (*Note: The portion of this provision that requires the ratio of the median of total compensation to total CEO compensation was added to the version of the Dodd Bill that was introduced on March 15, 2010.*)
Clawbacks of incentive-based compensation	Not addressed.	SEC required to issue rules directing national securities exchanges to prohibit the listing of any security of an issuer that does not develop, implement and disclose a policy providing for disclosure of incentive-based compensation. If an issuer is required to restate its financial statements due to material noncompliance with financial reporting requirements, such issuer also must recover any excess incentive-based compensation (including stock options) from current or former executive officers of the issuer during the three-year period preceding any accounting restatement resulting from erroneous data.[14] (§ 954)

Disclosure regarding employee and director hedging	Not addressed.	SEC required to issue rules requiring issuers to disclose in their annual proxy statements whether employees or directors are permitted to purchase financial instruments designed to hedge or offset any decrease in the market value of equity securities granted to such employees or board members as part of their compensation, or otherwise held, directly or indirectly, by such employee or board member. (§ 955)
Restrictions on compensation at certain financial institutions	Federal regulators must prescribe regulations to require "covered financial institutions" to disclose to the appropriate Federal regulator the structures of all incentive-based compensation arrangements. Federal regulators may set criteria that they determine to be appropriate to reduce "unreasonable incentives" offered by such institutions for employees to take "undue risks" that could threaten the safety and soundness of the covered financial institutions or could have "serious adverse effects" on economic conditions or financial stability. These requirements will not apply to covered financial institutions with assets of less than $1 billion. The term "covered financial institution" would include banks and thrifts (and their respective holding companies), credit unions, registered broker-dealers, investment advisers, Fannie Mae, Freddie Mac, and any other financial institutions that the appropriate Federal regulators determine should be treated as such. (§ 2004)	Federal Reserve Board of Governors required to issue rules establishing standards prohibiting, as an unsafe and unsound compensation practice, any compensation plan of a bank holding company that (1) provides an executive officer, employee, director, or principal shareholder of the bank holding company with excessive compensation, fees, or benefits or (2) could lead to material financial loss to the bank holding company. (§ 956)
Risk committees	Not addressed.	Federal Reserve Board of Governors required to issue rules requiring (1) each publicly-traded "nonbank financial company" supervised by the Board of Governors to establish a risk committee within 1 year after date of receipt of a notice of final determination from the Board of Governors and (2) each publicly traded bank holding company with total consolidated assets of $10 billion or more to establish a risk committee. Board of Governors may require publicly traded bank holding companies with total consolidated assets of less than $10 billion to establish risk committees as determined necessary or appropriate by the Board of Governors to promote sound risk management. The term "nonbank financial companies" supervised by the Board of Governors would include companies that are substantially engaged in financial activities in the US where it has been determined by the Financial Stability Oversight Council that

		material financial distress at the company would pose a threat to the financial stability of the United States (other than bank holding companies or their subsidiaries). A risk committee required by this provision is required to be responsible for the oversight of enterprise-wide risk management practices and shall include such number of independent directors as the Board of Governors deems appropriate, as well as at least 1 risk management expert having experience in identifying, assessing and managing risk exposures of large, complex firms. (§ 165)
Beneficial ownership of covered equity securities	Definition under Section 13 of the Exchange Act amended as follows: any person who "becomes or is deemed to become a beneficial owner of any [covered equity security] upon the purchase or sale of a security-based swap or other derivative instrument as the Commission may define by rule." (§ 3205)	Definition under Section 13 of the Exchange Act amended as follows: any person who "becomes or is deemed to become a beneficial owner of any [covered equity security] upon the purchase or sale of a security-based swap that the Commission may define by rule." (§ 766)
Short-swing profit reports	SEC has authority to shorten time periods for filing reports pursuant to Section 13(d) and Section 16 of the Exchange Act. (§ 7105)	Not addressed.
Exemption for non-accelerated filers	Sarbanes-Oxley to be amended to provide an exemption from 404(b) of the Act (requiring independent auditor attestation of internal control over financial reporting) for companies that are non-accelerated filers pursuant to Rule 12b-2. SEC is also directed to conduct a study to determine how to reduce the burden of complying with 404(b) for companies with market capitalization between $75,000,000 and $250,000,000 for the relevant reporting period and deliver a report on such study to Congress within 9 months of enactment. (§ 7606)	Not addressed.

Provisions of the Dodd Bill Related to the Securities and Exchange Commission

The Dodd Bill would amend the Securities Act and the Exchange Act to encourage investor feedback and whistleblowing, streamline SEC procedures with respect to self-regulatory organizations ("SROs"), and authorize self-funding for the SEC, as follows:

- ***Whistleblower Incentives***. The Dodd Bill would require the SEC to issue regulations to encourage whistleblowers to report securities law violations. Whistleblowers with information leading to a successful enforcement action (defined as a judicial or administrative action whereby the resulting monetary sanctions are in excess of $1,000,000) would be eligible for a reward equal to an aggregate amount of (1) not less than 10%, in total, of what was collected of the monetary sanctions imposed in the action and (2) not more than 30%, in total, of what was collected of the monetary sanctions imposed in the action by the SEC Investor Protection Fund (to be established pursuant to the Dodd Bill). Such rewards would be payable at the discretion of the SEC after taking into account the significance of the information provided by the whistleblower to the success of the action, the degree of assistance provided by the whistleblower, the interest of the SEC in deterring violations of securities laws, and any other factor the SEC deems relevant. No awards would be permitted to be made to any whistleblower who was convicted of a criminal violation relating to the action for which he or she provided the information.[15] Additionally, existing whistleblower protections of employees of issuers with securities registered under Section 12 of the Exchange Act or required to file reports under Section 15(d) of the Exchange Act would be extended to subsidiaries and affiliates of an issuer whose financial information was included in the consolidated financial statements of such issuer.[16] The main difference between the Frank Bill and the Dodd Bill is that the Frank Bill does not provide for a minimum reward of at least 10% of the recovered sanctions (subject to the SEC's discretion).[17]

- ***Self-Funding***. The Dodd Bill would amend the Exchange Act to exempt the SEC from the annual appropriations process and require the SEC to fund itself based on the fees it collects,[18] while the Frank Bill would continue to provide for annual appropriations by Congress to the SEC.[19]
- ***Office of Investor Advocate***. The Dodd Bill would amend the Exchange Act to create the Office of the Investor Advocate within the SEC with a mandate to (a) assist retail investors in resolving significant problems such investors may have with the SEC or with SROs, (b) identify areas in which investors would benefit from changes to the SEC regulations and SRO rules, (c) identify problems that investors have with financial service providers and investment products, and (d) propose changes in such rules and regulations that may be appropriate to mitigate any such issues.[20]
- ***Investor Feedback***. The Dodd Bill would amend the Securities Act to allow the SEC to directly gather information from and communicate with investors and the general public, to engage in temporary investor testing programs, and to consult with academics and consultants as necessary for the purposes of evaluating any rules carried out under any provision of the securities laws.[21] The Frank Bill contains a comparable provision, but does not expressly permit the SEC to consult with academics and consultants.[22]
- ***Streamlining of Filing Procedures for SROs***. The Dodd Bill would amend the Exchange Act to require the SEC either to (1) approve proposed SRO rule changes or (2) institute proceedings to determine whether the rule change should be disapproved, in both cases within 45 days after the date of publication of the proposed rule change. The SEC would be allowed to extend this period of time by not more than an additional 45 days as may be necessary to evaluate the proposed change or where the SRO has consented to a longer period, or a proposed rule change would be deemed to be approved.[23]

Provisions of the Dodd Bill Related to Regulation D Offerings

The Dodd Bill would amend the Securities Act to require the SEC to issue rules for the disqualification of offerings and sales of securities made under Regulation D that are substantially similar to the provisions of Rule 262 under the Securities Act and disqualify any offering or sale of securities by a person who has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC, as well as other specified "bad actors."[24] (Note: This provision replaced a provision relating to loss of status as a "covered security" under state "blue-sky" laws and rules that was included in the version of the Dodd Bill that was introduced on March 15, 2010.) Moreover, the Dodd Bill would require the SEC to adjust any net worth standard for an accredited investor so that the individual net worth of any natural person (or joint net worth with the person's spouse) is more than $1 million (as adjusted periodically), excluding the value of the person's primary residence. The SEC must also review the definition of "accredited investor" as defined in Rule 215 of the Securities Act at least once every four years.[25] (Note that periodic review is not required for the definition of "accredited investor" as defined in Rule 501(a) of Regulation D.)

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If you have any questions on these matters, please do not hesitate to speak to your regular contact at Weil, Gotshal & Manges LLP or to any member of the Firm's Public Company Advisory Group:

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ENDNOTES

[1] S. 3217, 111th Cong. (2010). The full text of the Dodd Bill is not available at the time of writing; however, it will be posted when available at http://thomas.loc.gov/cgi-bin/query/z?c111:s3217:.

[2] For a detailed discussion of the Frank Bill, see our Weil Briefing "Congressional Watch: House Passes Sweeping Wall Street Reform Bill Including Governance Provisions on "Say-on-Pay," Compensation Committee Independence and S.E.C. Proxy Access Authority" available at http://www.weil.com/news/pubdetail.aspx?pub=9670. The full text of the Frank Bill is available at http://thomas.loc.gov/cgi-bin/query/z?c111:h4173:.

[3] S. 3217, 111th Cong. § 1011 (2010).

[4] S. 3217, 111th Cong. §§ 111-112 (2010).

[5] S. 3217, 111th Cong., (2010). Title I contains provisions relating to financial stability and Title II addresses orderly liquidation.

[6] S. 3217, 111th Cong. § 911 (2010).

[7] S. 3217, 111th Cong., (2010). Title IV deals specifically with the regulation of hedge funds, Subtitle C of Title IX proposes improvements to the regulation of credit rating agencies, and Title VII governs improvements to the regulation of over-the counter derivatives markets.

[8] The SEC would also have the authority to exempt issuers from this requirement based on their size, market capitalization, number of shareholders or other criteria as it deems necessary and appropriate in the public interest or for protection of investors.

[9] This has also been addressed by the SEC's proxy disclosure amendments adopted on November 16, 2009. For a detailed discussion of these amendments, see our Weil Briefing "New Rules: SEC Approves Enhanced Compensation & Governance Disclosures for 2010 Proxy Season" available at http://www.weil.com/news/pubdetail.aspx?pub=9672.

[10] The Dodd Bill states that the shareholder advisory votes on executive compensation shall not be binding on the issuer or the board of directors, and may not be construed (1) as overruling a decision by such issuer or board of directors; (2) to create or imply any change to the fiduciary duties of such issuer or board of directors; (3) to create or imply any additional fiduciary duties for such issuer or board of directors; or (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation. S. 3217, 111th Cong. § 951 (2010). The Frank Bill contains very similar language but for the fact that it does not specifically state that the bill does not create or imply any change to the fiduciary duties of the issuer or the board. H.R. 4173, 111th Cong. (1st. Sess. 2009), § 2002.

[11] The Dodd Bill standard is consistent with that currently required of audit committees pursuant to Section 301 of the Sarbanes-Oxley Act. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 15 U.S.C. § 78(f) (2002).

[12] The Dodd Bill states that this cannot be construed to "require the compensation committee to implement or act consistently with the advice or recommendations of the compensation consultant or to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of the duties of the compensation committee." S. 3217, 111th Cong. § 952 (2010). The Frank Bill contains nearly identical language. H.R. 4173, 111th Cong. (1st. Sess. 2009), § 2003.

[13] Factors to be identified by the SEC include: "(A) the provision of other services to the issuer by the person that employs the compensation consultant, legal counsel, or other adviser; (B) the amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel, or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel, or other adviser; (C) the policies and procedures of the person that employs the compensation consultant, legal counsel, or other adviser that are designed to prevent conflicts of interest; (D) any business or personal relationship of

the compensation consultant, legal counsel, or other adviser with a member of the compensation committee; and (E) any stock of the issuer owned by the compensation consultant, legal counsel, or other adviser."

[14] This provision is broader than the existing incentive compensation clawback provided by Section 304 of the Sarbanes-Oxley Act, which provides that the SEC may seek disgorgement of excess compensation that (1) was paid to an issuer's chief executive officer and chief financial officer, (2) was received during the 12-month period prior to an accounting restatement and (3) resulted from misconduct (though not necessarily by the chief executive officer or chief financial officer). Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 15 U.S.C. § 7243 (2002).

[15] S. 3217, 111th Cong. § 922 (2010).

[16] S. 3217, 111th Cong. § 929A (2010).

[17] H.R. 4173, 111th Cong. (1st. Sess. 2009), § 7203.

[18] S. 3217, 111th Cong. § 991 (2010).

[19] H.R. 4173, 111th Cong. (1st Sess. 2009), §7301.

[20] S. 3217, 111th Cong. § 914 (2010).

[21] S. 3217, 111th Cong. § 912 (2010).

[22] H.R. 4173, 111th Cong. (1st. Sess. 2009), § 7102.

[23] S. 3217, 111th Cong. § 915 (2010). The Exchange Act currently allows the SEC 35 days from the date of publication or within such longer period as the SEC may designate up to 90 days of such date to approve or institute proceedings to disapprove the rule change (15 U.S.C. § 78s(b)(2) (1975)).

[24] S. 3217, 111th Cong. § 926 (2010).

[25] S. 3217, 111th Cong. § 412 (2010).