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AN ALERT FROM THE BDO COMPENSATION & BENEFITS TAX PRACTICE

BDO KNOWS:
COMPENSATION & BENEFITS

SUBJECT

IMPACT OF DODD-FRANK ACT ON EXECUTIVE COMPENSATION IN 2012

BACKGROUND

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") became law. Among several other purposes, the Dodd-Frank Act required public companies to comply with a number of disclosure and shareholder-voting provisions regarding their compensation practices, and gave the Securities and Exchange Commission (the "SEC") the authority to make additional rules in furtherance of these requirements. Last year the SEC adopted a number of new provisions requiring consideration of risk that could be associated with any of an organization's compensation plans as well as the solicitation of shareholder input on executive compensation practices, specifically:

- **Say on Pay.** The rules initiated a required shareholder vote (non-binding), at least once every three years, to approve the compensation of the company's named executive officers. This "say-on-pay" vote allows shareholders to assess pay practices and then render their "yes" or "no" votes.

- **Say on Pay Frequency.** The SEC permits companies to solicit a vote (non-binding) on the frequency of shareholder "say-on-pay" votes, offering choices of every one, two, or three years.

- **Shareholder Disclosure and Approval of Golden Parachutes.** The rules require an advisory shareholder vote related to all compensation arrangements with executive officers in connection with any merger, acquisition, consolidation, proposed sale, or other disposition of all or substantially all assets of the company. The requirement includes full disclosure of all agreements and understandings that both the acquiring and target organizations have established with the executives in connection with the transaction.

Read more

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Dodd-Frank/SEC Considerations and Implications for 2012:

For this year's shareholder meetings, management should be prepared to discuss the following:

1. Companies that did not receive significant "say-on-pay" support from shareholders in 2011 (e.g., at least 70% approval for say-on-pay votes or shareholder ratification of management's recommendation for frequency of say-on-pay votes) should be prepared to discuss and disclose steps taken to respond to shareholders' votes.
2. While many provisions of the Dodd-Frank Act have not yet been implemented with final regulations for the 2012 proxy season, their intent has broad support, and it should be expected that shareholders will likely query management about the company's policy position on any number of executive compensation practices, including:
   a. Has the company implemented "clawback" provisions that would allow it to recover compensation that was erroneously awarded in the three years prior to a financial accounting misstatement or other instance of overpayment?
   b. Has the company adopted a policy prohibiting an employee or outside director from hedging or pledging equity in the company held directly or indirectly, including compensatory equity grants?
   c. Has the company assured itself that the members of the board's compensation committee are independent?
   d. Does the compensation committee of the board engage the services of outside advisors including compensation consultants and legal counsel and, if so, by what process does it determine their independence?
3. Shareholders are increasingly aware and supportive of trends toward best practices. Companies should be prepared to discuss questions in a variety of areas, including the following:
   a. Compensation strategy: What is the compensation philosophy and how does each major compensation component (e.g., base salary increases, long-term incentive plans) support the overall strategy?
   b. Compensation risk assessments: What steps have been taken to discover all sources of risk associated with any compensation plan used by the organization?
   c. Compensation benchmarking practices: On what basis are organizations included in the company's external pay comparisons? Is an organization's performance a factor included in the competitive analyses? What role do competitive analyses play in determination of this company's pay practices?
   d. Structure of annual incentive and long-term incentive opportunities (including compensation committee discretion applied in evaluation of results): What steps are taken to ensure that existing incentive plans are correctly aligned with, and supportive of, performance for shareholders?
   e. Provisions of executive employment agreements: Do contracts or employment or separation agreements contain any guaranteed payments or other unusual features? If so, what is the rationale behind them?
   f. Reasons for the continued use of perquisites, gross-ups, or supplemental executive retirement plans, if any: What is the rationale behind any special arrangements/treatment offered to the company's Chief Executive Officer ("CEO") and/or other named executive officers in relation to other members of the company's leadership group?

Further Developments for 2013

Compensation committees should be aware that many additional regulations are expected to be developed during 2012 that will be implemented for 2013. Further analyses and disclosures (e.g., CEO pay compared with shareholder performance, CEO pay as a percentage of the "median" company employee (compensation, etc.) are in process and will require new and more in-depth examination and communication of executive pay practices. BDO will keep you advised as these are finalized.