

# **2010 Process and Regulatory Reform: Impact on Corporate Policy, Operations and Citizenship**

July 21, 2010



# **Dodd-Frank Financial Reform Act Corporate Governance and Securities Reform Provisions**

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## Overview

- A. Shareholder Proxy Access
- B. Say-on-Pay and Say-on-Golden Parachute
- C. Elimination of SOX Internal Controls Audit Requirement for Smaller Public Companies
- D. Elimination of Broker Discretionary Voting for Executive Compensation or “Any Other Significant Matter”
- E. Claw-backs with Three-Year Look Back
- F. Executive Compensation and Related Disclosures
- G. Compensation Committees (Independence and Advisors)

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## A. Shareholder Proxy Access

- ◆ The Act authorizes, but does not require, the SEC to adopt shareholder proxy access rules -- giving shareholders of companies the right to include an alternative director candidate in the company’s annual proxy.
- ◆ We expect the SEC to adopt rules in time for the 2011 proxy season. The content of those rules, including the types of issuers that may be exempted, remains uncertain. In determining whether to grant an exemption, the SEC must consider whether proxy access disproportionately burdens small issuers.

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## **B. Say-on-Pay and Say-on-Golden Parachute**

- ◆ The Act requires every public company to include in its proxy materials for its 2011 annual meeting:
  - a proposal for an advisory vote to approve executive compensation (“Say-on-Pay”); and
  - a proposal for an advisory vote to determine whether Say-on-Pay will occur every one, two or three years.
- ◆ The Act also requires new disclosures and an advisory vote of shareholders on “golden parachutes” (very broadly defined) for executives in a merger, acquisition or similar fundamental transaction (“Say-on-Golden Parachute”) unless they have been already approved in a Say-on-Pay vote.

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## **C. Elimination of SOX Internal Controls Audit Requirement for Smaller Public Companies**

- ◆ The Act permanently exempts smaller public companies (i.e., market cap under \$75 million) from the internal control over financial reporting auditor attestation requirements.
- ◆ The Act requires the SEC to study whether to extend the exemption to companies with market capitalizations between \$75 million and \$250 million.

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#### **D. Elimination of Broker Discretionary Voting for Executive Compensation or Any Other “Significant Matter”**

- ◆ The Act requires national securities exchanges to prohibit broker discretionary voting in connection with executive compensation and “any other significant matter,” as determined by the SEC.
- ◆ At a minimum, the Act prohibits broker discretionary voting on Say-on-Pay and Say-on-Golden Parachute.

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#### **E. Claw-backs with Three-Year Look Back**

- ◆ New rules will prohibit the stock exchange listing of a company that fails to adopt “claw-back” policies under which incentive based compensation (including stock options) can be recovered from current and former executive officers if an accounting restatement occurs.
- ◆ The new rules will apply to any current or former executive officer and have a three-year look back period.
- ◆ The Act focuses on whether the incentive compensation was greater than what would have been paid to the executive officers under the restated financial statements and does not require proof of misconduct as a condition to the claw-back.

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## F. Executive Compensation

- ◆ **Internal Pay Ratio Disclosure:** Companies will be required to disclose (1) the median annual total compensation of all employees (other than the CEO), (2) the annual total compensation of the CEO and (3) the ratio of (1) and (2).
- ◆ **Pay for Performance Disclosure:** Companies will be required to disclose the relationship between executive compensation actually paid and the company's financial performance, taking into account any change in stock value, dividends and any other distributions.
- ◆ **Hedging Policies Disclosure:** Companies will be required to disclose whether they prohibit hedging by all employees and directors with respect to any equity (i.e., not just compensation awards).

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## G. Compensation Committees (Independence and Advisors)

- ◆ All members of a compensation committee will be required to satisfy enhanced independence requirements similar to those required for audit committee members under SOX.
- ◆ Compensation committees may select compensation consultants, legal counsel or other advisors only after taking into consideration factors that may affect the advisor's independence.

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## **Dodd-Frank Financial Reform Act**

### **Durbin Amendment**

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July 21, 2010



## THE DURBIN AMENDMENT – AN OVERVIEW

- ◆ Some have referred to it as the "Swipe Fee" amendment – which is both too narrow and too broad of a characterization:
  - From the "Swipe Fee" perspective, it only regulates debit cards/not credit cards,
  - It also contains broader restrictions on payment network activities.

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## WHAT ARE THE ELEMENTS OF THE DURBIN AMENDMENT?

- ◆ Limits "interchange fees" that may be paid to issuers on certain types of debit cards to what is "reasonable and proportionate":
  - "Reasonable and proportionate" refers to *incremental cost* incurred by an issuer for the role of the issuer in authorization, clearance or settlement of a particular electronic debit transaction,
  - Excludes reloadable prepaid cards and government administered programs (with exceptions),
  - Excludes issuers under \$10 billion in assets – issuer is bank where the account is held,
  - Some accommodation to issuers for cost of implementing anti-fraud measures but subject to compliance with anti-fraud guidelines to be established by the Federal Reserve,
  - Federal Reserve must adopt rules within nine months of effective date of the Financial Reform Act and rules will be effective one year from the effective date of the Act.

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## **WHAT ARE THE ELEMENTS OF THE DURBIN ACT? (CONT.)**

- ◆ **Limits exclusive network arrangements:**
  - Issuers and payment networks prohibited from restricting the number of payment networks on which an electronic debit transaction may be processed to any one such network or two or more networks which are owned, controlled or otherwise operated by affiliated persons or networks affiliated with the issuer,
  - Cannot inhibit the ability of merchants to direct the payment network to which electronic debit transactions are routed,
  - Federal Reserve to prescribe regulations within one year of effective date of the Act.
- ◆ **Prohibits restrictions on merchants' ability to establish a minimum dollar value for acceptance of credit cards:**
  - Minimum may not differentiate between card issuers or payment networks,
  - Minimum amount may not exceed \$10.00 (subject to increase by Federal Reserve).

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## **WHAT ARE THE ELEMENTS OF THE DURBIN ACT? (CONT.)**

- ◆ **Prohibits restrictions on Federal Agencies' and colleges' and universities' ability to establish a maximum dollar value for acceptance of credit cards; provided maximum may not differentiate between card issuers or payment networks**
- ◆ **Prohibits payment networks from inhibiting ability of merchants to provide discount or in-kind incentive for use of a particular payment type:**
  - Provided discount or incentive may not differentiate on the basis of card issuers or payment networks,
  - Federal Reserve to prescribe regulations within one year of effective date of the Act.

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## WHAT MIGHT BE THE UNINTENDED CONSEQUENCES?

- ◆ Even though "smaller" issuers are exempt, all issuers will likely have to play by the same rules.
- ◆ Will likely impact development of de-coupled debit programs.
- ◆ Gives the Federal Reserve significant influence in the data security/privacy arena.

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# Healthcare Reform and Executive Compensation and Benefits

July 21, 2010



## PPACA – The Basics

- **Understanding effective dates and grandfathered plan rules**
- **Employer mandates for plan years starting on or after September 23, 2010 (all plans)**
  - Age 26 dependent coverage
  - No lifetime limits
  - Restricted annual limits
  - No rescissions
  - No pre-existing condition exclusions for under age 19
  - Notice and disclosure requirements
  - Auto-enrollment for large employers
  - No reimbursements for over-the-counter medicines (other than insulin and prescribed meds) under FSA plans (starting January 1, 2011)
  - W-2 reporting of value of benefits (for the 2011 plan year)
  - Uniform explanation of coverage (March 2012)

## **PPACA – The Basics**

### **➤ Employer mandates for non-grandfathered plans for plan years starting on or after September 23, 2010**

- Preventative health services coverage at "first dollar"
- Claims appeal process changes; notice re claims procedure
- No discrimination in favor of highly compensated individuals
- Notice of patient protections
- Choice of primary care physician, OB/GYN and pediatrician from available in-network
- Emergency services without preauthorization and treated as in-network

## **PPACA – The Basics**

### **➤ 2014 healthcare reform mandates**

- Minimum essential coverage/penalties/state exchanges
- No preexisting condition exclusions
- Limit on waiting period to 90 days
- For non-grandfathered plans:
  - Limits on cost sharing/deductibles
  - Coverage for individuals participating in clinical trial for life-threatening conditions
  - Nondiscrimination in participating providers

### **➤ 2018 – Cadillac Plan Tax**

### **PPACA – Planning Considerations**

- Grandfathered plan status determined on a benefit package level
- Identify what plan changes do and do not cause a plan to lose grandfathered status
- Consider collectively-bargained plans
- FAS 106 liabilities
- Retiree only plans not subject to PPACA mandates

### **PPACA – Executive Pay Deduction Limit**

- Code Section 162(m) has historically limited compensation deductions for a small select group of executives
- New Code Section 162(m)(6) limits compensation deduction for any "health insurance provider" to \$500,000 for any
  - officer, director, or employee, or
  - any individual who provides services for or on behalf of the covered health insurance provider

### **PPACA – Early Retiree Reimbursement**

- Plans providing health benefits to early retirees (between the age of 55 and the age of Medicare eligibility) may apply for reimbursements of certain expenses up to 80% of plan claims between \$15,000 and \$90,000
- Reimbursement must be used to reduce costs, premium or cost-sharing of plan participants
- HHS application process

### **Other Health Mandates/Disclosures 2010**




- CHIP Notice
- HIPAA Special Enrollment Rights
- Mental Health Parity
- GINA
- Medicare Secondary Payer Mandatory Reporting Requirements

## **Code Section 409A – One More Shot**

- Opportunity to correct certain written compliance issues
  - Definition of separation from service
  - Definition of disability
  - Definition of change of control
  - Timing of payment where payment conditioned on release/waiver
  - Length of payment period following a permissible payment event
  - Inclusion of specified employee 6-month delay rule
- Retroactive correction to January 1, 2009
- Penalties

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**21<sup>st</sup> Century Education:  
The Landscape and Implications  
for Corporate Action**

**Association of Corporate Counsel**

*2010 Process and Regulatory Reform:  
Impact on Corporate Policy, Operations and Citizenship*

**Atlanta, Georgia  
July 21, 2010**

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**Overview and Objectives**

- Brief national and state education landscape overview**
  - Challenges
  - Trends
- Implications for corporate action**
  - Meeting your business needs
  - Participation as good corporate citizens

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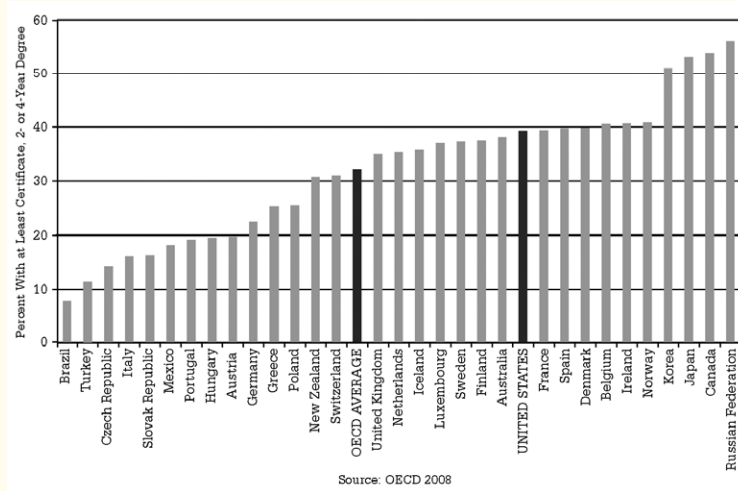
## The Education Landscape...

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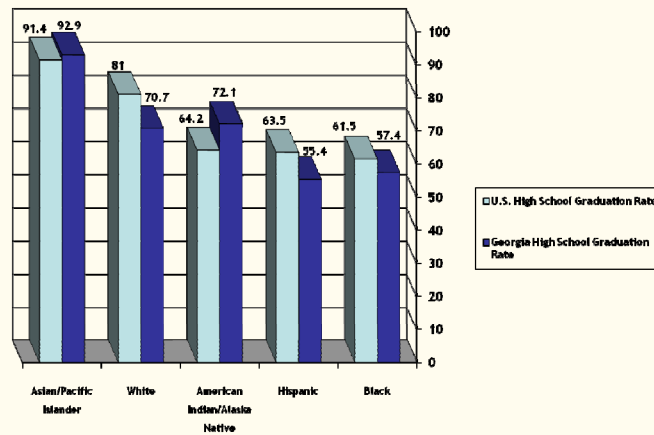
### The National Policy "Snapshot"

- ❑ **The 21<sup>st</sup> Century goal: "College and career readiness"**
  - President Obama: America should have the highest proportion of college graduates in the world by 2020.
- ❑ **The rationale: Rapidly changing economy**
  - ❖ Technological innovation, etc.
  - ❖ International competitiveness
- ❑ **Major challenges that remain:**
  - Achievement gaps: poverty, race, ethnicity, etc.
  - Dropout rates: ditto
  - Access to postsecondary education: ditto

## U.S. Ranks 11<sup>th</sup> in Postsecondary Attainment



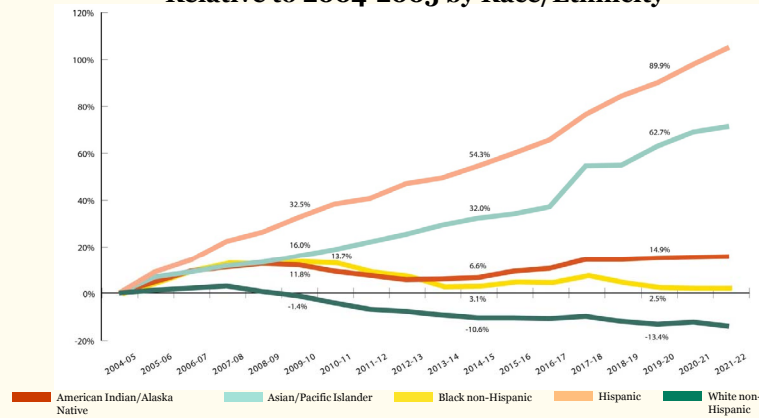
## Significant Achievement Gaps in U.S. and Georgia High School Graduation Rates



Source: NCES (2010); Data from 2007-2008 School Year

## The Coming "Perfect Storm" in the U.S.

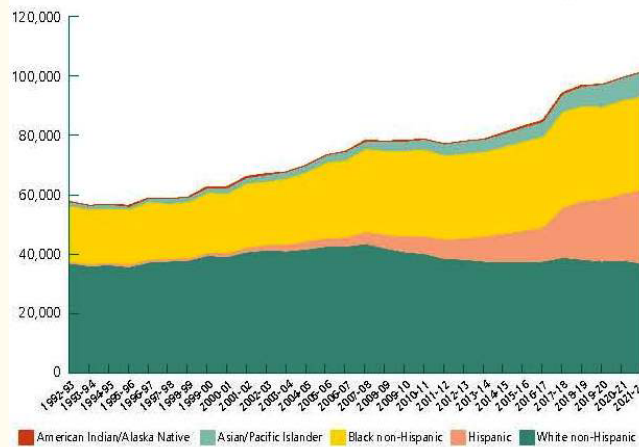
Cumulative Percent Change in US Public School Graduates Relative to 2004-2005 by Race/Ethnicity



Source: WICHE: Knocking at the College Door (March 2008)

## The Coming "Perfect Storm" in Georgia

Georgia High School Graduates by Race/Ethnicity 1992-93 to 2004-05 (Actual), 2005-06 to 2021-22 (Projected)



## The Pipeline for Low Income Students...

**For Every 100 Low-Income Students  
Who Enter High School...**



Prepared by Jobs for the Future (November 2008 presentation). Source: Goldberger Susan.  
Doing the Math: What It Means to Double the Number of Low-Income College Graduates, *Minding the Gap*.  
Harvard Press & Jobs for the Future: Cambridge, MA, 2007

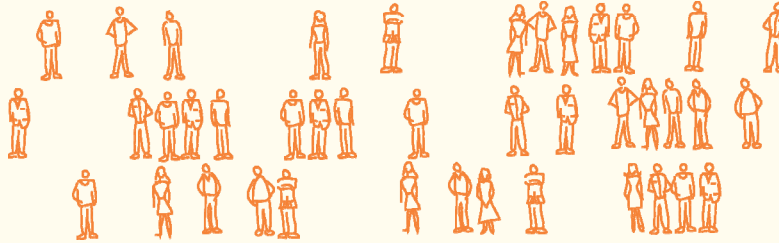
## The Pipeline for Low Income Students...

**65 Graduate from High School...**



## The Pipeline for Low Income Students...

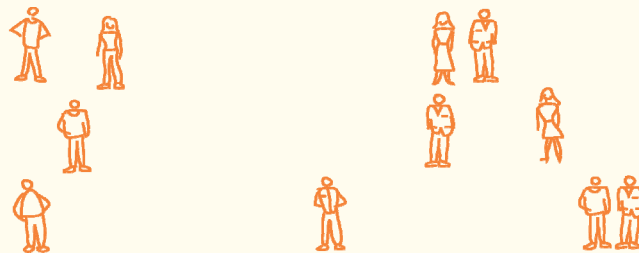
41 Enroll in College...



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## The Pipeline for Low Income Students...

And 11 Graduate College...



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## What's Being Done.....

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## Historic Levels of Federal Funding

- ❑ **To address 21<sup>st</sup> Century education reform goals and to**
  - Help states with unprecedented budget shortfalls
  - Incentivize education reform efforts
- ❑ **In FY10 \$100+ billion dollars was appropriated for education.**
  - The annual U.S. Department of Education discretionary budget is around \$60 billion.
  - FY10's discretionary budget is greater than the combined total of discretionary funds available to all previous U.S. Secretaries of Education.
  - As of May 2010, \$84 billion in recovery act grants have been awarded to states. Most of the funding has been used for teacher and other education staff pay (GAO, May 2010).
- ❑ **Efforts to provide additional support to states in the form of funding (up to \$23 billion) for teacher and other educational positions are stalled in Congress.**

## Core Elements of National Education Reform

- ❑ **Four "drivers" of education reform**
  - College- and career-ready **standards** and rigorous high-quality **assessments**
  - **P-20 data systems** used to track progress and foster continuous improvement
  - Improvements in **teacher effectiveness** and equitable distribution of qualified teachers
  - Intensive support and effective **interventions for the lowest-performing schools**
- ❑ **These points of focus are reflected in several federal initiatives, including:**
  - Race to the Top – \$4.3B
  - Investing in Innovation (I3) - \$650M
  - School Improvement grants - \$4B
  - Elementary and Secondary Education Act reauthorization

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## Georgia's Performance...

- ❑ **Georgia's improvement on assessments outpaces the nation— but still lags behind national averages.**
- ❑ **Georgia's high school graduation rate has increased from 63.3% in 2003 to 78.9% in 2010.**
  - African-American and Hispanic students are increasing their graduation rate at twice the rate of White students, but gaps remain.

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## Georgia's Reform Efforts

- ❑ **Georgia placed 3<sup>rd</sup> in the first round of the RTTT competition—but was not funded. 26 local school districts have signed on to the Round 2 application which emphasizes commitment to:**
  - Linking teacher evaluations to student achievement results
  - Turning around the lowest-achieving schools
  - Finalizing and using a P-20 data system that provides teachers and others with real-time data on student achievement
- ❑ **Governor Perdue was a co-chair of the Common Core State Standards Initiative. The State Board of Education just adopted the standards this month.**
- ❑ **Local school board governance reform legislation passed in 2010 to provide for additional training and accountability for local boards (sponsored by state business organizations).**

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## What You Can Do.....

## It's in Your Interest to Make YOUR Case

### ❑ Connect with relevant education leaders, as key stakeholder through organized or individual initiatives to:

1. Articulate the knowledge and skills your entering employees must have to succeed.
  - ❖ Specificity and concreteness will inform evolution of "college and career ready standards"
  - ❖ *Note: Key privacy-data use tensions emerging*
2. Explain clearly your workforce needs/projections, more generally (e.g. STEM fields, geographic needs).
3. Provide meaningful workforce experiences to students in middle and high school, in areas where you seek to attract interest and development.

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## It's in Your Interest When Investing...

### ❑ When making philanthropic investments:

1. Keep your business hats on! Demand accountability regarding results/impact; ensure data/evidence-based decisions.
  - ❖ Consider strategic investments/consortia that can guide investment strategies (with an accountability focus)
  - ❖ Consider strategies that incentivize positive action by public/non-profit actors
2. Focus on major needs addressing at-risk/underperforming students and key access issues.
3. Offer your expertise to others...support schools/districts regarding key management/data driven/accountability efforts and initiatives.

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## Contact Information

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