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Dodd-Frank Act Significantly Expands Corporate Disclosure and Transparency Standards

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In September 2010, the California Public Employees' Retirement System (CalPERS) the largest pension fund in the United States welcomed the SEC vote on Proxy Access, a critical part of the Dodd-Frank Act by stating; "Today's adoption of the proxy access rule by the SEC is an important advancement of the principles of investor relations. We commend the SEC for its thoughtful, fair rule, and we are confident that with its use it will be considered a win-win for business and investors."

This component of Dodd-Frank, while temporarily delayed in implementation by the SEC, is one of a broad range of rules and regulations incorporated into this far reaching act, and is already having a significant impact on virtually every part of corporate life. It is now considered one of the most comprehensive pieces of corporate governance legislation in the last two decades.

Dodd-Frank is also part one of a tidal wave of new regulation which promises to change the balance of power between company management, the board of directors and shareholders. Brought about by the "Great Recession" of 2007-2010, Congress and the SEC have collaborated to dramatically increase the bar of modern corporate transparency, and put into the hands of shareholders greater powers to influence the composition of the board, root out underperforming management, and allow shareholders to play a much more important role in defining the ground rules for management, including what they should be paid.

This legislation has also substantially expanded the role and scope of the investor relations function by adding additional complex layers of disclosure so as to align more closely the interests of shareholders, management and the board with new and stringent levels of legal and fiduciary accountability. Instead of viewing the new regulations as more "red tape" many progressive small and mid cap sized companies are already integrating these new disclosures into their business processes and positioning themselves as market leaders, transparent, and worthy of a lower cost of capital.

Here is just a brief summary of the key Dodd-Frank initiatives relating to public company management processes and corporate disclosure, and a discussion of the implications for the shareholder communication function and investor relations professionals.

- Proxy Access; holders with a 3% position who have owned the stock for three years can nominate board candidates to appear on management proxy statements. Larger shareholders, including pension funds, will more easily be able to vote in activist directors.
 - Say-On-Pay; Say-On-Frequency; Golden Parachute Disclosure; the Dodd-Frank Act requires companies to give shareholders a non-binding vote in the annual proxy on whether to approve the company's compensation for its key executive officers. Shareholders have the right to advise management whether this vote should occur every one, two or three years. It also requires much more disclosure regarding "golden parachute" packages provided to management triggered by a merger or acquisition, and allows shareholders to vote on a non-binding basis on the appropriateness of such pay packages.
 - No Broker Discretionary Voting; Dodd-Frank confirms what has been adopted by the national securities exchanges, that brokers may not vote uninstructed shares on executive compensation matters which means that when such matters are brought to a vote, at least 50% of the shareholder vote must be received to establish a quorum.
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- Whistleblowers incentivized; corporate whistleblowers can receive between 10% to 30% of any monetary penalties imposed as a result of a successful enforcement action that exceeds \$1 million. This is a gold mine for informants whose target companies are doing business in foreign countries with less transparent practices. Mischaracterized charges for attracting business in foreign countries will be high on the list for enforcement by the SEC.
- SEC rules pertaining to enhanced disclosure about risk, compensation and corporate governance, as well as disclosure dealing with climate change risk will require companies to describe the relationship of a company's compensation policies to risk management and performance; provide deeper background regarding director qualifications and board structure, including the separation of the Chairman and CEO role.

NEW RULES TO IMPACT ALL COMPANIES - SOME MORE THAN OTHERS

The enormity of these changes for companies with market capitalizations over \$75 million will undoubtedly catch some companies by surprise. Most impacted are;

- Companies who are underperforming their peers or are being targeted by short sellers;
- Companies who are changing their executive compensation plans;
- Companies who have a dispersed shareholder ownership profile;
- Companies where activist shareholders have lobbied for change in the past and;
- Companies who have a high risk profile to whistleblower actions.

How can investor relations professionals in-house, or serving as consultants, best guide and facilitate the transition between yesterday's standards of corporate disclosure to new and improved standards that incorporate the new governance and disclosure requirements required by Dodd-Frank, and stay current with leading- the- way, forward thinking companies? Rather than regulatory overload, this corporate disclosure transition will allow some companies to shine as management demonstrates new competencies in governance and shareholder relations.

DEEPEN KNOWLEDGE AND UNDERSTANDING OF SHAREHOLDER BASE AND ATTITUDES

- "Know your shareholders" has always been a basic tenant of shareholder communication. Historically the threshold for identifying and communicating with such shareholders has been the 5% ownership mark. But with increased shareholder activism, it is more important to learn more about shareholders owning less than 5%. In the future Proxy Access will allow certain shareholders individually, or in a group owning 3%, to place nominees on the ballot at the company's expense. You can now expect smaller dissatisfied shareholders, or groups of shareholders, to vote for change of management rather than act through the sale of their stock position. Once an ownership position has been established, it will now be easier than ever to change company management through representation on the board than to find a new equity position. Direct mailings and proxy solicitors and other advisors can help companies identify smaller shareholders. Once identified it is crucial that regular and constructive communications occur with all levels of shareholders. Keeping in mind Reg FD issues it will be important to layer the depth and the frequency of shareholder communications so that larger and sophisticated shareholders have more access to management and company strategy without violating disclosure rules.



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- Corporate governance road shows can be used to highlight management's awareness and focus on these new priorities. For larger companies this may allow investor relations professionals to work with corporate secretaries and visit large investors, and specifically the portfolio manager responsible for corporate governance. The same is true for visiting proxy advisory consultants. For smaller companies a discussion of pay linked to performance; improving the quality of directors; and attention to risk management issues which may give rise to whistle blowers should now be part of the core investor presentation and web site disclosure. A similar discussion of enhanced corporate governance practice and implementation can be included in the quarterly reporting cycle, and periodic reporting including the company's Form 10-K.

TIE GOVERNANCE TO CORPORATE PERFORMANCE METRICS

- Good governance may lead to good performance, but it is very rare that bad governance leads to good performance. Therefore it is advisable to improve the qualitative value of shareholder disclosure to tie corporate governance to performance metrics. Today shareholders and corporate governance advisory services are much more interested in understanding company strategy, not only as it relates to building shareholder value but also to know the thinking behind board composition, the role of committees; particularly audit, risk and compensation, and the link between long term performance and compensation. Some companies are introducing longer compensation escrows and claw backs for key managers so that if decisions are deemed unsuccessful 4 or 5 years after implementation, the escrowed compensation is returned to the company. Analyst days are changing and becoming much more detailed to include governance and strategic thinking sessions. Investors need to know in greater detail why a company is applying resources in one area in favor of another, and whether there are any reputational risks that are imbedded into the company's business model that could pop out and impact market valuation and reputation.
 - Evaluate sitting directors more carefully. In the last proxy season companies were required for the first time to provide disclosure of individual director experience qualifications, attributes and skills. Too many directors' bios are pro forma and do not send a compelling message as to why that director is a good fit for a company. It is not enough to be the president of the local bank. In the future directors need to have clear and specific qualifications that represent competency, diversity from other board members, integrity and courage to butt heads with the CEO on occasion.
 - Sustainability is now a vital part of the investment thesis and corporate governance disclosure requirements. Leading companies, including small cap are taking the initiative in redesigning not only their business processes but also their disclosure to match. In addition to disclosure on climate change, companies are expanding their disclosure on international hiring practices, employee safety, and community involvement. Increasingly investors are aware that sustainable profits are not only a function of solid management vision and execution but also a keen awareness of changing trends in public policy, not only in the United States, but wherever they operate around the world. Practices regarding the environment, employees, and the community are now an important part of the shareholder dialogue.
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EVALUATE AND UPGRADE BEST PRACTICE DISCLOSURE

- Crisis communications plans need to be developed, tested and implemented. For example, incentives for whistle blowers to disclose either potentially damaging information which is either fact based or unfounded will undoubtedly bring many more whistle blowers out of the woodwork. In most cases these accusations will eventually be processed by the SEC and disappear, but in other cases may require an internal investigation that could trigger a duty to disclose the investigation and its causes. In addition to reviewing accounting controls and procedures investor relations professionals should think through and implement new processes to anticipate areas of weakness in company operations, the range of potential leaks from whistle blowers, and the management of rumors and short seller attacks.
- Manage the transition to XBRL- tagged disclosure carefully. The goal is to assist investors in evaluating company performance and compare one company to another. However one company's XBRL tagged items may not be consistent or comparable to others resulting in financial analysis distortions instead of helpful comparisons. Such issues require regular audits of all investor relations processes so as to reduce or eliminate areas of confusion or poorly designed disclosure practices.
- Put Shareholder Relations on the board agenda for every meeting. The measure of success is whether management is meeting the expectations of the majority of shareholders. In this regard one of the most important elements of board consideration should be "What do the shareholders think?" Investor relations professionals can play a crucial role in bringing to the board attention regular updates on investor relations activities, concerns being raised by shareholders including issues that could give rise to activism, and to help rate the company against the best of their peers.

In this new era of regulatory reform, shareholders are more likely to shoot first and ask questions later. There has never been a better time for private and public companies and their investor relations professionals to step up their game and engage shareholders in a more substantial and more frequent dialogue, have greater sensitivity to their concerns, and demonstrate a deeper commitment to high quality corporate governance practices and disclosure transparency.

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