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Small Business Securities Bulletin

A periodic bulletin keeping small businesses informed about current developments in securities law and related matters

Corporate and Securities Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act

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This past Friday, June 25, House and Senate conferees agreed on the final text of the financial regulatory reform act, now named the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Act"). Although the recent death of Senator Bryd early Monday morning might delay passage of the Act, it is still widely expected to soon become law, maybe even by July 4th, when President Obama is hoping to sign the legislation should both the House and Senate pass the Act this week.

The securities and corporate governance provisions of the Act are largely in line with those included in the version of the Act passed by the Senate in May, and detailed in our first June and our April Bulletins. In this Bulletin we summarize the provisions in (what is expected to be) the final Act, highlighting differences with the Senate version we had previously discussed.

Securities Provisions – Regulation D Private Offerings

The Act, as discussed in our first June bulletin, imposes "bad boy" disqualifications prohibiting certain persons from participating in private securities offerings conducted pursuant to Rule 506 of Regulation D under the Securities Act of 1933. The Act requires the Securities and Exchange Commission (SEC) to promulgate rules that prohibit certain issuers from conducting a private offering under Rule 506, including provisions substantially similar to the Rule 262 prohibitions currently applicable to private offerings under Rule 505. For example, Rule 262 prohibits an issuer subject to an SEC stop order in connection with a previous registration statement filing or that has been convicted within the prior five years of a felony or misdemeanor in connection with the purchase or sale of a security or involving the making of any false filing with the SEC, or who has an officer, director or holder of 10% or more of any class of its equity securities that has been convicted within the prior ten years of a felony or misdemeanor in connection with the purchase or sale of a security or involving the making of a false filing with the SEC, from conducting an offering under Rule 505. The SEC rule pursuant to the Act must extend this prohibition to any such conviction, without the ten-year time limit, and also prohibit additional categories of persons from conducting a Rule 506 offering, including persons subject to a final order of a state securities, banking or similar regulator that (i) bars the person from association with a regulated entity, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities, or (ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct within the past ten years.

The Act also directs the SEC to adjust the definition of "accredited investor." Issuers conducting a private offering under Rule 505 or 506 directed solely at accredited investors do not need to provide the expansive information otherwise required under Regulation D of the Securities Act, and such investors do not count towards the 35-person limit for such offerings. Under the Act, the current $1 million net worth standard for "accredited investor" status would immediately be adjusted to exclude the value of the investor's primary residence. The Act also directs the SEC to regularly review, and as appropriate, adjust, the standards of the accredited investor definition.

Finally, the Act allows the SEC to shorten the existing 10-day filing requirement for (i) initial statements of beneficial ownership of securities on Form 3 required to be filed by directors, executive officers, and persons holding more than 10% of a class of securities registered under Section 12 of the Securities Exchange Act of 1934 pursuant to Section 16(a) of the Exchange Act and (ii) the reports of beneficial ownership on Schedules 13D or 13G required to be filed by persons who acquire more than 5% of a class of securities registered under Section 12 of the Exchange Act pursuant to Section 13(d) of the Exchange Act.

Corporate Governance Provisions of the Final Bill

The Act includes most of the corporate governance provisions that were included in the Senate version of the legislation and which we discussed in our first June and our April Bulletins, including (i) a mandatory say-on-pay stockholder vote for all SEC reporting companies, (ii) required disclosure with respect to pay for performance (relationship of executive compensation to financial performance, namely change in stock price and dividends paid), pay of the company's CEO in relation to the median pay of all employees, and permitted hedging with respect to the company's securities by employees and directors for all reporting companies, (iii) heightened compensation committee requirements and adoption of clawback policies for exchange-listed companies, (iv) disclosure regarding the separation or combination of a reporting company's CEO and Chairman, and (v) prohibiting voting by brokers and other certain record holders of securities in certain matters without instructions from the beneficial owner thereof. The Act did not include the Senate bill's provisions requiring majority voting in the election of directors.

Pursuant to the Act, each company's stockholders will vote on whether the say-on-pay vote shall occur annually, bi-annually or tri-annually. In addition, the Act provides a say-on-golden parachute vote, similar to the say-on-pay vote, for compensation to be paid to a reporting company's named executive officers in a merger, acquisition, consolidation, or sale or other disposition of all or substantially all of the company's assets. The Act allows the SEC to exempt certain companies from the "say-on" voting requirements, in particular, taking into account "whether the requirement … disproportionately burdens small issuers."

Importantly, the Act exempts SEC reporting companies that do not qualify as accelerated or large accelerated filers – i.e. companies with a public float (market value of equity securities held by non-affiliates) of less than $75 million, including smaller reporting companies, from the provisions of Section 404(b) of the Sarbanes-Oxley Act of 2002, which require public companies' auditors to attest to and report on the company's internal control over financial reporting. Such companies must still maintain, and conduct an annual evaluation of their, internal control over financial reporting in compliance with Section 404(a) of Sarbanes-Oxley.

The Act also authorizes the SEC to adopt "proxy access" – rules requiring companies to include in their proxy materials nominees for election to the board of directors nominated by dissident stockholders, but, unlike the Senate bill, permits the SEC to exempt certain issuers from its proxy access rules, in particular, taking into account "whether the requirement … disproportionately burdens small issuers."

Finally, the Act requires the Federal banking regulators to establish standards prohibiting incentive-based payment arrangements that encourage inappropriate risks by "covered financial institutions - by providing …

excessive compensation, fees, or benefits" or that "could lead to material financial loss to the covered financial institution." In addition, the Act requires financial institutions to provide the regulators compensation information allowing them to make this determination with respect to current compensation. The Act, compared to the Senate bill, expands the range of institutions covered by this requirement to not just banks and bank holding companies, but also broker-dealers, investor advisors, Fannie Mae and Freddie Mac, but also exempts from these provisions entirely financial institutions with total assets of less then $1 billion.

A First Look at the Legislation – Impact on Community Banks

While this Bulletin focuses on the securities and corporate governance provisions of the Act, the Act will obviously have additional far-reaching impacts on financial institutions, including community banks. We are planning to host a seminar next month that will provide an overview of the Act's impact on community banks. We expect to distribute information on this upcoming seminar soon, but in the meantime, please feel free to contact us if you would like additional information.

About Me

I am a former SEC attorney who also has prior "big firm" experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you. Visit my bio at www.ober.com/attorneys/penny-somer-greif.

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