

The Dodd-Frank Act: Compensation for Financial Institutions

July 21, 2011

Say-on-Golden Parachutes

- The Dodd-Frank Act (the “Act”) requires that to the extent that any “golden parachute”-related compensation is not subject to a Say-on-Pay vote, public companies must solicit shareholder approval of this compensation through a separate non-binding vote at the meeting where they are asked to approve a merger or similar extraordinary transaction that would trigger golden parachute payments.
- The proxy statement for the above-referenced meeting needs to include “clear and simple” disclosure of the golden parachute arrangements or understandings and the amounts payable.

Golden Parachute Rules

- New paragraph (t) of Item 402 of Regulation S-K requires additional disclosure regarding golden parachutes in certain circumstances.
- The table quantifies cash severance payments, the value of equity awards that are accelerated or cashed out; pension and nonqualified deferred compensation enhancements, perquisites, and other personal benefits; and tax reimbursements. The “Other” column also must include any additional compensation that is not included in any other column. Separate footnote identification of amounts attributable to “single trigger” and “double trigger” arrangements is also required. The table requires quantification with respect to any type of compensation, whether present, deferred, or contingent, that is based on or relates to an acquisition, merger, consolidation, sale, or other disposition of all or substantially all assets.

Independence Considerations

- The Act requires that stock exchanges adopt listing standards providing that the members of the compensation committee meet enhanced independence standards.
- The listing standards must also prescribe that a compensation committee may only select compensation consultants, legal counsel, or other advisers after taking into consideration independence standards established by the SEC.
- Enhanced disclosure will be required of whether the compensation committee retained or obtained the advice of a compensation consultant and whether the consultant's work raised any conflicts of interest, the nature of any such conflict, and how it was addressed.

Comp Committee Independence

- The new independence standards will direct boards to consider:
 - The source of compensation received by a compensation committee member, including whether he or she receives any consulting, advisory, or other compensatory fee; and
 - Whether the compensation committee member is affiliated with the company, a subsidiary of the company, or an affiliate of a subsidiary of the company.
- Other factors could be imposed in the course of the SEC and exchange rulemaking process.
- The new standard is comparable, but not identical, to what is required for audit committee members under the Sarbanes-Oxley Act of 2002 and related exchange listing standards.

Adviser Independence

- The Act requires that advisers retained by compensation committees of listed companies to advise on executive compensation may only be selected after a company has taken into consideration independence factors to be established by the SEC.
- The Act requires that the independence factors include:
 - Provision of other services by the person that employs the adviser;
 - The amount of fees received as a percentage of an entity's total revenue;
 - Policies and procedures designed to prevent conflicts of interest;
 - Any business or personal relationship of the adviser with a member of the compensation committee; and
 - Any stock of the company owned by an adviser.

SEC Rulemaking

- The SEC has proposed Rule 10C-1 under the Section 10C of the Exchange Act to direct the national securities exchanges, including the New York Stock Exchange and Nasdaq, to adopt listing standards regarding compensation committees and the compensation advisers that they retain.
- Under proposed amendments to Item 407, a company would be required to disclose whether the compensation committee has retained or obtained the advice of a compensation consultant during the last completed fiscal.
- Companies would also be required under the proposed amendments to Item 407 of Regulation S-K to disclose whether the work of the compensation consultant has raised any conflict of interest and, if so, provide a description of the nature of the conflict of interest and how it is being addressed.

Compensation Recovery

- The SEC must adopt rules directing the exchanges to adopt listing standards requiring that each listed company adopt a compensation recovery policy.
- The policy must provide that if a company is required to restate its financials due to material noncompliance with the securities laws, the company will:
 - Recover from any current or former executive officer
 - Any incentive-based compensation received in the three-year period prior to the restatement
 - That is in excess of what would have been paid to the executive officer under the restated amounts.
- Enhanced disclosure will be required of a company's policy on incentive-based compensation that is based on financial information required to be reported under the securities laws.

Incentive-Based Compensation

- Section 956 of the Act directs federal regulators to jointly prescribe regulations requiring covered financial institutions to disclose the structures of incentive-based compensation arrangements offered by the institution, and prohibiting any incentive-based compensation arrangement that encourages inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees or benefits, or that could lead to material financial loss to the institution.
- This provision of the Act and the proposed regulations are similar to principles and rules issued by other national and international regulators over the last several years.

Incentive-Based Compensation

- Rules were proposed in 2011 by banking regulators and the SEC to address:
 - Covered financial institutions
 - Covered persons
 - Definition of incentive-based compensation
 - Prohibitions on excessive compensation
 - Material financial loss prohibition
 - Mandatory deferral of incentive-based compensation for executives
 - Applicability to other employees
 - Required reporting
 - Necessary policies and procedures