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Subject: **Executive Compensation Provisions Included in Dodd-Frank Wall Street Reform and Consumer Protection Act Passed by House of Representatives**

Major References: [*Title IX, Part E of Dodd-Frank Wall Street Reform and Consumer Protection Act*](#)

Prior AALU Washington Reports: 10-38, 10-69

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On June 30, the House passed the massive finance reform bill entitled Dodd-Frank "Wall Street Reform and Consumer Protection Act" (Dodd-Frank) by a heavily partisan vote of 237 to 192. The bill contains, among many other matters of financial regulation, various provisions addressing executive compensation. These provisions are similar to what was approved March 22, 2010 by the Senate Committee on Banking, Housing, and Urban Affairs as the "Restoring American Financial Stability Act of 2010" (the Financial Stability Act). (See our Bulletin No. 10-38.) The proposed legislation, as it relates to compensation issues, includes principally requirements for say-on-pay and for a clawback of compensation which is based on financial statements that are subsequently restated.

Below is a brief summary of the executive compensation provisions included in Dodd-Frank, which bill awaits final passage by the Senate:

(1) Say on Pay: Like the Financial Stability Act, Dodd-Frank requires a nonbinding shareholder vote on compensation paid to executives; however, the vote need not take place annually.

Shareholders will determine by vote the frequency on which they will vote on executive compensation, provided the nonbinding vote occurs at least once every three years. Additionally, not only are golden parachute agreements now subject to a nonbinding shareholder vote, but if a merger, acquisition, consolidation, sale or other disposition of all or substantially all of a company's assets triggers golden parachute compensation, the proxy material addressing the transaction must disclose that fact. Dodd-Frank grants the SEC authority to exempt from these requirements small issuers that are disproportionately burdened by these rules.

(2) Compensation Committee Independence: These provisions are the same as those included in the Financial Stability Act, which provides that board committees setting compensation policy will consist only of directors who are independent.

(3) Independence of Compensation Consultants and Other Advisors: Dodd-Frank continues to stress independence for compensation consultants, legal counsel and other advisers to the compensation committee; however, such advisers need not, necessarily, be independent. Rather, when selecting compensation consultants, legal counsel and other advisers, the compensation committee must take into consideration factors to be prescribed by the SEC that affect the independence of these advisers. The factors to be developed by the SEC are the same factors required under the Financial Stability Act. (See our Bulletin No. 10-38.) The factors prescribed by the SEC must be competitively neutral among categories of consultants, legal counsel and other advisers and preserve the ability of compensation committees to retain the services of members in any of those categories of advisers. As provided in the Financial Stability Act, the compensation committee shall have the sole discretion to retain or obtain the advice of compensation consultants, legal counsel and any other advisers. Dodd-Frank has added an exemption from these independence rules for companies in which more than 50% of the voting power is held by an individual, a group or another company.

(4) Disclosure of Pay Versus Performance: The proposed legislation, like the Financial Stability Act, continues to require a company to disclose annually how its executives' compensation relates to the company's financial performance.

(5) Recovery of Erroneously Awarded Compensation: Dodd-Frank continues to require that companies set policies to take back executive compensation if such compensation was based on financials that later have to be restated due to an accounting error. (For more details regarding this requirement, see our Bulletin No. 10-38.)

(6) Disclosure Regarding Employee and Director Hedging: Like the Financial Stability Act, Dodd-Frank requires companies to disclose in the annual proxy statement whether employees or directors may hedge or offset any decrease in the market value of equity securities granted to or held by such persons.

(7) Enhanced Compensation Structure Reporting: Dodd-Frank expands the category of companies subject to prohibitions on incentive-based arrangements that encourage inappropriate risks. Federal financial regulators, specifically the Federal Reserve System, the Comptroller of the Currency, the FDIC, the OTS, NCUA, the SEC and the Federal Housing Finance Agency, must monitor incentive-based payment arrangements of federally regulated financial institutions larger than \$1 billion and prohibit incentive-based payment arrangements that the regulators determine jointly could threaten the financial institutions' safety and soundness or could have serious adverse effects on economic conditions or financial stability.

(8) Voting by Brokers: Dodd-Frank adds a provision prohibiting brokers who are not beneficial owners of a security from voting through company proxies unless the beneficial owner has instructed the broker to vote on the owner's behalf.

Next Steps

Some had hoped that the Dodd-Frank would be ready for the President's signature by July 4th; however, the Senate is not set to vote on the measure until mid-July. Sens. Scott Brown (R-MA), Olympia Snowe, (R-ME) and Susan Collins (R-ME), who had previously voted for the Senate version of the bill (before it went to conference), withdrew their support when the report that came out of conference on June 24, 2010 contained a \$19 billion tax. As their support is crucial for this measure to pass the Senate, Senate and House Democrats went back to conference on June 29, 2010 to remove the tax. Funding for the proposed legislation will now come from unused funds resulting from a provision terminating TARP four months earlier than expected. Although it appears there may be enough support for approving this measure, its passage is not assured (see our bulletin 10-69 for additional analysis).

Any AALU member who wishes to obtain a copy of the executive compensation provisions (included in Title IX, Part E) of Dodd-Frank, as approved by the House, may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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