The Dodd-Frank Wall Street Reform and Consumer Protection Act: Executive Compensation

Michael V. Seitzinger
Legislative Attorney

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Summary

As part of their financial regulatory reform legislation, both the House and the Senate passed bills with provisions applying to executive compensation. The House- and Senate-passed executive compensation provisions differed, in some cases significantly.

The House and Senate conferees on Wall Street reform passed an executive compensation subtitle. On June 30, 2010, the House agreed to the conference report for H.R. 4173, now referred to as the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Senate agreed to the conference report on July 15, 2010. The President signed the bill into law as P.L. 111-203 on July 21, 2010.

Among the provisions of the bill are say-on-pay requirements, the establishing of independent compensation committees, the clawback of unwarranted excessive compensation, and requirements on the executive compensation at financial institutions.

Concern about shareholder value, corporate governance, and the economic and social impact of escalating pay for corporate executives has led to discussions, particularly over the past few years, regarding the practices of paying these executives. Since the economic downturn, Congress has considered various proposals to address the concerns relating to executive compensation. As part of their financial regulatory reform legislation, both the House[1] and the Senate[2] passed bills with provisions applying to executive compensation.[3] The House- and Senate-passed executive compensation provisions differed, in some cases significantly, but both required a nonbinding shareholder vote on approval of the executives' compensation packages.

The House and Senate conferees on Wall Street reform passed an executive compensation subtitle; subtitle E of Title IX of the bill is titled Accountability and Executive Compensation. On June 30, 2010, the House agreed to the conference report[4] for H.R. 4173, now referred to as the Dodd-Frank Wall Street Reform and Consumer Protection Act. On July 15, 2010, the Senate agreed to the conference report. The President signed the bill into law as P.L. 111-203 on July 21, 2010.

Section 951. Shareholder Vote on Executive Compensation Disclosures. This section amends section 14[5] of the Securities Exchange Act of 1934[6] to require that, not less frequently than every three years at any annual or other meeting of shareholders, companies must provide their shareholders with a nonbinding vote to approve executive compensation, pursuant to federal regulations. Shareholders must also be provided with a nonbinding vote at least every six years to determine whether the shareholder approval vote shall occur every one, two, or three years. If a company asks voters to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of the assets of the company, the company must disclose any compensation arrangements to be paid to the company's executive officers (golden parachutes) and provide shareholders with a nonbinding approval vote on these arrangements. An institutional investment manager must disclose at least annually how it voted on say-on-pay and golden parachutes. The Securities and Exchange Commission (SEC or Commission) may exempt an issuer from the voting requirements and must, among other considerations, take into account in its exemption decisions whether the voting requirements disproportionately burden small issuers.

Section 952. Compensation Committee Independence. According to requirements of the bill, the SEC must by rule require the national securities exchanges and associations to prohibit the listing of equity securities of an issuer unless each member of the compensation committee of the board of directors of the issuer is an actual member of the board and independent. In determining the definition of "independence," the national securities exchanges and associations must consider relevant factors, such as the source of compensation of a board member, and whether the board member is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. The independence requirement shall not apply to a controlled company, limited

[1] H.R. 4173, Title II.

[2] S. 3217, Title IX, Subtitle E.

[3] For additional information about Securities and Exchange Commission and congressional executive compensation proposals, see CRS Report RS22583, *Executive Compensation: SEC Regulations and Congressional Proposals*, by Michael V. Seitzinger.

[4] H.Rept. 111-517.

[5] 15 U.S.C. § 78n.

[6] 15 U.S.C. §§ 78a *et seq*.

partnership, company in bankruptcy, open-ended management investment company, or a foreign private issuer. Only an issuer's compensation committee may select a compensation consultant, legal counsel, or other adviser to the compensation committee, and must take into consideration the factors identified by the Commission as affecting the independence of the consultant, counsel, or other adviser. The SEC's rules must provide for appropriate procedures for an issuer to cure any defects concerning the independence of compensation committees before the SEC prohibits the selling of the issuer's stock. The SEC may allow an exchange or association to provide for independent compensation committee exemptions, taking into account the impact of the independence requirements upon smaller reporting issuers. Controlled companies, as defined, are not covered by the independent compensation committee requirements.

Section 953. Executive Compensation Disclosures. This section amends section 14 of the Securities Exchange Act of 1934 to require that the SEC must by rule require each issuer to disclose in annual meeting materials a clear description of executive compensation, including information showing the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the issuer's shares of stock, dividends, and distributions. The SEC shall require each issuer to disclose the median of the annual total compensation of all employees of the issuer, except the chief executive officer; the annual total compensation of the chief executive officer (CEO); and the ratio of the employees' median salary to the CEO.

Section 954. Recovery of Erroneously Awarded Compensation. The Commission must issue rules which direct the national securities exchanges and associations to prohibit the listing of a security of any issuer that does not have a policy providing for (1) the disclosure of the issuer's policy on incentive-based compensation and (2) clawback policies which recover incentive-based compensation after an accounting restatement. The clawback trigger is based upon the material noncompliance of the issuer with any financial reporting requirement which leads to the accounting restatement. The amount to be clawed back is the excess of what would have been paid to the executive under the accounting restatement.

Section 955. Disclosure Regarding Employee and Director Hedging. The provision amends section 14 of the Securities Exchange Act of 1934 to require the Commission by rule to require each issuer to disclose in annual meeting materials whether any employee or member of the board of directors is permitted to purchase financial instruments designed to hedge or offset any decrease in the market value of equity securities.

Section 956. Enhanced Compensation Structure Reporting. According to the bill, the appropriate federal regulators[7] shall jointly prescribe regulations requiring each covered financial institution[8] to disclose the structures of all incentive-based compensation structures which it offers to an executive officer, employee, director, or principal shareholder so as to determine whether excessive compensation is provided or whether the compensation could lead to material financial loss to the covered financial institution. The appropriate federal regulators shall jointly prescribe regulations which prohibit incentive-based compensation that is excessive or that could

[7] Federal Reserve, Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration Board, Securities and Exchange Commission, and Federal Housing Finance Agency.

[8] Depository institution, depository institution holding company, registered broker-dealer, credit union, investment adviser, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and any other institution which the regulators determine should be covered.

lead to material financial loss. The standards for compensation shall be comparable to the standards for insured depository institutions under the Federal Deposit Insurance Act.[9]

Section 957. Voting by Brokers. This section amends section 6(b)[10] of the Securities Exchange Act of 1934 to prohibit a broker from voting a shareholder's proxy without authorization from the beneficial owner of the security.

Author Contact Information

Michael V. Seitzinger
Legislative Attorney
mseitzinger@crs.loc.gov, 7-7895

[9] 12 U.S.C. § 1831p-1 (standards of safety and soundness).

[10] 15 U.S.C. § 78f(b).