



Financial Services Management

Incentive-Based Compensation Restrictions

CEO

Human Relations
Action Item

Cite

Dodd-Frank Act

Public Law No: 111-203

Subtitle E of Title IX

Recommended Distribution

CEO, Corporate Secretary, Human Relations, Risk Management, Compliance, Legal,
Government Relations

Website

[http://frwebgate.access.gpo.gov/cgibin/
getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ203.111.pdf](http://frwebgate.access.gpo.gov/cgibin/getdoc.cgi?dbname=111_cong_public_laws&docid=f:publ203.111.pdf)

Overview

In this report, the provisions in the Dodd-Frank Act germane to financial-industry compensation are assessed. Subtitle E of Title IX also addresses an array of compensation and corporate-government issues covering all publicly traded firms. These include a mandate for clawbacks at any firm listed on a national exchange and tough disclosure standards (including one designed to bar executives from hedging away performance-related risk in their compensation packages). However, the law also strikes directly at a “covered financial institution.”

Dodd-Frank here reaches more broadly into the financial industry than the Senate bill, which would have covered only bank holding companies. However, it still gives regulators considerable discretion, mandating only guidelines. These would, however, not only have to define problematic incentive-based compensation arrangements, but also prohibit any of particular concern. The banking agencies have recently issued guidance in this area¹ that will doubtless serve as the starting point for the latest

¹ See Client Report COMPENSATION29, *Financial Services Management*, June 29, 2010.

requirements, although the new ones will almost surely be tougher because of the Congressional injunction for express prohibitions and the joint rulemaking with other agencies now required.

Analysis

The guidelines and rules described below must be issued nine months after enactment.

A. Coverage

1. *Institutions*

Unless they have less than \$1 billion in assets, the following financial institutions come under the guidelines and/or rules discussed below:

- depository institutions and depository institution holding companies;
- registered broker-dealers;
- registered investment advisers;
- credit unions;
- Fannie Mae and Freddie Mac (but not Federal Home Loan Banks); and
- any other financial institution covered by joint rule of the agencies listed below.

2. *Regulators*

The following agencies must jointly issue the guidelines or rules discussed below:

- FRB;
- OCC;
- FDIC;
- OTS (although it is eliminated in Title III of the Act);²
- NCUA;
- SEC; and
- FHFA.

² See Client Report REFORM39, April 1, 2010.

B. Guidelines

These will need to require covered financial institutions to disclose to regulators (but not the public) the structure of its incentive-based compensation arrangement so the regulator can determine:

- if executive officers, directors, employees or principal shareholders are being given excessive compensation, fees or benefits; or
- if it could lead to material financial loss at the firm.

The terms “excess” and “incentive-based” are not defined in law, giving the regulators considerable scope here and, as discussed below, with regard to any prohibited practices. Nothing here is meant to require disclosure of individual compensation nor are firms without incentive-based compensation required to report.

C. Prohibited Practice

Rules or guidelines are required to bar incentive-based arrangements that encourage “inappropriate risk” (with this term also left undefined in law). These are to be comparable to those now governing insured depositories (although the guidelines noted above do not prohibit any specific practice).

D. Enforcement

All of the agencies may enforce these rules, but the FRB is given express power to do so at any financial holding company (where its powers over functionally regulated subsidiaries is increased in Title VI).³

³ See Client Report FHC18, June 1, 2010.