

An Action Plan for the Next Dodd-Frank Executive Compensation Rules

By David Seitz, Managing Director, Pearl Meyer

Despite the fact that the Dodd-Frank Act was signed more than seven years ago, there are still a number of its executive compensation regulations pending. With the swearing-in of the Trump administration, many anticipated that these rules would be repealed or at least simplified, and the long-debated CEO Pay Ratio disclosure had all the makings to be the first in line.

However, this mandate had the distinction of being the only outstanding provision with approved rules and an implementation date. As we nudge closer to 2018 proxy filings (for calendar-year filers), it is doubtful at this juncture that we will see any meaningful action on the part of Congress or the SEC to change the status of any of the provisions and the CEO Pay Ratio is likely to go forward as planned.

Current Status of Dodd-Frank Pay Regulations

PROVISION	RULE STATUS	EFFECTIVE DATES
Internal Equity Ratio Disclosure (also known as the “CEO Pay Ratio”)	Final Rules August 5, 2015	Effective for 2018 proxy filing based on 2017 data (for calendar filers)
Pay-versus-Performance Disclosure	Proposed Rules April 29, 2015	Final Rules pending per SEC; comment period ended Effective date: uncertain; 2019 at earliest
Clawback Policy	Proposed Rules July 1, 2015	Final Rules pending per SEC; comment period ended Effective date: uncertain; 2019 at earliest
Disclosure of Hedging	Proposed Rules February 9, 2015	Final Rules pending per SEC; comment period ended Effective date: uncertain; 2019 at earliest
Incentive Compensation Arrangements at Covered Financial Institutions	Re-proposed Rules April 21, 2016	Interagency task-force issued proposed rules; comment period ended Effective date: uncertain; 2020 at earliest

The first four rules will generally apply to all public companies, while the proposed rules on the Incentive Compensation Arrangements are more narrowly construed to apply only to covered financial institutions, both public and private, with consolidated balance sheet assets greater than \$1B.

Given what we now know about the regulatory climate, we suggest community and regional banks concentrate on the CEO Pay Ratio and then begin paying careful attention to the ICA rule.

How Should We Be Preparing for the CEO Pay Ratio?

Clearly, the most pressing priority for all public companies is the CEO Pay Ratio disclosure which will be required in early 2018. As with many government regulations, there may be unintended consequences, and non-public banks should remain aware of the rule and how it rolls out in 2018. Here’s why: the big, new revelation is that companies must disclose the pay of the median employee since CEO pay is already disclosed for public entities.

According to a Pearl Meyer survey, almost all companies (86 percent) are more concerned about employees comparing their pay to the median employee than to the CEO. Furthermore, approximately 60 percent of the companies have concerns about the ability of HR and line managers to answer employee questions concerning how their pay compares to that of the median employee. This increased focus on possible pay equity questions and internal pay among bank employees may very well spill over into conversations in private institutions.

In preparation for this 2018 disclosure, companies should take action now. First, if the bank has not done so, conduct a pro-forma calculation for discussion and review. Second, start planning a communication strategy. In terms of external disclosure, companies need to decide where in the proxy statement to disclose the ratio, as well as the appropriate summary commentary. Furthermore, companies must begin preparing internal communications to address inevitable employee questions about how this ratio was calculated (which is not

exactly intuitive) and how their pay compares to this calculated number. It's advisable for non-public banks and their HR teams to think about their own internal communications and perhaps take the opportunity to be proactive and increase transparency about pay.

What Should We Plan for Next?

The original rules were proposed in 2011 and re-proposed in 2016 after 10,000 comment letters. Next on the agenda should be a careful investigation of the ICA provision.

The proposed rule provides important guidance around balanced incentive performance metrics, as well as incentive documentation requirements which apply to all covered financial institutions. Most community banks will need to take a critical look at incentive plan design, as well as recordkeeping and governance, in order to comply with these ICA rules. There are more onerous requirements, including mandatory deferrals for large covered institutions with over \$50B in assets.

The likely effective date for the re-proposed incentive compensation provision is probably no earlier than 2020. While

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there is ample time to comply at this point, the rules are far-reaching, and covered financial institutions will find it helpful to start preparing sooner rather than later. Some key steps to prepare for these rules include taking inventory of all existing incentive plans, reviewing plan design, strengthening plan documentation and recordkeeping, and improving plan governance. >>

David Seitz is a managing director with Pearl Meyer located in Dallas. He has 30 years' experience in executive compensation consulting and particular expertise in long-term incentive plan design.