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Eye On The Restoring American Financial Stability Act

Law360, New York (November 24, 2009) -- In a continuing effort by Congress to address the perceived causes of the recent financial crisis, on Nov. 10, 2009, the Senate Committee on Banking, Housing and Urban Affairs, through its Chairman, Sen. Christopher Dodd, D-Conn., introduced the Restoring American Financial Stability Act in the U.S. Senate.

Mr. Dodd's proposed legislation would cover three principal subjects.

First, the proposed legislation, which remains in its draft stages, proposes financial regulatory reform initiatives similar to those outlined in a piece of legislation introduced in the U.S. House of Representatives in October 2009, entitled the Financial Stability Improvement Act.

Second, the proposed legislation contains provisions that would mandate certain changes in the areas of executive compensation that would be applicable to public companies.

Third, the legislation would impact corporate governance at public companies.

As to the latter two topics, Mr. Dodd's proposed legislation adds to the growing list of similar reform legislation currently pending in Congress (including the Shareholder Bill of Rights introduced in May 2009 by Sens. Charles Schumer, D-N.Y., and Maria Cantwell, D-Wash.; the Shareholder Empowerment Act of 2009, introduced in June 2009 by Rep. Gary Peters, D-Mich.; and the Corporate and Financial Institution Compensation Fairness Act of 2009, introduced in July 2009 by Rep. Barney Frank, D-Mass.).

Mr. Dodd's proposed legislation would substantially overhaul the existing U.S. financial regulatory system by creating more streamlined regulatory oversight and provide additional measures intended to protect American consumers.

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In particular, the proposed legislation would:

- Create the Consumer Financial Protection Agency, an independent regulatory body with the responsibility to monitor consumer financial products.

The agency would consolidate the consumer protection responsibilities of several federal agencies, including the Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, the Federal Reserve, the National Credit Union Administration and the Federal Trade Commission.

- Create the Agency for Financial Stability, an independent agency tasked with identifying risks posed to the economy by the complex products and activities of large financial institutions and other companies.

Among other things, the proposed legislation would give this new agency the authority to require a company to divest assets if the agency deems the size or nature of the company or its products or activities a potential danger to the systemic health of the economy, and to require companies identified as a risk to the economy to periodically submit plans for their shut down should their businesses fail.

- Eliminate the complicated system of multiple federal bank regulators by creating the Financial Institutions Regulatory Administration.

The administration would combine the bank regulatory functions of the Office of the Comptroller of the Currency and the Office of Thrift Savings, the state bank supervisory functions of the Federal Deposit Insurance Corporation and the Federal Reserve, and the bank holding company supervision authority of the Federal Reserve, and is intended to increase accountability, eliminate regulatory overlap and eliminate conflicting regulation.

- Establish a new Office of Credit Rating Agencies at the U.S. Securities and Exchange Commission to strengthen regulation of credit rating agencies.

The office would enforce new rules applicable to credit rating agencies relating to internal controls, independence, transparency and penalties for poor performance, with the goal of restoring investor confidence in credit agency ratings.

- Introduce new rules for investment advisors and financial brokers to protect investors.

The new rules, which would be enforced by the SEC, would create uniform standards for those providing customers investment advice by mandating that financial brokers who give investment advice be subject to the same fiduciary requirement to act in their clients' best interest as investment advisers.

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In this regard, the proposed legislation also mandates an annual assessment of the SEC's internal supervisory controls and a biannual Government Accountability Office study of SEC management.

In response to scrutiny by the Obama administration regarding executive compensation by troubled financial institutions and other public companies, the proposed legislation also introduces a number of provisions targeted at reining in excessive executive pay and shifting management's focus from short-term profits to long-term growth and stability. Most notably:

- Shareholders of public companies would be provided a “say on pay” through required shareholder advisory votes to approve the compensation of company executives as well as any golden parachute agreements designed to protect company executives in the event of a takeover. The shareholder votes would be nonbinding and could not be construed to overrule a decision by the company's board of directors.

- Public companies would be required to implement “claw back” policies to recover executive compensation awarded on the basis of inaccurate financial statements.

In addition, the proposed legislation would indirectly, through new disclosure requirements, or directly impact corporate governance, including through the following:

- The SEC would be required, within 180 days of enactment of the proposed legislation, to issue rules permitting shareholders to use management's proxy solicitation materials for the purpose of nominating individuals to the board of directors.

- Public companies would be required to implement a form of majority voting in uncontested director elections whereby any nominee for director who receives a greater number of votes “withheld” from his or her election than votes “for” such election must promptly tender his or her resignation to be promptly accepted or unanimously rejected by the board of directors.

- Public companies would be required to disclose in their annual meeting proxy statements why they have chosen to separate or not separate the positions of the chairman of the board of directors and chief executive officer of the company.

- Public companies would be prohibited from having a board of directors with staggered terms unless adopted or ratified in advance by the shareholders of the company.

Companies that already have boards with staggered terms not approved by shareholders would be required to seek shareholder approval at the first annual meeting after the SEC rules are adopted.

As noted above, the Restoring American Financial Stability Act remains in its draft stages. Mr. Dodd has commented that he will move forward to mark up the bill by the first week of December 2009.

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