HANK BOERNER

THE DODD–FRANK ACT AT THE FIVE-YEAR ANNIVERSARY MARK — THE SWEEPING LEGISLATIVE EFFORT TO ADDRESS GOVERNANCE

The banking and securities market crisis of 2008 resulted in an estimated loss of $7 trillion of shareholder assets, as well as an estimated loss of $3 trillion of housing equity, creating a historic loss of wealth of more than $10 trillion according to some market observers.[1]

Two senior lawmakers — Senator Christopher Dodd and Congressman Barney Frank — set out to enact sweeping legislation that would "reform" the securities markets, address issues in investment banking practices, and "right wrongs" in commercial banking and consumer finance services.

The Democratic Party at the time controlled both the Senate and House of Representative chambers, and after more than a year of hearings — and intense lobbying on both sides of the issues — the massive package of legislation we know as the Dodd–Frank Act passed and was signed into law by President Barack Obama.[2] The next step for the federal government agencies in charge of overseeing the legislation was the development of rules to put the intentions of the statutes in force.

This summer was the fifth anniversary of the Dodd–Frank passage and while many rules have been formulated, a significant amount of rule-making is still ahead for the affected federal agencies. Not that rule-making stood still: There are 22,296 pages of rules published (after public process) as we mark the fifth year of Dodd–Frank. That is 34 times the number of pages in *Moby Dick*, according to one calculation. And the work is not done yet — more than one-third of Dodd–Frank statutes are not yet regulatory releases for the business sector to follow.[3]

As the corporate governance commentator of this journal since 2002 and since the passage of the previous attempt at corporate governance reforms (Sarbanes-Oxley), this writer has been closely monitoring developments following passage of the Dodd–Frank Act five years ago. We consulted with corporate governance experts who have been involved in Dodd–Frank affairs since the first hearings in Congress following the 2008 market crash. What are their views? What is positive and negative about Dodd–Frank, and what would they like to have seen included? We present their perspectives in this commentary for your consideration.

Background: Highlights of Dodd–Frank

As with many Congressional legislative initiatives, the overall title of the statutory package (Dodd–Frank) in fact is comprised of "titles," which are separate entities (this was the case with Sarbanes-Oxley, for example). There are 15 titles within Dodd–Frank; the details were published in *The Federal Register*:[4]

- Title I: Financial Stability (this in part created the Financial Stability Oversight Council);
- Title II: Orderly Liquidation Authority (dealing with the ability of the federal government to wind down "too big to fail" financial institutions);

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- Title III: Transfer of Powers to the Comptroller of the Currency (OCC), the Corporation, and the Board of Governors (concerning FDIC, OCC, and revisions of previous statutes);
- Title IV: Regulation of Advisors to Hedge Funds and Others;
- Title V: Insurance (insurance industry reforms);
- Title VI: Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions;
- Title VII: Wall Street Transparency and Accountability (including regulation of SWAP markets);
- Title VIII: Payment, Clearing, and Settlement Supervision;
- Title IX: Investor Protections and Improvements to the Regulations of Securities (updating prior legislative approaches at reform);
- Title X: Bureau of Consumer Financial Protection (this authority created the Consumer Financial Protection Bureau (CFPB));
- Title XI: Federal Reserve System Revisions (addressed the Federal Reserve Act and other elements of federal governance);
- Title XII: Improving Access to Mainstream Financial Institutions;
- Title XIII: Pay It Back Act (dealing with the Troubled Asset Relief Program (TARP) authorizations);
- Title XIV: Mortgage Reform and Anti-Predatory Lending Act (dealing with residential mortgage loan reforms); and
- Title XV: Miscellaneous Provisions (this included reports by companies on conflict minerals sourcing activities).

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Within the titles are voluminous numbered "sections" that deal with details such as the section of Title IX (investor protections). This is the "shareholder vote on executive compensation disclosure" rule that created the annual or periodic shareholder base vote on corporate executive compensation plans. There are many such sections in the comprehensive Dodd–Frank legislative package that had to be fashioned based on the details of the rules to be followed by regulators and issuers (banks, financial service institutions, public agencies, and publicly traded companies).

The report card at five years

It should be noted that prominent among the primary elected opponents of the Dodd–Frank Act are the Republican members of the Senate and the House (the party gained control of both chambers after passage of the legislation and as the rulemaking process began in earnest). To date, there have been 139 bills introduced in Congress to roll back, amend, or repeal some or all of the legislation; a handful have been enacted into law.[5]

What are the "clear, positive results" of Dodd–Frank? The negatives? What might have been included? We consulted Lisa Woll, chief executive officer of the influential Forum for Sustainable and Responsible Investment (US SIF), the asset management trade association based in Washington, D.C., who offered this appraisal:

> Congress approved the Act following one of the worst financial crises in our country. The 2008 crash impacted the lives of millions of Americans who lost their homes, jobs, and retirement savings. The Dodd–Frank Act helped to bring about much-needed accountability and transparency to the financial markets.
>
> One of the most important achievements is the creation of the Consumer Financial Protection Bureau, which is up and running and now one of the most important agencies providing relief to consumers facing abuse from creditors. CFPB has handled more than 677,000 complaints since it opened its doors four years ago.
>
> Another recently released rule addresses pay-ration disclosure, Section 953(b) of Dodd-Frank. This requires publicly traded companies beginning in 2017 to disclose the median of annual total compensation of all employees except the CEO, the total of the CEO compensation, and the ratio of the two amounts. Disclosure of the CEO-to-worker pay ratio is a key measure to ensure sound corporate governance.

US SIF members are pleased that the Securities and Exchange Commission (SEC) rule applies to U.S. and non-U.S. employees as well as full-time, part-time, seasonal, and temporary workers employed by the company or any consolidated subsidiaries, with some excep-

tions. Says Lisa Woll: "The rule will provide important information about companies' compensation strategies and whether CEO pay is out of balance in comparison to what the company pays its workers. Those will be measurable results."[6]

Corporate governance expert views

A long-time expert in corporate governance and observer of the positive/negative impact on investor attitudes is Stephen L. Brown, who was director of corporate governance and general counsel at Teachers Insurance and Annuity Association of America-College Retirement Equities Fund (TIAA-CREF), which has $350 billion-plus in assets under management and is one of the largest pension fund complexes in the United States.[7]

Over the five years since passage of the Dodd–Frank Act, there has been criticism of the SEC because of the often slow pace of the agency's rule-making process. We asked Stephen Brown about this. He is sympathetic to the SEC; the Act's provisions "were massive," he observes, and the agency is frequently underfunded to carry out its duties.

While the rule-making process continues, Brown raises the issue of "fading memories" of the consequences of the 2008 stock market crash and ensuing investment losses. Brown states:

> As time passes, public sensitivities to the consequences in the 2008–2010 period will diminish. The rules not yet passed, or even those in effect, are being criticized, and as the economy and market conditions continue to improve, there may be less support for putting the balance of rules in effect, those still to be released, and also criticism of rules already adopted.

Rules that are in effect

The important corporate governance rules now in effect include the much-debated "say on pay" provisions mandating shareholder voting on executive compensation plans, says Brown:

> It's interesting, despite dire predictions of calamity, we are seeing as much as 97 percent of votes are cast in favor of corporate comp plans every year. This should be comforting for corporate managements, and an affirmation of shareholders that the plans put forth by boards for their inspection and approval are sensible and in their interest. I see this as a very positive outcome of at least one important provision of Dodd–Frank.

More subtly, Dodd–Frank is bringing about changes in the relationship between boards of directors and institutional shareholders, Stephen Brown thinks. In his role at TIAA-CREF, Brown closely monitored the corporate governance strategies and actions of many companies in which TIAA-CREF held shares. He says:

> No director wants to see a 'bad score' on his or her performance in board duties, and the 90 percent plus positive voting on say-on-pay is an affirmation of directors getting compensation right. Executive comp is usually the number one governance issue for institutional investors.

What doesn't work/may be missing in Dodd–Frank?

Stephen Brown notes that some advocates wanted broad, strict provisions for "clawback" of executive compensation included in Dodd–Frank to address what they viewed as failures in the boardroom and management suite that lead to investor losses. One prominent U.S. senator campaigned to "empower" shareholders to better "police" companies in portfolio, explains Stephen Brown. The Dodd–Frank Act in some instances does address that.

> On balance, Dodd–Frank advanced 'good governance' through the Act's various provisions. Some of the more punitive approaches advanced by advocates did not make it into the legislation, which disappointed some. Over the years we see that a number of institutional investors in fact are passive, and not publicly critical of management and boards, so support for more punitive measures was not more widespread.

CEO Lisa Woll of US SIF says investors were disappointed that the pay ratio provision (CEO-to-worker) did not include smaller companies and that up to 5 percent of non-U.S. employees may be excluded from reporting. "High pay disparities within companies can damage employee morale and productivity and threaten a company's long-term performance," she explained. "In a global economy, with increased outsourcing, comprehensive information about a com-

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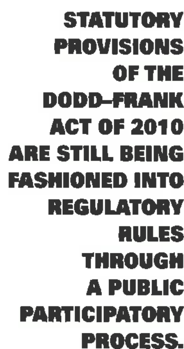
pany's pay and employment practices is material to investors."

Conflict minerals rule — Part of Dodd–Frank

The head of the institutional investor association continues:

> Another positive result is the rule on conflict minerals disclosures under section 1502. The submission of these reports exposes operational risks that are material to investors, and 1,315 companies have submitted disclosures in last year's filings, according to Responsible Sourcing Network. We continue to urge more transparency in conflict minerals reporting.

Lisa Woll's views on rule-making can be taken in the context of whether the statutes "went too far or not far enough," as opponents and proponents of Dodd–Frank variously assert. Closely monitoring and being involved in the rule-making process, the US SIF CEO notes that of the 390 rules required to be enacted, 60 rules have yet to be finalized and another 83 have not even been proposed, according to the law firm of Davis Polk.[8] "One example is the Cardin–Lugar Amendment, requiring any U.S. or foreign company trading on a U.S. stock exchange to publicly disclose resource extraction payment made to governments on a project basis. We are still waiting for SEC to complete the rule."



STATUTORY PROVISIONS OF THE DODD–FRANK ACT OF 2010 ARE STILL BEING FASHIONED INTO REGULATORY RULES THROUGH A PUBLIC PARTICIPATORY PROCESS.

CEO Woll sees the ongoing effort by some members of the U.S. Congress to undermine or weaken the Dodd–Frank Act as "very concerning" and putting the investor, consumer, and members of the general public at risk. She goes on to say:

> In my own work with our asset management members, I am seeing positive effects in that they have greater access to information in order to make an investment decision in companies. The examples are rules around transparency and disclosure. At the same time, asset managers lack access to information in a number of areas where rules are still pending, such as payment disclosures to companies by extractive companies.

Commenting on the fifth anniversary of the historic package of legislation, Lisa Woll offers this: "We hope to see more of the rules finalized so that we can move toward more transparent financial markets and a more sustainable economy."

Corporate governance veteran's observations

Stephen Brown, who after being head of governance at TIAA-CREF served as CEO of the Society of Corporate Secretaries and Governance Professionals, is a long-term participant in the investor-side efforts to improve U.S. corporate governance. Looking at developments over the five years of the aftermath of the Dodd–Frank Act, and at the volumes of rules-of-the-road that have been released, he sees "company by company" improvement in governance, or lack of improvement, for such activities as greater access to the corporate proxy process by shareholders. "[The] SEC developed rules which the federal courts set aside, and we now see individual companies responding to the expectations of investors on this and other issues." He continues:

> The Dodd–Frank Act did not address all of the issues of the capital markets or in corporate governance to the satisfaction of investors, and so we see continuation of the company-by-company approach, with shareholder engagement to address shareholder issues. Up to one-third of the legislation has not been enacted into rules by the respective federal agencies, so we will see continuing public dialogue on these elements of Dodd–Frank. On balance, I think the legislation and the rules enacted have had positive results in bringing about more effective corporate governance of large-cap companies.

Summing up

The sweeping federal statutes adopted over two successive terms of the 73rd Congress in 1933 (The Securities Act) and 1934 (The Exchange Act) followed the 1929 stock market crash that helped usher in the Great Depression of the 1930s. These acts have since been modified many times with "reforms" that update the Acts to address current events and situations. Statutory provisions of the Dodd–Frank Act of 2010 — enacted during the Great Recession — are still being fashioned into regulatory rules through a public participatory process. Not all of the leg-

islative intent is in force through rules (for instance, issued by SEC).

Both proponents and opponents of the statutes and rules are not entirely happy with the outcomes. As publicly traded companies, banks, and financial services companies adjust to their new operating environments, there will be rules that apply and do not apply to specific corporate governance issues. "The devil is in the details," German architect Ludwig Mies van der Rohe is said (by *The New York Times*) to have observed. Corporate executives and board members will see continuing public dialogue on what Dodd-Frank means and does not mean to their companies. As Dodd-Frank rules are interpreted, applied, contested, argued over, and in some cases supported or set aside by courts of law, corporate finance professionals will have to constantly adjust to public policy and regulatory developments. After all, the 1933, 1934, and subsequent securities legislation (such as the 1940 mutual fund reforms) has been constantly updated and expanded. Dodd-Frank at five years can be said to be somewhat of a moving target as to future consequences affecting some aspects of future corporate finance. ■

NOTES

[1] Carney, J., America lost $10.2 trillion in 2008, *Business Insider* (Feb 3, 2009). Available at: http://www.businessinsider.com/2009/2/america-lost-102-trillion-of-wealth-in-2008.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, H. R. 4173.

[3] "Five years of Dodd-Frank," Davis Polk. Available at: http://www.volckerrule.com/infographic/july2015infographic.html.

[4] Dodd-Frank was passed in the 111th Congress. The Federal Register official notice is at: https://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

[5] *Op. cit.* note 3.

[6] The US SIF is an asset management trade association based in Washington, D.C. Member institutions include Bank of America, UBS Global Asset Management, Bloomberg, Calvert Investments, Legg Mason, and many other "names." Members are engaged in sustainable, responsible, and impact investing, and advance investment practices that consider environmental, social, and governance criteria. Lisa Woll has been CEO since 2006. Quotes obtained from email interview Sept 2015. Information available at: http://www.ussif.org/institutions.

[7] Stephen L. Brown, a former executive of Goldman Sachs, TIAA-CREF, and the Society of Corporate Secretaries and Governance Professionals, is now Principal, The Edgerton Group LLC, corporate governance advisors. Quotes obtained from author interview Aug 24, 2015. Profile at: https://www.linkedin.com/in/stephenlbrown.

[8] *Op. cit.* note 3.