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Financial Reform Legislation: A Guide to the Employment-Related Provisions

August 2010

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Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform Act) was signed into law by President Obama on July 21, 2010. The new law contains a number of provisions that affect the workplace of employers in the financial services industry and other public companies. It enacts new whistleblower protections, regulates compensation for mortgage originators, provides new scrutiny of diversity in the workplace, and regulates executive compensation.

- **Whistleblower Protections** – The Wall Street Reform Act strengthens the whistleblower provisions contained in the Sarbanes-Oxley Act (SOX), and creates new whistleblower protections for employees who engage in certain whistleblowing activities to the U.S. Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), or the newly established Consumer Financial Protection Bureau (Bureau).

- **Compensation for Mortgage Originators –** The Wall Street Reform Act amends Section 129B of the Truth in Lending Act to prohibit forms of compensation for mortgage originators that vary based on any rate or term of the loan (other than the loan amount).

- **Diversity in the Workplace** – The Wall Street Reform Act also provides for the creation of a new diversity "czar" for each of the major federal financial regulatory agencies, and directs each agency to create an Office of Minority and Women Inclusion (Office) that "shall be responsible for all matters of the agency relating to diversity in management, employment, and business activities."

  Among other things, the Office will be responsible for assessing the diversity policies and practices of **every** entity regulated by the major financial regulatory agencies and of contractors performing any kind of service for the agency. The Office is authorized to take action where it concludes that the contractor is not making a good-faith effort to comply with the diversity provisions of the Wall Street Reform Act.

- **Executive Compensation and Corporate Governance** – The Wall Street Reform Act also addresses executive compensation and corporate governance issues, such as recovery of erroneously awarded compensation (clawbacks); executive compensation disclosures (internal pay equity); disclosure of employee and director hedging; restrictions on voting by brokers; disclosure and justification where the chairman and CEO positions are held by one person; required shareholder voting on executive compensation disclosures ("say on pay"); enhanced reporting on compensation structures applicable to covered financial institutions; and mandated compensation committee independence.

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Whistleblower Protections

Morgan Lewis previously summarized the significant changes and additions to whistleblower protections in its July 20, 2010 LawFlash, "Congress Passes Sweeping Changes to Labor and Employment Whistleblower Protections."[1] Briefly summarized, the Wall Street Reform Act includes important changes to SOX, and institutes the following significant new whistleblower provisions:

- **Amends SOX to include the following additional protections:**
    - **Unenforceability of waivers and predispute arbitration agreements.** The rights and remedies provided for under the SOX civil whistleblower provisions may not be waived by any agreement, policy, form, or condition of employment, including by a predispute arbitration agreement. The Wall Street Reform Act further provides that "no predispute arbitration agreement shall be valid or enforceable if the agreement requires arbitration of a dispute arising under" the SOX civil whistleblower provisions.
    - **Expansion of SOX civil whistleblower protections to employees of public company subsidiaries.** The definition of public companies covered by SOX now includes any "subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company."
    - **Expansion of SOX statute of limitations from 90 days to 180 days.** The amount of time under SOX for a whistleblower to file a complaint of retaliation with the Occupational Safety and Health Administration (OSHA) is increased from 90 days to 180 days. The filing period is now measured from either the date of a violation or the date on which the employee becomes aware of a violation.
    - **Right to a jury trial.** Whistleblowers who bring a private action in federal court following the Department of Labor's (DOL's) failure to issue a final decision within 180 days now have a statutory right to a jury trial.
- **Creates a new SEC Whistleblower Program (SEC WP):**
    - Establishes significant monetary incentives to provide "original information" to the SEC relating to a violation of securities laws. If such information leads to successful enforcement in any judicial or administrative proceeding brought by the SEC under the securities laws, and the recovery of monetary sanctions exceeding $1,000,000, the whistleblower is entitled to an award of 10% to 30% of the monetary sanctions recovered in such proceeding.
    - Protects whistleblowers from retaliation for lawful acts undertaken while (1) providing information to the SEC in accordance with the statute; (2) initiating, testifying, or assisting in any investigation or judicial or administrative action of the SEC based upon or related to such information; or (3) making disclosures that are required or protected under SOX or securities laws, rules, or regulations.
    - Provides a private right of action for retaliation in federal court, without requiring or permitting administrative proceedings (unlike a SOX retaliation claim, which is filed with and adjudicated by OSHA and the DOL (see discussion above)).
    - Contains a new, longer statute of limitations for retaliation claims brought under the SEC WP; claims may not be brought more than (i) six years from the date of the alleged

[1] *Available at* http://www.morganlewis.com/pubs/FRR_ChangesToWhistleblowerProtections_20july10.pdf.

retaliatory act or (ii) three years from the date “the facts material to the right of action are known or reasonably should have been known by the employee” alleging retaliation. In no event can any claim be brought more than 10 years after the date of the alleged retaliatory act.

  - Provides the following remedies for retaliation: (1) reinstatement; (2) double back pay with interest; and (3) reasonable attorneys’ fees, expert witness fees, and litigation costs.

- **Creates a new CFTC Whistleblower Program (CFTC WP):**

  - Creates a new whistleblower program to encourage reporting of violations of the Commodity Exchange Act to the CFTC.

  - Provides monetary incentives similar to the SEC WP (an award of 10% to 30% of the monetary sanctions recovered) for those who provide “original information” of a violation of the Commodity Exchange Act to the CFTC that results in a judicial or administrative action by the CFTC and the recovery of more than $1,000,000 in monetary sanctions.

  - Provides a private right of action for retaliation in federal court, without requiring or providing for administrative proceedings.

  - Contains a statute of limitations limited to two years after the date on which the alleged statutory violation was committed.

  - Provides the following remedies for retaliation: (1) reinstatement; (2) single back pay with interest; and (3) special damages, including reasonable attorneys’ fees, expert witness fees, and litigation costs.

  - Similar to the amendment to SOX, the rights and remedies provided to whistleblowers under the CFTC WP provisions cannot be waived by agreement, policy, form, or condition of employment, or be subject to a predispute arbitration agreement.

- **Creates a new whistleblower program for financial services employees reporting alleged violations of various consumer protection laws:**

  - Creates significant new protections for employees working in the consumer financial services sector.

  - Employers that offer or provide a consumer financial product or service; participate in designing, operating, or maintaining the consumer financial product or service; or process transactions related to consumer financial products or services are prohibited from terminating or otherwise discriminating against “any individual performing tasks related to the offering or provision of a consumer financial product or service,” by reason of the fact that the individual:

    - Provided, caused to be provided, or is about to provide or cause to be provided information—whether at the initiative of the employee or in the ordinary course of the duties of the employee—to the employer; the newly created Consumer Financial Protection Bureau; or any other local, state, or federal authority or agency relating to any violation of, or act or omission that the employee reasonably believes to be a violation of one of the laws protected by the Bureau or other rules promulgated by the Bureau.

    - Testified or will testify in any proceeding resulting from the administration or enforcement of the Consumer Financial Protection Act of 2010, any of the laws protected by the Bureau, or other rules promulgated by the Bureau.

        - Filed or instituted (or caused to be filed or instituted) any proceeding under federal consumer financial law.

        - Objected to, or refused to participate in, any activity, policy, practice, or assigned task that the employee (or other such person) reasonably believed to be in violation of any law subject to the jurisdiction of the Bureau or enforced by the Bureau.

    - ➢ A person who believes that he or she has been terminated or otherwise discriminated against because of one of the above actions may file a complaint with the DOL within 180 days of the alleged violation.

    - ➢ The DOL may issue a preliminary order of reinstatement that is not subject to stay pending appeal.

    - ➢ The complainant may seek de novo review in federal court if the DOL has not issued a final order within 210 days after the filing of the complaint (compared with the 180-day time period under SOX), or within 90 days of the initial written determination.

    - ➢ Similar to the amendments to SOX and the CFTC WP, the rights and remedies provided to whistleblowers under this section of the Wall Street Reform Act cannot be waived by any agreement, policy, form, or condition of employment, or be subject to a predispute arbitration agreement.

- **Amends the False Claims Act (FCA) whistleblower protections:**

    - ➢ Establishes a three-year statute of limitations for civil actions under the antiretaliation section of the FCA.

    - ➢ Modifies the existing definition of covered individuals and protected conduct.

The Whistleblower Provisions: Recommendations

In light of the passage of the Wall Street Reform Act and its significant impact on whistleblower protections, public company employers and their subsidiaries and affiliates need to consider doing the following:

- **Review waiver and arbitration agreements.** Due to the restrictions on waivers and predispute arbitration agreements**,** employers need to review their employment agreements and policies and their enforcement procedures to ensure they do not conflict with these restrictions.

- **Find new ways to encourage internal reporting.** In response to the increased financial incentives to whistleblowers who provide original information to the government, employers should consider how best to encourage would-be whistleblowers to raise compliance concerns internally.

- **Audit subsidiary compliance.** While public companies are now well versed in the “compliance culture” created by SOX in 2002, companies must be mindful to extend the same corporate compliance structures to subsidiaries and other related entities. Employers should also audit existing compliance structures and develop ways to extend them to umbrella organizations.

Compensation for Mortgage Originators

The Mortgage Reform and Anti-Predatory Lending Act (the Mortgage Reform Act, which is contained within the Wall Street Reform Act) amends the Truth in Lending Act and creates a host of new rules prohibiting compensation-related steering incentives for mortgage originators.

Subject to certain exclusions, mortgage originators are defined as persons who, for direct or indirect compensation or gain, (i) take a residential mortgage loan application, (ii) assist a consumer in obtaining or applying for a residential mortgage loan, or (iii) offer or negotiate terms of a residential mortgage loan application. These provisions also cover persons who represent to the public through advertising or other communication or information that they can or will do any of the things listed in (i) through (iii) above.

The Mortgage Reform Act establishes new restrictions on compensation for mortgage originators, including the following:

- For any residential mortgage loan, the Mortgage Reform Act prohibits any mortgage originator from receiving or being paid, directly or indirectly, compensation that varies based on the terms of the loan (other than the amount of the principal).

- For any mortgage loan, the Mortgage Reform Act generally prohibits a mortgage originator from receiving from any person (other than the consumer) any origination fee or charge, except bona fide third-party charges not retained by the creditor, mortgage originator, or an affiliate of the creditor or mortgage originator.

- The Mortgage Reform Act expressly permits a mortgage originator to receive (from a person other than the consumer) an origination fee or charge if (i) the mortgage originator does not receive any compensation directly from the consumer; and (ii) the consumer does not make an upfront payment of discount points, origination points, or fees, however denominated (other than bona fide third-party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator). This last precondition (clause (ii)) may be waived or subject to exemptions by rule.

- The Mortgage Reform Act further provides that its provisions shall not be construed as:

    - Permitting any yield spread premium or other similar compensation that would, for any residential mortgage loan, permit the total amount of direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of a loan (other than the amount of the principal).

    - Restricting the mortgage originator’s right to receive permitted origination fees and costs (including compensation) from any person (subject to the above provisions), so long as such fees and costs do not vary based on the terms of the loan (other than the amount of the principal) or the consumer’s decision about whether to finance such fees and costs.

    - Prohibiting a mortgage originator to receive incentive payments based on the number of residential mortgage loans originated within a specified period of time.

The provisions of the Mortgage Reform Act will take effect on the effective date of final regulations implementing such provisions. We believe that will occur sometime within the next 12 to 18 months.

In light of the Mortgage Reform Act, employers of mortgage originators should review compensation plans and structures to ensure compliance with the Mortgage Reform Act.

Diversity in the Workplace

In an effort to promote the "fair inclusion of women and minorities" in the businesses subject to the oversight of federal financial regulatory agencies, the Wall Street Reform Act requires each of the major federal financial regulatory agencies to create an Office of Minority and Women Inclusion. Each Office must be created within six months of the date of enactment, and will be headed by a director who "shall be responsible for all matters of the agency relating to diversity in management, employment, and business activities."

The Director will be responsible for developing standards for the following areas:

(i) Equal employment opportunity and the racial, ethnic, and gender diversity of the workforce of the agency

(ii) Increased minority participation in the programs and contracts of the agency, including standards for coordinating technical assistance to such businesses

(iii) Assessing the diversity policies and practices of entities regulated by the agency

The Director of each Office is required to "develop and implement standards and procedures to ensure, to the maximum extent possible, the fair inclusion and utilization of minorities, women, and minority-owned and women-owned businesses in all business and activities of the agency at all levels, including in procurement, insurance, and all types of contracts."

The Office's oversight applies to all contracts of federal financial regulatory agencies for services of any kind, including the services of financial institutions, investment banking firms, mortgage banking firms, asset management firms, brokers, dealers, financial services entities, underwriters, accountants, investment consultants, and providers of legal services.

The contracts subject to oversight include contracts for all business and activities of an agency at all levels, including contracts for the issuance or guarantee of any debt, equity, or security; the sale of assets; the management of the assets of the financial agency; the making of equity investments by the financial agency; and the implementation by the financial agency of programs to address economic recovery.

With this new law, the diversity initiatives of businesses subject to the oversight of federal financial regulatory agencies are likely to be more closely scrutinized. With respect to companies that have contracts with federal financial regulatory agencies, if the agency's Office Director does not believe the contractor is making a good-faith effort to include minorities and women in its workforce, the agency administrator may (i) terminate the contract with the entity; (ii) refer the firm to the Office of Federal Contract Compliance Programs (OFCCP); or (iii) "take other appropriate action."

Executive Compensation and Corporate Governance

Morgan Lewis previously summarized the significant changes in the Wall Street Reform Act to executive compensation requirements in its July 16, 2010 LawFlash, "Financial Reform Bill Imposes Significant New Executive Compensation and Corporate Governance Requirements," many of which are immediately applicable.[2] Briefly summarized, the executive compensation and corporate governance provisions of the Wall Street Reform Act address the following issues:

- Recovery of erroneously awarded compensation (clawbacks)

[2] *Available at* http://www.morganlewis.com/pubs/FRR_NewExecCompAndCorpGovReq_LF_16jul10.pdf.

- Executive compensation disclosures (internal pay equity)
- Disclosure regarding employee and director hedging
- Voting by brokers
- Disclosures regarding whether the chairman and CEO are combined positions, and if so, why
- Shareholder vote on executive compensation disclosures (“say on pay”)
- Enhanced compensation structure reporting applicable to covered financial institutions
- Compensation committee independence

Executive Compensation and Corporate Governance Provisions: Recommendations

Notably, the clawback provisions also create a potential tension between compliance with the Wall Street Reform Act and compliance with applicable state wage laws.

As noted in our prior LawFlash on this topic, the Wall Street Reform Act requires public companies to develop and implement a clawback policy with respect to incentive-based compensation for their executive officers. The policy must provide for recovery from current and former executive officers of the amount of incentive-based compensation (including stock options) they improperly received, based on financial statements later found to be materially inaccurate and restated during a relevant three-year period.

Companies that must draft or revise clawback policies to comply with these provisions should examine existing incentive compensation plans and other contractual agreements applicable to their executive officers. These plans and agreements may need to be amended because applicable state wage and contract law principles may not allow the company to implement its clawback policy in compliance with the Wall Street Reform Act. The clawback could have the effect of violating state wage laws or breaching existing contractual entitlements of its executive officers.

Many states have statutes that prohibit an employer from forcing an employee to “pay back” to the employer any amount paid as wages after those wages have been earned by the employee. Many state statutes prohibit employers from engaging in self-help by withholding or taking clawbacks from compensation currently due to an employee based on amounts that the employee may owe the employer for any variety of reasons.

To avoid disputes under state law, companies subject to the Wall Street Reform Act should ensure that their incentive-based compensation plans and other contractual agreements applicable to their executive officers meet the following criteria:

- Are carefully drafted or amended to (i) expressly condition the incentive compensation earnings and vesting entitlements on accurate financial statements that are not subsequently required to be restated during the relevant three-year period specified by the Wall Street Reform Act and (ii) expressly provide that incentive compensation payments or awards, made based on financial statements, are advances subject to repayment or recovery in the event the underlying financial statements require restatement during the relevant three-year period specified by the Wall Street Reform Act.

- Avoid any vague and ambiguous language that, arguably, conflicts with the company's intent to comply with the Wall Street Reform Act (one of the penalties of noncompliance is the delisting of a company's stock).

- Expressly provide mechanisms, lawful under applicable state law, for payment of the clawback amounts required by the Wall Street Reform Act in the event that the executive officer is continuing in the employ of the company, or is no longer employed by the company.

Summary

The Wall Street Reform Act dramatically changes the employer-employee landscape—it significantly expands government oversight and regulation of the workplace for employers in the financial services industry and public companies. Employers should act swiftly and carefully to understand and address the new or revised rules and regulations ushered in by this significant legislation.

We will continue to monitor the unfolding impact of this Financial Regulatory Reform. If you have any questions or would like more information on the issues discussed in this LawFlash, please contact the authors, **Sarah Bouchard** (215.963.5077; sbouchard@morganlewis.com) and **Tom Linthorst** (609.919.6642; tlinthorst@morganlewis.com), or any of the following Morgan Lewis attorneys:

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In addition, Morgan Lewis's multidisciplinary Financial Regulatory Reform resource team is available to assist with a wide range of issues and areas of concern related to the reform effort. You can access a complete collection of the firm's updates and alerts on the subject on our website's Financial Regulatory Reform page.

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