Dodd-Frank for Foreign Financial Institutions and Publicly Traded Companies in the U.S.: An Update

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which was signed into law by President Obama on July 21, 2010, launched a sweeping overhaul of U.S. financial institutions and publicly traded companies. Some key provisions enacted under Dodd-Frank apply to foreign financial institutions and foreign private issuers. This memorandum focuses on the international reach of some of Dodd-Frank's employment provisions, including its corporate governance and compensation rules, expanded whistleblower programs and anti-retaliation protections, and new diversity obligations for covered federal agencies.

Foreign Entities Affected By Employment Aspects of Dodd-Frank

United States branches and agencies of international banks are subject to certain Dodd-Frank employment provisions that apply to U.S. financial institutions, including certain whistleblower provisions and incentive compensation restrictions. Foreign non-bank financial companies – companies incorporated or organized in a country other than the United States that engage in financial activities in the United States, but do not hold a banking license and are not allowed to take deposits from the public – may also be covered by certain Dodd-Frank employment provisions that apply to U.S. financial institutions.

Foreign private issuers are subject to some of Dodd-Frank's provisions that pertain to all issuers listed on national securities exchanges, such as the clawback requirement established by Section 954. However, foreign private issuers are *exempt* from many of the Securities and Exchange Commission ("SEC") and U.S. stock market rules related to executive compensation that apply to domestic companies. They are not subject to the normal proxy pay disclosure rules and are excused from most of the NASDAQ and New York Stock Exchange corporate governance requirements. Thus, although foreign private issuers are covered by some Dodd-Frank provisions, those provisions that achieve their effect by amending or expanding proxy requirements, such as shareholder voting rules, most likely do not apply to foreign private issuers.

Provisions of Dodd-Frank with Employment Aspects

a) Whistleblowing and Anti-Retaliation

Dodd-Frank greatly enhanced whistleblower protections by expanding the securities whistleblower laws enacted under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "SOX") by creating new retaliation protections for certain whistleblowers. Under the new and amended laws, foreign companies are likely to be subject to whistleblower actions in the United States.

Securities Whistleblowers

Dodd-Frank ushered in new protections for whistleblowers and enhanced existing protections under SOX. The new anti-retaliation protections enacted under Dodd-Frank protect whistleblowers who provide information regarding (or cooperate in the investigation of) *any* potential violation of U.S. securities laws. An employer may not discharge, demote, suspend, threaten, or harass, directly or indirectly, or in any other manner discriminate against an individual based on his or her whistleblowing.

Under Dodd-Frank, unlike SOX, securities whistleblowers can bypass the U.S. Department of Labor and file retaliation actions directly in federal court. Dodd-Frank also provides a lengthy statute of limitations, ranging between six and ten years, depending upon when

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the whistleblower becomes aware of the facts material to his or her claim. Whistleblowers can also avail themselves of expansive remedies under Dodd-Frank, including reinstatement, double back pay plus interest, attorneys' fees and litigation costs.

Dodd-Frank expanded the protections available under SOX. For example, Dodd-Frank extended the statute of limitations under SOX from 90 to 180 days. Dodd-Frank also amended SOX by establishing that its anti-retaliation provisions also apply to employees of *non-publicly* traded subsidiaries and affiliates of publicly traded companies.

In addition to creating and expanding protections for whistleblowers, Dodd-Frank established an incentive program that encourages securities whistleblowers to come forward by offering monetary awards (sometimes referred to as "bounties") for valuable information. To be considered for an award, a whistleblower must voluntarily provide the SEC with original information that leads to its successful enforcement of a federal court or administrative action and results in monetary sanctions over $1 million. The SEC may award qualifying whistleblowers between ten and thirty percent of the sanctions obtained as a result of the information provided. Whistleblowers seeking bounty awards can remain anonymous until it is time to claim an award, so long as they are represented by counsel. Furthermore, even once a whistleblower has stepped forward to claim a bounty award, the SEC will protect his or her identity from public disclosure.

Impact on Foreign Companies:

Foreign subsidiaries and affiliates of U.S. public companies are now subject to U.S. securities whistleblower actions, regardless of whether they are publicly traded. Furthermore, whistleblowers can claim bounty awards based on monetary sanctions collected in *any* judicial or administrative action brought under the securities laws, with no exceptions for actions involving foreign private issuers. Notably, the SEC can share information it receives from whistleblowers with foreign securities and law enforcement authorities, though it will only share information that could potentially reveal the whistleblower's identity once it has obtained adequate assurances of confidentiality. Final regulations enacted by the SEC do clarify, however, that a whistleblower cannot collect an award based upon reports of a possible violation of foreign securities laws. Also, foreign government officers, members and employees are not eligible for whistleblower bounty awards.

Neither Dodd-Frank nor the SEC's implementing regulations discuss whether Dodd-Frank's anti-retaliation protections apply extraterritorially. At least one U.S. District Court has held that they do not.[1] However, Dodd-Frank extended the extraterritorial reach of anti-fraud securities laws in enforcement actions brought by the SEC and Department of Justice, and Congress instructed the SEC to study whether extraterritorial application should be similarly expanded in private actions.

The SEC reported its findings on this issue to Congress in April 2012. Although the SEC expressed its support for expanded extraterritorial application in private actions, it stopped short of making a formal recommendation. Instead, the SEC summarized issues raised in comment letters submitted to the agency and identified a number of potential options with regard to private actions. Congress has not yet taken legislative action in response to the SEC's report.

Commodities Whistleblowers

Enacted under Dodd-Frank, Section 23 of the Commodity Exchange Act provides whistleblower protections to individuals who report potential violations of the Commodity Exchange Act to the Commodity Futures Trading Commission ("CFTC"). Like securities whistleblowers, retaliation against commodities whistleblowers is prohibited, and the law affords them a private right of action in federal court. Commodities whistleblowers have up to two years from the date of the alleged adverse action to bring their claim.

Dodd-Frank also created a "bounty" program for commodities whistleblowers, similar to that available to individuals that blow the whistle on securities violations. Individuals who voluntarily provide original information that leads to the successful resolution of a covered CFTC judicial or administrative action or the successful enforcement of a related action may be awarded between ten and thirty percent of the sanctions obtained by the CFTC, if the sanctions exceed $1 million.

1 *See Asadi v. G.E. Energy (USA), LLC,* No. 4:12-345, 2012 U.S. Dist. LEXIS 89746 (S.D. Tex. June 28, 2012).

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Impact on Foreign Companies:

Although Dodd-Frank does not directly address whether foreign companies are subject to commodities whistleblower actions or whether U.S. commodities laws have extraterritorial jurisdiction, the CFTC has taken the position that it has broad authority to enforce the Commodity Exchange Act as amended by Dodd-Frank outside of the United States. Thus, any foreign institution engaged in U.S. commodity futures or options markets may be susceptible to whistleblower retaliation actions in federal court.

Financial Services Whistleblowers

Dodd-Frank created a new consumer protection entity, the consumer Financial Protection Bureau ("CFPB"), and new protections for whistleblowing employees in the financial services industry. A wide range of employers are covered by these new protections, including organizations that extend credit or service loans, engage in credit reporting, provide certain real estate-related services or engage in other similar financial activities. Protected activity includes, among other things, providing information to the employer, CFPB, or other government or law enforcement agency about an act or omission that the whistleblower reasonably believes to be a violation of consumer protection laws. To bring a retaliation claim under the new law, an employee must file a complaint with the Secretary of Labor within 180 days after the alleged retaliation.

Impact on Foreign Companies:

Although the international reach of the financial services whistleblower provision is not directly addressed by Dodd-Frank, it is possible that foreign financial companies operating in the United States, or those that provide financial products or services to the United States, may be subject to whistleblower actions. These protections went into effect on July 21, 2011. To date, no guidance has been issued by the Department of Labor, nor has it identified when any such guidance can be expected.

b) Executive Compensation

Say on Pay and Golden Parachutes

On January 25, 2011, the SEC adopted final rules implementing Dodd-Frank provisions that require shareholder advisory votes on executive compensation. Under the new rules, proxy statements for the first annual or other shareholder meeting occurring on or after January 21, 2011 must include a separate resolution allowing shareholders to cast a non-binding vote on proposed pay packages to certain executive officers. Companies are required to hold a "frequency" vote at least once every six years, allowing shareholders to decide how often they would like to hold a "say on pay" vote.

Under certain circumstances, shareholders must also be permitted to cast non-binding votes on "golden parachutes" (i.e., compensation paid to executive officers in connection with merger transactions), if those provisions were not approved as part of a say-on-pay vote. Golden parachute disclosures and votes are required for initial proxy and information statements filed on or after April 25, 2011.

Impact on Foreign Companies:

The shareholder voting rules, which were adopted by the SEC on January 25, 2011, apply to all public companies subject to the proxy rules of the Securities and Exchange Act. Before the adoption of those rules, it was anticipated that the shareholder voting rules would *not* apply to foreign private issuers, because they are generally exempt from proxy rules, and indeed the final rules confirm that the "say on pay" and "golden parachutes" provisions do not apply to foreign private issuers.

Independent Compensation Committees

On June 20, 2012, the SEC issued final rules implementing Section 952 of Dodd-Frank. The new rules require the national exchanges to prohibit the listing on national exchanges of companies that lack independent compensation committees, comprised of independent board members. The SEC rules identify criteria for establishing the independence of compensation committee members,

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including sources of a committee member's compensation and whether he or she is affiliated with the company in any way. The national exchanges must now adopt new listing rules that comply with the SEC regulations. Once the rules are adopted, public companies will be required to determine whether their compensation committees satisfy the SEC's criteria for independence.

Impact on Foreign Companies:

Dodd-Frank explicitly excludes foreign private issuers from the independent compensation committee requirement *if* they annually disclose to shareholders the reasons why they lack such a committee.

Pay for Performance

Under Section 953 of Dodd-Frank, the SEC must develop rules that will require public companies to disclose in their proxy statements the relationship between the compensation paid to executive officers and the financial performance of the company. In addition, companies will be required to disclose the median total annual compensation paid to all employees *other than* the chief executive officer, the total annual compensation paid to the chief executive officer, and the ratio between the two amounts.

Impact on Foreign Companies:

The pay for performance provision will be implemented through proxy statements, so it most likely will not apply to foreign private issuers. The SEC has yet to issue rules that should clarify whether the new requirements apply to foreign private issuers. The SEC has twice extended its expected time frame for releasing the proposed rules, most recently stating that the rules would be adopted in the second half of 2012. In August 2012, however, the SEC removed the Dodd-Frank regulation implementation timeline from its website and no longer identifies a target date for proposal or adoption of the new rules.

Clawbacks

Section 954 of Dodd-Frank requires national securities exchanges to adopt rules as directed by the SEC that will require issuers to recover certain incentive-based compensation from current or former executive officers in the event of a financial restatement due to material noncompliance with any financial reporting requirement under the securities laws. Executives will be permitted to retain the incentive pay they would have earned if the financial information had been reported correctly.

Impact on Foreign Companies:

Because the clawback requirement will be imposed through mandatory changes to listing standards at national securities exchanges, any entity listed on such an exchange should be covered. This means that foreign private issuers *will* most likely be required to comply with the clawback provision under the SEC rules. As in the case of the pay-for-performance rules, the SEC has delayed release of the proposed rules and, at present, has identified no target date for their release.

Incentive Compensation Structure and Reporting

Dodd-Frank requires federal regulators, including the SEC, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System, to jointly promulgate regulations or guidelines for covered financial institutions that will enhance disclosures of incentive based compensation and prohibit incentive-based compensation that encourages inappropriate risks or could lead to material loss. The seven federal regulators tasked with promulgating the regulations proposed a rule on March 30, 2011, but a final rule has not yet been adopted.

Under Dodd-Frank and the proposed rule, covered financial institutions are defined broadly to include depository institutions and holding companies, registered broker-dealers, credit unions, investment advisors, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Importantly, however, institutions that have total consolidated assets of less than $1 billion are not subject to the proposed rule.[2]

2 The federal regulators are empowered to expand the definition of covered institutions to include other categories of financial institutions.

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Impact on Foreign Companies:

Dodd-Frank did not address whether a foreign financial institution operating in the United States that falls within one of the categories of "covered institutions" is required to comply with the mandated disclosures and prohibitions that will be promulgated by the federal regulators. However, the proposed rule expands "covered institutions" to include the uninsured branches and agencies of a foreign bank and other U.S. operations of foreign banking organizations that are treated as bank holding companies pursuant to section 8(a) of the International Banking Act of 1978.

c) Diversity Obligations

In Section 342, Dodd-Frank requires almost thirty covered federal financial agencies, including the SEC, the FDIC and the Federal Reserve, to establish an Office of Minority and Women Inclusion to be responsible for all agency matters relating to diversity in management, employment and business activities. The offices are charged with monitoring the diversity of agency contractors and entities regulated by the agencies, in addition to the diversity of the agencies themselves. Regulated entities will be subject to diversity assessment by the office, whereas agency contractors and potential contractors may be required to meet certain diversity standards in order to maintain or achieve a contract with the agency.

Impact on Foreign Companies:

The diversity standards of the newly established Offices of Minority and Women Inclusion in federal financial agencies may apply to foreign companies that are regulated by or contractors of these agencies. Dodd-Frank does not identify specific diversity requirements that must be implemented, so the precise standards adopted by each agency will not be known until issued.

The SEC established its Office of Minority and Women Inclusion in July 2011 and appointed a permanent director in December 2011. In the Office's first annual report, issued in April 2012, it noted the director's responsibility for, among other things, assessing the diversity policies and practices of entities regulated by the SEC. The report also explained that the director is working with other agencies' Offices of Minority and Women Inclusion to develop appropriate standards for conducting this assessment.

Littler will continue to monitor developments in this area. Should you have any questions, please contact your Littler attorney or Philip Berkowitz, pberkowitz@littler.com or Steven Friedman, sfriedman@littler.com.

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