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COUNSELORS AT LAW

Practical Summaries of Key Sections of The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act is widely expected to transform the financial regulatory landscape. The vast majority of the Act's provisions charge the many affected federal rulemaking agencies to interpret and issue implementing regulations within a specified period, leaving the ultimate impact of the Act unknown for the time being.

This first part of this article provides a high-level overview of certain of the Act's provisions that will have the most direct impact on asset managers. The second part of this article provides an overview of regulatory changes to executive compensation practices and public company proxy disclosures. The third part of this article provides an overview of the Act's whistleblower and related anti-retaliation provisions.

In connection with its rulemaking activities under the Act, the SEC is seeking preliminary comments on a number of issues related to the Act, prior to its proposing new rules in respect of such issues. As the SEC and the other rulemaking bodies begin to propose new rules in respect of the Act's provisions, we will continue to update our clients and other interested parties with information and analysis of the ongoing impact of the Act.

PART I

Regulation of Investment Advisers – Title IV

Registration of Investment Advisers

Advisers to hedge funds, private equity funds, and other types of investment funds will be directly impacted by Title IV of the Act, also known as the Private Fund Investment Advisers Registration Act of 2010. Title IV significantly extends the reach of the registration, disclosure, reporting and monitoring regime originally promulgated under the Investment Advisers Act of 1940 for "private funds."

Under Title IV, many advisers, previously exempt from registration under the Advisers Act through the "private investment adviser" exemption (i.e., persons having fewer than 15 advised clients), will be required to register with the SEC. Specifically, beginning one year after enactment of the Act, investment advisers to private funds (defined as any fund that would have had to register as an "investment company" but for the exemptions provided by Section 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 with assets under management of at least $150 million will be required to register as investment advisers with the SEC, and will be subject to the reporting and monitoring regime thereunder. Title IV does not specify how assets under management will be calculated, and asset managers will need to await expected SEC guidance on this issue.

The following investment advisers of private funds will still be exempt from registration:

- Advisers to venture capital funds. The SEC is charged with defining the term "venture capital fund" within one year after enactment (although they will remain exempt from registration, advisers to venture capital funds will still need to comply with reporting and recordkeeping requirements to be established by the SEC);

- Advisers to private equity funds with assets under management of less than $150 million in the U.S. (as with advisers to venture capital funds, advisers to private equity funds with assets under management of less than $150 million will still need to comply with reporting and recordkeeping requirements to be established by the SEC). The SEC is expected to engage in rulemaking to determine how "assets under management" will need to be calculated;

- Advisers to foreign private funds (i) with no place of business in the U.S., (ii) with fewer than 15 U.S. based clients and investors in private funds at any time, (iii) with assets under management of less than $25 million attributable to U.S. based clients in private funds, and (iv) which do not hold themselves out to U.S. investors as investment advisers;

- Advisers to Small Business Investment Companies licensed under the Small Business Investment Act of 1958; and

- Advisers to family offices (the SEC is charged with defining "family office" within one year after enactment).

Title IV of the Act will significantly increase the number of investment advisers subject to the supervision of state securities regulators by requiring investment advisers with up to $100 million of assets under management (as opposed to the $25 million threshold currently in effect) to register in the state where their headquarters are located.

Disclosure and Reporting Requirements

The records and reports to be maintained by investment advisers required to be registered under Title IV, which the SEC will have the right to inspect, will include a description of the following items: (i) total assets under management, (ii) types of assets held, (iii) use of leverage, (iv) counter-party credit risk exposure, (v) trading and investment positions, (vi) valuation policies and practices of the fund, (vii) side arrangements or side letters, whereby certain investors in a fund obtain more favorable rights or entitlements than other investors, and (viii) other information as determined by the SEC (the purpose of gathering such additional information will be to address and manage systemic risk). Further, the SEC is required to conduct periodic inspections of such records (subject to certain public policy caveats, confidential non-public information remains protected to the same extent as such information was protected under the Advisers Act).

Not later than 12 months after enactment of the Act, the various regulatory bodies charged with rulemaking under the Act will jointly promulgate rules to establish the content and form of the reports to be filed with each such body under the Act.

Adjustment of Accredited Investor Standard

The Act has also changed the definition of "accredited investor" under Regulation D of the Securities Act of 1933, effective immediately, by excluding the value of an investor's primary residence from the calculation of such investor's net worth, provided that any debt associated with such residence (up to the fair market value of the residence) may also be excluded from the net worth calculation. In addition, the SEC is charged with increasing the current personal net worth standard of $1 million following the fourth anniversary of the Act, and reviewing that amount every four years thereafter.

Proprietary Trading and the "Volcker Rule" – Section 619 of Title VI

The Act places a significant number of restrictions on banking activity – one of which is set out in the so-called "Volcker Rule," named after former Federal Reserve Chairman Paul Volcker. Unless otherwise provided for under the Act, a banking entity is prohibited from (i) engaging in proprietary trading (the buying or selling of any security, derivative or other financial instrument for its own trading account, as opposed to the accounts of its customers) or (ii) acquiring or retaining any equity, partnership or other ownership interest in or sponsoring a fund (i.e., any issuer that would be required to be registered as an investment company under the Investment Company Act, but for the Section 3(c)(1) and 3(c)(7) exemptions, including most hedge funds and private equity funds established by banking entities). "Sponsoring" a fund means (A)(1) serving as its general partner, managing member or trustee, and (2) in any manner selecting or controlling (or having employees, officers, or directors or agents who constitute) a majority of the directors, trustees, or management of a fund, or (B) sharing with a fund, for corporate, marketing, promotional or other purposes, the same name or a variation of the same name.

The SEC and other rule making bodies are required to adopt rules to carry out the Volcker Rule within nine months of enactment of the Act. The rules promulgated by the regulatory agencies will be effective the earlier of (i) 12 months after the issuance of such final rules or (ii) 2 years after the enactment of the Act. Banking entities must bring their activities and investments into compliance with the Volcker Rule not later than 2 years following the effective date of those rules. Extensions may be granted on a case by case basis for one-year terms, with not more than a total of three 1-year extensions granted for each case, however extensions granted for illiquid funds may be granted for up to five years, following which divestiture is required by the fund. To qualify as an "illiquid fund" under the Act, the fund, as of May 1, 2010, (i) must have been principally invested in, or was invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments, and (ii) must have made all investments pursuant to, and consistent with, an investment strategy to principally invest in such illiquid assets.

Exemptions from the Ban on Proprietary Trading

Certain exemptions from the ban on proprietary trading are provided for under the Act:

- Customer transactions;
- Transactions in U.S. government or government-sponsored enterprise securities;
- Transactions in connection with underwriting or market-making activities;
- Risk mitigating or hedging activities;
- Investments in small business investment companies, or for the promotion of public welfare or qualified rehabilitation expenditures; and
- Transactions in connection with the buying and selling of insurance products.

Exemptions from the Ban on Fund Activities

A banking entity may organize and offer a private equity or hedge fund, including serving as its managing member, general partner or trustee, and in any manner selecting or controlling the day-to-day operations of the fund, only if:

- the banking entity provides bona fide trust, fiduciary or investment advisory services;
- the fund is organized and offered only in connection with the provision of a bona fide trust, fiduciary, or investment advisory services and only to persons that are customers of such services of the banking entity;
- the banking entity does not acquire or retain an equity interest, partnership interest, or other ownership interest in the funds except for a de minimis investment (seed investment);
- not later than 1 year after establishment of the fund, the banking entity's ownership interest shall be reduced through redemption, sale, or dilution to an amount not more than 3% of the total ownership of the fund;
- in no case may the aggregate of all of the interests of the banking entity in all such funds exceed 3% of the Tier 1 capital of the banking entity;
- the banking entity avoids certain transactions specified in the detailed affiliate rules of Section 23A of the Federal Reserve Act with respect to the fund;
- the banking entity does not guarantee, assume or otherwise insure the obligations or performance of the fund;
- the banking entity does not share the same or a similar name with fund;
- no director or employee of the banking entity not directly involved in providing advisory services retains an equity interest, partnership interest or other ownership interest in the fund; and
- the banking entity must disclose that all losses will be borne by the investors.

PART II

The Act provides public company shareholders with a greater say over executive pay, and increases compensation committee independence and accountability. It also enhances executive pay proxy disclosures and requires broad "clawback" policies for executive pay. While the

provisions have various effective dates, we anticipate that much of the provisions discussed below will be effective with the 2011 proxy season.

Say-on-Pay

- At least once every three years, shareholders must have the right to cast a non-binding advisory vote to approve the compensation of executives which is required under SEC rules. At least once every six years, shareholders must vote to determine whether the so-called "say-on-pay" vote will occur every one, two or three years.

- If shareholders are asked to approve a "change of control" of the company, shareholders must have the right to cast a non-binding advisory vote on all payments to be made to the company's principal executive officers that are contingent upon such change of control if not previously disclosed and voted upon.

- Institutional investment managers must annually report to the SEC how they voted on those non-binding measures, unless the vote is otherwise required to be reported publicly.

Increased Compensation Committee Independence and Accountability

- Each compensation committee member must be both a board member and "independent" under applicable exchange and national securities association standards.

- Compensation committees must now be directly responsible for the appointment, compensation and oversight of any compensation consultant, legal counsel and other adviser retained by the committee.

- When retaining a compensation consultant, legal counsel or other advisor, compensation committees must now take into account the independence of the advisor, but there is no requirement that the adviser's actual independence be established by the committee.

- Beginning July 2011, a company's proxy must state whether the compensation committee retained a compensation consultant and whether this raised any conflict of interest and, if so, the nature of the conflict and how it is being addressed.

- If a company fails to comply with the foregoing requirements, its equity securities can be de-listed, after a reasonable opportunity to cure. However, these requirements do not apply to any controlled company (i.e., a company in which more than 50% of the voting power is held by an individual, a group or another company).

Further Disclosures Regarding Executive Compensation and Corporate Governance

- A company's proxy must disclose:
    - information that shows the relationship between the executive compensation actually paid and the company's financial performance;

- the median annual total compensation of all employees (excluding the chief executive officer), the annual total compensation of the chief executive officer and the ratio between the two;

- whether any employee or director is permitted pursuant to company policies to purchase financial instruments that are designed to hedge or offset any decrease in the value of the company's equity securities; and

- why the company has chosen to have the same person or different persons serve as chairman of the board and chief executive officer.

- Financial institutions must disclose to the appropriate Federal regulator all incentive-based compensation arrangements. The Federal regulator will determine whether such compensation structure provides excessive compensation, fees or benefits or could lead to material financial loss and, if so, such compensation structure will be prohibited.

- Shareholders are prohibited from granting a broker a proxy to vote their securities with respect to the election of directors, executive compensation or other significant matters.

Clawback Policy

- A company is required to develop and implement a policy requiring, in the event of an accounting restatement due to the company's material noncompliance with *any* financial reporting requirements under the securities laws, the clawback of *all* incentive-based compensation paid to any current or former executive during the three-year period preceding the accounting restatement. The amount required to be clawed back is the amount in excess of what the executive would have received under the accounting restatement.

PART III

Whistleblower and Anti-Retaliation Provisions

The Act authorizes the SEC to encourage people to report securities violations, providing for rewards of up to 30% of funds recovered as a result of whistleblowing.

Section 922 of the Act amends the Securities and Exchange Act of 1934 and Section 748 of the Act amends the Commodities Exchange Act of 1936 to establish financial incentives (*i.e.,* the award of 10-30% of the amount of monetary sanctions (in excess of $1,000,000)) for potential whistleblowers who voluntarily provide "original information" to the Commodities Futures Trading Commission. Under these provisions, would-be whistleblowers who voluntarily report to the SEC or CFTC "original information" that leads to the recovery of more than $1 million in sanctions are entitled to an award of between 10-30% of the collected monetary sanctions. As used in the legislation, "Original information" means information derived from the independently derived knowledge or analysis of the whistleblower, which is not known by the SEC or CFTC from a source which is independent of the whistleblower (and where such information is not derived from allegations made in judicial or administrative hearings,

governmental reports, hearings, audits or investigations, or news media, unless the whistleblower is a source of the information).

Section 1057 of the Act creates a new right of action for employees in the financial services industry who perceive themselves the victim of retaliation for disclosing information about fraudulent or unlawful conduct related to the offering or provision of a consumer financial product or service. Section 1057 covers employees of businesses that offer or provide consumer financial products or services primarily for personal, family or household purposes, including businesses that:

- extend credit or service loans or broker leases;
- provide real estate settlement services or perform real estate or personal property appraisals;
- engage in deposit-taking activities, transmit or exchange funds, or otherwise act as custodian of funds or any financial instrument used by or on behalf of consumers;
- sell, provide or issue stored value or payment instruments;
- provide check cashing, check collection, or check guaranty services;
- provide payments or other financial data processing products or services to a consumer by any technological means;
- provide financial advisory services to consumers on individual financial matters or relating to proprietary financial products or services;
- collect, analyze, maintain, or provide consumer report information or other account information to be used in connection with decisions regarding the offering or provision of a consumer financial product or service; and
- collect debt related to any consumer financial product or service.

Activity protected by the Act includes:

- providing or attempting or causing to provide information to an employer, the newly created Bureau of Consumer Financial Protection, or any other state, local, or federal government authority or law enforcement agency relating to any violation of the laws subject to the jurisdiction of the Bureau;
- testifying or intending to testify in, or filing, instituting or causing to be filed or instituted, any proceeding under any federal consumer financial law; and
- refusing to participate in any activity the financial services employee reasonably believes is in violation of any laws subject to the new bureau's jurisdiction.

A complainant seeking relief from claimed retaliation (either as a result of the termination of his/her employment or other adverse consequences) may institute a complaint with the Secretary of Labor within 180 days of the events claimed to have been in violation of the Act. Such a complainant may remove the proceeding to federal district court within 90 days after the date of receipt of a written determination by the Secretary or within 210 days after the filing in the event that a final order has not been issued by the Secretary. Either party may request a jury trial. Perhaps most significantly, in order to prevail the complainant must demonstrate only that protected conduct was a "contributing factor" in the adverse employment action alleged in the

complaint. This is a significantly lower standard of proof than other laws outlawing employment discrimination or retaliation which require proof that the protected activity was the "determining" factor in such decision, requiring that the employer articulate a legitimate, non-discriminatory reason for the unfavorable personnel action in order to shift the burden back to the complainant. In the new legislation, an employer must advance clear and convincing evidence that the employer would have taken the same unfavorable personnel action in the absence of the complainant's protected activity.

Employees cannot waive their statutory rights under Section 1057, either by entering into a pre-dispute agreement to arbitrate or otherwise compromise remedies available under the Act. Remedies available to successful litigants include reinstatement, back pay, compensatory damages, as well as costs of suit (including attorneys' fees, expert witness fees) as well as an order compelling the employer to take affirmative action to abate any noted violations.

In contrast to the 180 day window provided by Section 1057, potential complainants under Sections 922 and 748 of the Act are granted longer periods within which to institute their claims -- 6 years under the Exchange Act (or 3 years after learning of the conduct complained of, to a maximum of 10 years after the conduct occurred) or 2 years in connection with a claim brought under the Commodities Exchange Act. Remedies available under such provisions include reinstatement, back pay with interest (and twice that amount for claims under the Exchange Act), as well as costs of suit (including reasonable attorneys' fees and expert witness fees).

The Act also provides for greater clarity, and in some instances increased protection, to would be complainants under the Sarbanes-Oxley Act and under the False Claims Act. More specifically, Section 922 of the Act makes clear that an employee's retaliation claim under Sarbanes-Oxley may be tried before a jury and increases the period within which a claim may be made from 90 to 180 days after the employee became aware of the employer's retaliatory conduct. Section 929 of the Act extends Sarbanes-Oxley whistleblower protection to subsidiaries or affiliates of publicly traded companies whose financial information is included in the consolidated financial statements of such entities.

The Act now makes clear that a claim may be brought under the False Claims Act for three (3) years rather than relying on diverse state limitations periods. Moreover, while earlier amendments to that statute provide remedies for persons wrongfully discharged or otherwise discriminated against in their employment because of lawful acts done in furtherance of an action brought under it, Section 1079B of the Act amends these anti-retaliation provisions by expanding "protected conduct" to include "lawful acts done by the employee . . . in furtherance of an action under this section . . . ." In so doing, the statute's anti-retaliation provisions and the protection afforded thereunder are now extended to individuals who take action pursuant to the Act's specific consumer protection provisions.

As is clear, the Act provides a comprehensive program to bolster prior anti-retaliation mechanisms and affords far greater protection to employees who are the victims of employers' efforts to retaliate against whistleblowers. A comprehensive reexamination of employer's programs and its corporate reaction to individual employees' efforts to disclose information about employer activities is now extremely important to avoid potential liability.

Questions and Contact Information

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