The Banking Law Journal

Established 1889

AN A.S. PRATT & SONS PUBLICATION MARCH 2014

HEADNOTE: VOLCKER, CONTINUED
Steven A. Meyerowitz

THE FINAL VOLCKER RULE: THE COVERED FUND PROVISIONS
Satish M. Kini, Paul L. Lee. and Gregory J. Lyons

SECTION 1111(B) OF THE BANKRUPTCY CODE: AN EFFECTIVE WEAPON FOR UNDERSECURED CREDITORS OPPOSING CONFIRMATION OF CRAM CHAPTER 11 PLANS
Patrick E. Mears and John T. Gregg

BANKRUPTCY POISON PILLS: NEW ATTEMPTS TO AVOID ABSOLUTE PRIORITY
Michael A. Nardella

FIVE KEY ISSUES IMPACTING EMPLOYERS IN THE FINANCIAL SERVICES INDUSTRY
John F. Fullerton III and Jason Kaufman

EU RISK RETENTION REQUIREMENT: WHO CAN NOW RETAIN IN A MANAGED CLO?
Nick Shiren and Robert Cannon

U.S. SWAP REGULATION: CROSS-BORDER DEBATE AMONG ISSUES TO WATCH
Mark D. Young, Maureen A. Donley, Rachel Kaplan Reicher, and Elizabeth A. Doyle

EMIR REGULATIONS CONTINUE TO IMPACT DERIVATIVES MARKETS IN 2014
Patrick Brandt

THE EU BANKING UNION: WILL THE NEW REGULATORY FRAMEWORK RESTORE CONFIDENCE IN EUROPEAN BANKING?
Sven G. Mickisch and Patrick Brandt

THE FUTURE OF MARKETING NON-EU ALTERNATIVE INVESTMENT FUNDS IN EUROPE
Stephen G. Sims, Patrick Brandt, and Daniel F. Faundez

BANKING BRIEFS
Terence G. Banich

EDITOR-IN-CHIEF

Steven A. Meyerowitz

President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Paul Barron
Professor of Law
Tulane Univ. School of Law

George Brandon
Partner, Squire, Sanders & Dempsey LLP

Barkley Clark
Partner, Stinson Morrison Hecker LLP

John F. Dolan
Professor of Law
Wayne State Univ. Law School

Thomas J. Hall
Partner, Chadbourne & Parke LLP

Jeremy W. Hochberg
Counsel, Wilmer Cutler Pickering Hale and Dorr LLP

Kirk D. Jensen
Partner, BuckleySandler LLP

Satish M. Kini
Partner, Debevoise & Plimpton LLP

Douglas Landy
Partner, Milbank, Tweed, Hadley & McCloy LLP

Paul L. Lee
Of Counsel, Debevoise & Plimpton LLP

Jonathan R. Macey
Professor of Law
Yale Law School

Martin Mayer
The Brookings Institution

Stephen J. Newman
Partner, Stroock & Stroock & Lavan LLP

Sarah L. Reid
Partner, Kelley Drye & Warren LLP

Heath P. Tarbert
Partner, Allen & Overy LLP

Stephen B. Weissman
Partner, Rivkin Radler LLP

Elizabeth C. Yen
Partner, Hudson Cook, LLP

Bankruptcy for Bankers
Howard Seife
Partner, Chadbourne & Parke LLP

Regional Banking Outlook
James F. Bauerle
Keevican Weiss Bauerle & Hirsch LLC

Recapitalizations
Christopher J. Zinski
Partner, Schiff Hardin LLP

Banking Briefs
Terence G. Banich
Member, Shaw Fishman Glantz & Towbin LLC

Intellectual Property
Stephen T. Schreiner
Partner, Goodwin Procter LLP

The Banking Law Journal (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices.

Copyright 2014 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. No part of this journal may be reproduced in any form — by microfilm, xerography, or otherwise — or incorporated into any information retrieval system without the written permission of the copyright owner.

For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone) / 631.331.3664 (fax). Material for publication is welcomed — articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys.

This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to The Banking Law Journal LexisNexis Matthew Bender, 121 Chanlon Road, North Building, New Providence, NJ 07974.

Five Key Issues Impacting Employers in the Financial Services Industry

JOHN F. FULLERTON III AND JASON KAUFMAN

The authors identify five employment-related issues to which financial services institutions should pay attention.

The economy may be improving, but challenges remain for employers in the financial services industry. From ever-increasing whistleblower claims to new diversity and inclusion regulations and recent Internal Revenue Service ("IRS") determinations affecting bonus payments, financial services industry employers now have to navigate a number of new developments and potential pitfalls. Here are five issues that these employers should keep an eye on.

DODD-FRANK AND SARBANES-OXLEY WHISTLEBLOWER PROGRAMS

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") established a whistleblower "bounty" program entitling individuals who voluntarily provide the U.S. Securities Exchange Commission ("SEC") or the U.S. Commodity Futures Trading Commission ("CFTC") original information that leads to an enforcement action resulting in monetary sanctions greater than $1 million to an award of between 10 and

John F. Fullerton III, a member of the firm in Epstein Becker Green's Labor and Employment practice in New York, can be reached at jfullerton@ebglaw.com. Jason Kaufman, an associate in the firm's New York office, can be reached at jkaufman@ebglaw.com.

Published by Matthew Bender & Company, Inc. in the March 2014 issue of *The Banking Law Journal*. Copyright © 2014 Reed Elsevier Properties SA.

30 percent of the total sanctions collected. Claims can easily be submitted online through the SEC and CFTC websites. Whistleblowers are *not* required to report alleged violations internally before going to the SEC or CFTC, and employers are prohibited from impeding individuals from speaking directly with the SEC or CFTC about a potential violation.

The bounty program permits whistleblowers to remain anonymous if represented by counsel, and this confidentiality remains in place unless and until a cash reward is paid. Dodd-Frank also includes strong anti-retaliation protections, such as:

- the right to bring retaliation claims directly to court without having to first exhaust administrative remedies;
- a six to 10 year statute of limitations; and
- the right to collect damages equal to two times back pay (with interest) if successful.

Dodd-Frank also amended Section 806 of the Sarbanes-Oxley Act ("SOX"), which specifically prohibits publicly traded companies from retaliating against employees who report conduct adverse to shareholder interests. It extended the statute of limitations on SOX retaliation claims from 90 days after an alleged violation to 180 days after such violation or after the date on which the employee became aware of the violation. It also prohibited agreements between employers and employees that waive employees' rights under SOX or require employees to submit to pre-dispute arbitration of SOX complaints. Finally, it expanded the definition of "publicly traded" companies to include *privately-held* subsidiaries and affiliates of such companies.

Recent developments reflect an increasingly whistleblower-friendly landscape. For example, several New York federal court decisions have held that, like SOX, Dodd-Frank protects an employee who merely reports an alleged violation to his or her supervisor or manager. Further, the U.S. Department of Labor's ("DOL") Administrative Review Board has issued decisions in the past several years that have opened the floodgates for potential SOX claims by broadly holding that SOX anti-retaliation protections apply to employees of privately-held contractors and sub-contractors of publicly-held companies (a federal appellate court came to the opposite conclusion in May 2013, and the

Supreme Court granted *certiorari* and already has heard arguments on the issue). In addition, this past December, the DOL announced that whistleblowers can now file SOX complaints online through submission of a computer-based form available on the Occupational Safety & Health Administration's website.

The impact of these developments is tangible: The SEC recently reported that the number of Dodd-Frank whistleblower complaints is at its highest level since the whistleblower bounty program went into effect.

DODD-FRANK DIVERSITY STANDARDS PROPOSED FOR THE FINANCIAL SERVICES INDUSTRY

Section 342 of Dodd-Frank requires each federal financial agency to establish an Office of Minority and Women Inclusion ("OMWI") to oversee all matters concerning diversity in management, employment, and business activities. Each agency's OMWI is headed by a Director responsible for developing standards for assessing the diversity policies and practices of entities regulated by the agency ("Covered Entities").

In accordance with this mandate, six federal financial agencies — the Federal Reserve Board, the Consumer Financial Protection Bureau ("CFPB"), the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and SEC (the "Agencies") — have issued jointly proposed standards in four key areas of diversity and inclusion assessment:

- *Organizational Commitment to Diversity and Inclusion* **—** standards for gauging how the Covered Entity promotes diversity and inclusion in employment and contracting, and how it fosters a corporate culture that embraces diversity and inclusion (*e.g.,* the Covered Entity includes diversity and inclusion considerations as an important part of its strategic plan, conducts equal opportunity and diversity and inclusion education, and takes proactive steps to promote a diverse pool of candidates in hiring and promoting).
- *Workforce Profile and Employment Practices* **—** standards for evaluating, on an annual basis, the Covered Entity's diversity and inclusion efforts through

the use of analytical tools (*e.g.,* the Covered Entity uses metrics and tracks workforce data to assess diversity and has policies and practices that create diverse applicant pools for internal and external opportunities).

- *Procurement and Business Practices — Supplier Diversity* — standards for assessing, on an annual basis, the Covered Entity's use of minority-owned and women-owned suppliers, contractors, and subcontractors (*e.g.,* the Covered Entity has a supplier diversity policy that provides a fair opportunity for minority/women-owned business to compete in procurement of goods and services and employs analytical methods to measure minority and women inclusion among suppliers).
- *Practices to Promote Transparency of Organization Diversity and Inclusion* — standards for evaluating the transparency of the Covered Entity's diversity and inclusion activities (*e.g.,* the Covered Entity annually publicizes its strategic plan for diversity and inclusion, its commitment to diversity and inclusion, and its progress toward achieving diversity and inclusion in its workforces and procurement activities).

Recognizing the need for flexibility, the Agencies proposed that the standards be applied "in a manner reflective of the individual entity's size and other characteristics" and acknowledged that they "may need to change and improve over time."

The Agencies outlined a model approach for assessing a Covered Entity, which would include:

- self-assessment by the Covered Entities, utilizing the proposed standards;
- voluntary disclosure of the self-assessment to the appropriate regulating agency; and
- publication of efforts to comply with the proposed standards.

The model approach does not include any enforcement provisions, but it does provide that the Agencies will monitor the information submitted by the Covered Entities for use "in carrying out the Agencies' diversity and inclusion responsibilities" and "may periodically review the information displayed on Covered Entities' websites to monitor diversity and inclusion practices."

Because the final, binding diversity and inclusion regulations will likely reflect the Agencies' proposed standards, Covered Entities should take steps now to create policies and procedures in keeping with the proposed standards, to be ready when the final regulations are issued.

PAY DISPUTES IN THE FINANCIAL SERVICES INDUSTRY

Pay disputes are a byproduct of the financial services industry's widespread use of incentive compensation. The potential exposure can be difficult to predict because many such disputes are handled in arbitrations administered by the Financial Industry Regulatory Authority ("FINRA") Dispute Resolution program, where arbitrators are free to render awards for employees based on notions of equity and fairness rather than on a strict application of legal principles and precedent. Over the past few years, however, cases in which equitable concerns have given way to hard facts and legal precedent provide some solace to employers.

For example, in *Goldstein v. Fifth Third Secs.*,[1] a licensed personal banker claimed that his former employer, Fifth Third Securities (a broker-dealer and investment subsidiary of Fifth Third Bank), owed him a bonus payment for the second quarter of 2010. The arbitrator denied the claim, finding that because claimant tendered his resignation with two weeks' notice on June 15, 2010, and specifically designated June 29 as his last day of employment, he was not entitled to a bonus since the company's policy was that bonus eligibility was contingent on active employment for the entire quarter. This decision is significant because it was reached through strict adherence to written policy, without regard to less stringent equitable considerations upon which arbitrators sometimes rely (*e.g.*, that claimant would have been eligible for a bonus had he resigned just one day later).

In *Yuan v. Getco LLC*,[2] a former Getco trader argued that the company failed to make certain fixed bonus payments in accordance with a contract he signed when he was hired. Noting that claimant was an "at will" employee and that nothing in that contract precluded Getco from changing his compensation, the arbitration panel concluded that the company had switched to a discretionary bonus system during claimant's employment and had informed him of the change. Significantly, claimant was awarded nothing, even

though the panel found fault with the employer's documentation regarding the change.

Finally, in *Koh v. Barclays Capital Inc.*,[3] claimant, who was terminated as part of a reduction in force, sought unpaid bonus and severance compensation. The panel majority awarded no damages. Although it was standard practice at the company to award bonuses, the bonus claim was denied because an established policy stated that bonus compensation was discretionary. As for the severance claim, claimant was offered a severance package but rejected it and, thus, was not entitled to an award.

One notable and unusual aspect of the decision was the dissenting opinion of one of the panel members, which explicitly articulated the difference between arbitrating pay disputes and having them decided in court. Primarily concerned that claimant was not treated "with adequate fairness and equity" during the termination process, the dissent suggested the claimant should have received some portion of her expected bonus and all of her severance. The dissent felt that "[r]ather than deciding complex issues based solely on their legality ... equal or greater consideration should be given to the 'spirit of the law,' rather than its hard and fast interpretation." According to the dissent, the flexibility and authority afforded to FINRA arbitrators to render "nonreviewable" decisions should be used to craft awards based on fairness and equity, not just case law or policy.

Although the goal is to avoid litigation altogether, the above examples demonstrate that clearly-written and well-documented compensation policies and procedures can go a long way toward setting employers up to prevail in pay disputes even before they arise, and that — even in arbitration — employers are able to prevail when their policies clearly state that bonus payments are discretionary (or that bonuses are not due if the employee terminates prior to the payment date). Nevertheless, as reflected in the *Koh* dissent, employers should always proceed with an awareness that an arbitrator may decide a case based on the law's spirit, despite its letter.

IT PERSONNEL: INDEPENDENT CONTRACTORS OR EMPLOYEES

As the financial sector becomes increasingly reliant on information technology ("IT") solutions and the use of independent contractors to manage

and support them, employers must be careful that these IT support personnel are, in fact, independent contractors and not employees. Correctly determining employment status is critical because misclassifying workers can expose an employer to substantial legal liability.

More than ever, banks and other financial institutions are implementing rapidly developing IT capabilities to interface with customers, quickly process complex data and financial transactions, ensure regulatory compliance, and manage business needs through increased automation and internal networking. As a result, the financial sector requires significant IT support services.

The use of independent contractors to support these IT needs is quite common. Doing so provides a number of advantages. For one, independent contractors are often more cost effective. Employers are not required to:

- pay minimum and overtime wages to independent contractors;
- provide them with employee benefits;
- withhold income, social security, and Medicare taxes from their compensation; or
- make unemployment insurance or workers' compensation contributions on their behalf.

In addition, independent IT contractors provide greater staffing flexibility since they can be retained on an as-needed basis and, of course, generally are not included in the department's "head count" for budgetary purposes. Given the dynamic and complex IT solutions being used today, independent contractors are often more efficient and productive because they bring specialized expertise (*e.g.*, database administration or business application programming) to a particular project. Moreover, independent contractors are precluded from asserting claims for wrongful termination and certain types of employment discrimination.

That said, the employer must be certain that IT support staff retained as independent contractors truly fit the definition. If they do not, the employer could be liable for millions of dollars in unpaid wages and benefits owed to the misclassified employees, as well as back taxes and penalties owed to federal, state, and local governments.

Generally speaking, whether an individual is an employee or an independent contractor depends on the amount of control the putative employer has over the work: The more control the employer exercises, the more likely the individual will be deemed an employee. Because a financial institution may be unable to relinquish a certain level of control over projects that require close coordination with IT support — and because such projects necessitate access to sensitive financial information and secure systems — such IT support personnel may actually be functioning as employees. It is not uncommon for independent contractors to be in place such a long period of time, working side-by-side with employees, that even if they were independent contractors at the commencement of their project, their role evolves to the extent that they are essentially indistinguishable from employees.

Employers should consider the following when determining the proper employment status of IT personnel:

- Whether the IT workers' services are an integral part of the company's business;
- The extent of their investment in the equipment or materials they use;
- The permanency of their relationship with the putative employer;
- The degree of skill required for their services;
- Their opportunity for profit or loss, depending on skill, efficiency, or productivity;
- Whether the putative employer controls the manner in which their work is performed; and
- Other relevant factors, including: where their work is performed; whether they are free to set their own hours; how they are paid; whether they can work for competitors and take other jobs; and whether they have a contractual relationship with the putative employer.

Recently, the government has been cracking down on employee misclassification, which is not surprising given the billions of dollars in tax revenue at stake. Last November, New York became the fifteenth state to agree to collaborate with the DOL in a coordinated effort to prevent employers from mis-

classifying employees as independent contractors. Further, some states, such as California, have passed legislation that penalizes employers for misclassification. Employers need to carefully evaluate their compliance with the appropriate legal standards, to protect themselves against the significant monetary sanctions that could result from a government audit or class action lawsuit.

EMPLOYER DEDUCTIONS FOR BONUS COMPENSATION[4]

Employers implementing annual bonus plans should be aware of recent developments that could impact the deductibility of bonus payments and whether they are in compliance with applicable tax regulations. An Internal Revenue Service ("IRS") legal advice memorandum dated September 18, 2013 (the "FAA"),[5] indicates that certain common bonus plan provisions might affect the timing of an employer's deduction for such payments under the "all events" test.

In the context of tax deductions, the "all events" test provides that, under the accrual method of accounting, a liability is incurred and is generally taken into account for federal income tax purposes in the taxable year in which:

- all the events have occurred that establish the liability (*i.e.*, the deduction);
- the amount of the liability can be determined with reasonable accuracy; and
- economic performance has occurred for the liability.

Generally, all events occur when all required performance or other event upon which payment is conditioned is satisfied, or when payment is otherwise unconditionally due, whichever is earliest.

An expense may be deductible before it is actually paid, but liability for the expense must first be firmly established. An employer may not deduct an anticipated expense based on events that have not occurred by the close of the taxable year.

Revenue Ruling 2011-29 concluded that the "all events" test would be satisfied for purposes of deducting a bonus pool if, at the end of a year, the

employer must pay the bonus pool without any contingencies applying. In CCA 201246029, the IRS Chief Counsel Office opined that if any portion of the bonus pool might be forfeited after the current tax year, then all contingencies have not been satisfied and therefore none of the bonus pool can be deducted in the current year. For a typical annual bonus plan, the pool will generally be deductible in the next year, when actually paid.

The FAA addressed three bonus plan provisions under the "all events" test:

- Whether bonus amounts satisfy the test any earlier than they are paid, if the employer retains the unilateral right to modify or eliminate bonuses prior to payment;
- Whether bonus amounts that must be approved by a committee of the employer's board of directors before payment satisfy the test any earlier than they are approved; and
- Whether bonus amounts that are, in part, based on subjective employee performance appraisals satisfy the test any earlier than such appraisals are completed.

The FAA answered each point above in the negative. The IRS concluded that neither the fact of liability nor the amount of the liability prong of the "all events" test can be satisfied if after the end of the year of performance the employer still has the right to modify or eliminate bonuses, bonuses are still subject to committee approval, or subjective determinations still need to be made to calculate bonus amounts.

This has important tax consequences for employers, as discretion and committee review are relatively common features of bonus plans, particularly those of publicly traded companies. Although the effect of the FAA is not entirely clear (it was issued by an IRS Field Counsel Office rather than the National Office), it does provide some insight as to the IRS's thinking on the matter and how retaining discretion to affect bonus payments — whether outright or as part of certifying and approving performance results — could delay an employer's tax deductions.

NOTES

[1] No. 10-04426 (FINRA Dec. 28, 2011).
[2] No. 11-03970 (FINRA Nov. 29, 2012).
[3] No. 11-02699 (FINRA Mar. 26, 2013).
[4] The authors gratefully acknowledge the input of Jeffrey A. Lieberman, a member of the firm in the executive compensation practice, with respect to this section.
[5] FAA 20134301F.