Financial Regulatory Reform:

## Dodd-Frank at One Year—

# What Non-US Companies Need to Know



Weil, Gotshal & Manges LLP

# Introduction

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act) was enacted one year ago. At that time, it was heralded as perhaps the most dramatic set of regulatory reforms since the 1930s. The Act was expected to have significant effects in both the short and long term. Dodd-Frank's provisions, however, are not confined to the US market. The Act is intended to have significant implications for non-US companies doing business in the United States or whose securities are listed on a US stock exchange. What is more, the Act purports to regulate certain transactions and entities with little direct connection to the United States.

Some commentators predicted that costs of compliance would reach US$5 billion, with systemically important financial institutions—or what are now referred to in shorthand as "SIFIs"—bearing the lion's share. It is still too early to say whether the predictions of the costs of compliance have been or will prove accurate. The top leadership posts at several key agencies overseeing the reforms remain vacant. What is clear, however, is that the Act's provisions have already changed the landscape in which financial institutions—and in some cases non-financial companies—now operate. And much will depend on the outcome of the nearly 400 mandated agency rulemakings, which all members of the public, including affected companies, will have the ability to influence through relevant notice-and-comment procedures each agency must follow under timetables specified in the Act.[1]

This report outlines some of the key provisions of the Act and their possible impact on non-US companies as regulators move past the one-year mark.

### Key Areas Covered in this Report:

- Systemic Risk
- Volcker Rule
- Hedge Funds and Private Equity
- Derivatives
- Securitisations
- Credit Ratings for US-Registered Debt and Preferred Securities
- Corporate Governance
- Whistleblower Protections
- Conflict Minerals and Extractive Industry Reporting

1 As of 21 July 2011, the first anniversary of Dodd-Frank, fewer than 50 rulemakings had been finalized.

# Systemic Risk

The cornerstone of Dodd-Frank is a new framework for monitoring and regulating systemic risk. The framework primarily governs many of the largest US-based financial institutions; however, non-US firms with significant operations in the United States may find themselves subject to all or part of the Act's new regulatory regime.

**Financial Stability Oversight Council**

Implementation of Dodd-Frank's systemic risk framework resides largely in a powerful council of financial regulators—the Financial Stability Oversight Council (FSOC). The FSOC's chief responsibilities are to monitor sources of risk to US financial stability and to promulgate rules to be implemented by one or more of the financial regulatory agencies represented on the FSOC. In the event of disagreements among US financial regulators, the FSOC's responsibilities include coordinating and resolving such disputes. The FSOC has convened on a regular basis, having held its first official meeting on 1 October 2010.

In certain respects, the FSOC has quickly become the most influential regulatory body in the United States—and indeed perhaps the world. Its foremost power lies in its authority to designate certain companies and other entities as SIFIs upon the affirmative vote of two-thirds of the FSOC's members. SIFI designation subjects a company to Federal Reserve supervision and, potentially, a host of prudential regulatory measures discussed further below.

The FSOC also has the power to require SIFIs to divest assets where the FSOC determines that continued ownership of such assets by one firm would present a "grave threat" to US financial stability. As a practical matter, the FSOC exercises broad information-collecting powers to fulfil its mandate through a new entity called the Office of Financial Research (OFR). Both US and non-US companies in the financial sector—even if unlikely to be deemed as SIFIs—may find themselves subject to sporadic or periodic information requests from the OFR.

**Kinds of SIFIs**

The most important question for non-US companies is who will be subject to the systemic risk rules promulgated by the FSOC and enforced by the Federal Reserve. Broadly speaking, two kinds of entities will be subject to the FSOC's registration and reporting requirements and to direct supervision by the Federal Reserve—one is essentially designated by the Act itself and the other largely left to the FSOC's designation: the largest bank holding companies and those institutions deemed to be "nonbank financial companies."[2]

2 Dodd-Frank arguably includes a third kind of SIFI: "financial market utilities." Under the Act, the FSOC may designate for supervision by appropriate regulators entities that engage in systemically important payment, clearing, or settlement activities.

*"Large, Interconnected" Bank Holding Companies (BHCs)*

All BHCs are currently regulated and supervised by the Federal Reserve for safety and soundness, but those BHCs falling into the "large, interconnected" category will be separately and additionally regulated under Dodd-Frank for systemic risk containment. Under Dodd-Frank, the US Congress has essentially deemed as SIFIs all BHCs with consolidated assets of US$50 billion or greater. At present, there are fewer than ten such BHCs controlled by non-US banks. Along with US-based BHCs, the "large, interconnected" category may include certain non-US banking organizations treated as the equivalent of BHCs under current US law. Indeed, US regulators have suggested that they may apply certain heightened prudential measures (*e.g.*, resolution plans) to the dozens of non-US based banks that have US$50 billion or more in worldwide assets and a significant presence in the United States.

*Nonbank Financial Companies*

On the premise that systemic importance extends beyond traditional banks, Dodd-Frank also creates and regulates a potentially broad category of "nonbank financial companies" that is designed to capture any entity "predominantly" engaged in financial services activities. To some extent, this represents a fundamental shift in US financial regulation, which heretofore has regulated traditional commercial banks in a wholly different manner from similarly-sized financial services companies. The financial crisis proved that this prior regime had in part been built upon a distinction without a difference—particularly with respect to systemic risk concerns. To fit within the "nonbank financial company" category, at least 85% of a company's consolidated revenues or assets must derive from "activities that are financial in nature." The FSOC has clarified that this test also encompasses any activities that are "closely related" to those otherwise deemed "financial in nature." Although the 85% test will exclude many large corporations that engage in purely commercial or industrial activities, the category of "nonbank financial company" has the potential to be applied broadly to many sectors within the global financial services sector.

**Six categories likely to determine whether a covered company is systemically important in the FSOC's Proposed Rules:**

- Size
- Lack of substitutes for the financial services and products the company provides
- Interconnectedness with other financial firms
- Leverage
- Liquidity risk and maturity mismatch
- Existing regulatory scrutiny

## Financial Regulatory Reform

Non-US businesses also may be classified as nonbank financial companies if they satisfy certain criteria and the FSOC determines that their US presence meets sufficient quantitative and qualitative thresholds. The details of the thresholds for both US and non-US businesses and their application will largely be left to the FSOC to articulate in the months ahead.

Essentially, a non-US business will be regulated if the FSOC determines that material financial distress at the company—or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company—could pose a threat to the financial stability of the United States. It would therefore seem that only a handful of non-US entities are likely to meet this relatively high bar. Nevertheless, substantial counterparty exposures and interconnectedness to US-based SIFIs and other financial institutions could cause the FSOC to commence the designation process for a non-US entity. In making such a determination, however, the FSOC is required to consult with the appropriate home country regulators.

### Possible Consequences of Designation

Those US and non-US companies that are designated as SIFIs by the FSOC will be subject to a variety of restrictions, limits, and supervision by the Federal Reserve. The Federal Reserve may impose:

- enhanced capital and leverage requirements
- additional liquidity provisioning
- mandatory contingent capital instruments
- resolution plans (commonly called "living wills")
- credit exposure reports
- concentration limits
- supplemental public disclosures
- periodic stress testing
- other risk management protocols

Although Dodd-Frank carries the potential for extensive regulation of overseas entities, there are some advantages for non-US companies. When making recommendations concerning prudential standards that would apply to either non-US nonbank financial companies or overseas-based BHCs, Dodd-Frank requires the FSOC to give due regard to the principle of national treatment and equality of competitive opportunity. Moreover, the FSOC must take into account the extent to which the non-US SIFI is subject to home country standards that are comparable to those applied in the United States. At the one-year anniversary of Dodd-Frank, the FSOC has yet to designate any US or non-US company as a nonbank SIFI.

## Who Potentially Can Be Designated as a Nonbank SIFI?

### Financial Activities (inside 85% test)

- Financial Institutions
  - Consumer lending
  - Commercial lending
  - Investment banking
- Bank Services
  - Private banking
  - Bank cards
  - Credit card machines and services
- Foreign exchange services
- Investment services
  - Asset management
  - Hedge fund management
- Insurance
  - Brokers
  - Underwriters
- Other financial services
  - Advisory services/stockbrokers
  - Hedge funds
  - Private equity
  - Venture capital
  - Debt resolution

### Non-Financial Activities (outside 85% test)

- Energy Sector
  - Oil/Petroleum
  - Natural Gas
  - Hydroelectric
  - Nuclear
- Agricultural Sector
- Manufacturing Sector
- Retail Sector
- Legal Services
- Consulting Services

# Volcker Rule

Of the many restrictions Dodd-Frank imposes on banks and similar institutions,[3] one of the most important is known as the "Volcker Rule," named after former Federal Reserve Chairman Paul Volcker, who initially proposed it. The Volcker Rule is actually two separate rules: (1) a prohibition on proprietary trading, and (2) a ban on certain hedge fund and private equity activities. These controversial restrictions, discussed further below, stem from the US Congress's view that banks and similar institutions have moved too far beyond traditional lending and deposit-taking into other businesses that present undesirable risks to insured deposits. The Volcker Rule is particularly controversial because many believe there is little evidence that the prohibited activities played a factor in the financial crisis.

The Volcker Rule will apply to all "banking entities," a term that includes banks, BHCs, savings associations, savings and loan holding companies (SLHCs), foreign companies treated as BHCs under the International Banking Act (*i.e.*, non-US banks with a branch or agency office in the United States), and their affiliates. Institutions designated as nonbank financial companies by the FSOC may not always be "banking entities" for purposes of the Volcker Rule. However, the US Congress has directed the Federal Reserve to impose additional capital requirements and quantitative limits on such companies with regard to their proprietary trading, hedge fund, and private equity activities.

**Prohibition on Proprietary Trading**

The Volcker Rule prohibits any banking entity from buying or selling any security, derivative, or other financial instrument for its "trading account" (as opposed to the accounts of customers). Certain transactions are, however, generally excluded from the ban on proprietary trading, including:

- customer transactions
- transactions in connection with underwriting or market-making activities
- bona fide risk-mitigating or hedging activities
- buying and selling of securities in the context of an insurance business
- transactions in US government or government-sponsored enterprise securities and proprietary trading conducted by a banking entity solely outside the United States pursuant to certain provisions of the US Bank Holding Company Act, unless the banking entity is directly or indirectly controlled by a banking entity organized in the United States

3 For example, the statute contains a host of detailed rules for banks and other insured depository institutions related to minimum capital and leverage requirements, mergers and acquisitions, branching restrictions, lending limits, and transactions involving management and directors. A number of these would apply to non-US banks operating inside the United States.

**Ban on Hedge Fund and Private Equity Activities**

The Volcker Rule also prohibits banking entities from acquiring or retaining any equity, partnership, or other ownership interest in or sponsoring any hedge fund or private equity fund, subject to certain exceptions.

### A banking entity "sponsors" a hedge fund or private equity fund if:

- it serves as the general partner or managing member of the fund
- selects or controls (or has employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the fund
- shares the same or a similar name with the fund

As with the proprietary trading ban, this prohibition will not apply to sponsorship of and investments in hedge and private equity funds by a banking entity solely outside the United States pursuant to certain provisions of the US Bank Holding Company Act, provided that no ownership interest in such fund is offered or sold to a resident of the United States and that the banking entity is not directly or indirectly controlled by a banking entity organized in the United States. A non-US banking entity can therefore largely avoid the Volcker Rule simply by moving its private fund activities outside the United States and away from US investors. Some have noted that non-US financial institutions may enjoy an important competitive advantage over their US-based peers as a result.

Despite the expansive scope of the ban, moreover, a key exception will allow banking entities to organize and offer private equity or hedge funds if a number of requirements are met. The banking entity, among other things, may not make, acquire, or retain other than a seed investment in the fund (generally less than 3%) and the aggregate of all the banking entity's investments in private equity and hedge funds must be 3% or less of the banking entity's core regulatory capital. Although this exemption will make it possible for many banking entities to devote resources to hedge fund and private equity activities in the coming years, some of the larger financial institutions in the United States currently exceed both of the 3% thresholds.

The major form of relief the US Congress has granted banking entities is the potentially lengthy time frame for the Volcker Rule's implementation—the regulation will likely become effective in the middle of 2012, followed by a two-year divestment period with various possible extensions available from federal regulators. As a practical matter, therefore, forced divestments under the Volcker Rule could take place anywhere from approximately three to possibly 12 years after the enactment of the statute. Nevertheless, the Volcker Rule could have a major effect on some non-US companies with significant proprietary trading and private fund activities in the United States.

## Hedge Funds and Private Equity

Dodd-Frank also increased the number of hedge fund and private equity advisers required to register with US regulatory authorities. The Securities and Exchange Commission (SEC) has historically focused on whether an adviser provides investment services to US-based clients and not simply on the physical location of the adviser for purposes of determining whether the adviser must register with the SEC under the US Investment Advisers Act. Dodd-Frank has not altered this analysis. However, a non-US investment adviser that uses any US jurisdictional means (*i.e.*, the US mail or any means or instrumentality of interstate commerce) in connection with its advisory business generally must register with the SEC unless it is eligible for an exemption from registration. What has changed with the passage of Dodd-Frank is the availability of traditional exemptions. The Act eliminated the "private adviser" exemption for advisers to fewer than 15 clients, with the result being that many currently-unregistered US and non-US investment advisers will be required to register with the SEC.

Until recently, a non-US fund manager that advised fewer than 15 clients in the United States was exempt from registration if it neither held itself out to the public in the United States as an adviser nor acted as an adviser to a US-registered investment company. Numerous non-US private fund managers currently rely on this exemption. Under Dodd-Frank, however, an adviser to any "private fund" (a term defined broadly to include private equity, venture capital, and hedge funds)—regardless of the number of clients—generally must register with the SEC unless the adviser falls within one of the new exemptions created by the Act.

**Three Important Exemptions for Non-US-based Advisers**

*Foreign Private Advisers.* To qualify, advisers must meet all the following criteria:

- have no place of business in the United States
- have fewer than 15 US-based clients and investors in private funds at any time
- have assets under management attributable to US-based clients and investors in private funds of less than US$25 million (or such higher amount as the SEC, by rule, deems appropriate)
- not hold themselves out to the public in the United States as an investment adviser

Many European and Asian advisers to private funds also serving US investors will be unable to meet this somewhat narrow exemption. If a non-US adviser has more than $25 million in assets under management attributable to US investors, then it may not rely on the exemption.

*Private Fund Advisers.* Dodd-Frank provides an exemption from SEC registration for investment managers that advise one or more private funds and have assets under management of less than US$150 million in the United States. Under this exemption, advisers to smaller funds will not have to register, but will still be required to maintain records and file informational or other reports as determined by the SEC.

*Venture Capital Advisers.* The Act provides a carve-out for advisers to venture capital funds, as recently defined by the SEC. However, like the private fund advisers exemption discussed above, venture capital fund advisers who satisfy the exemption must comply with certain SEC reporting and recordkeeping requirements.

The new exemptions are designed to exempt smaller hedge fund and private equity advisers from SEC registration, allowing the SEC to concentrate on private fund advisers perceived to have a greater impact on investors and markets. Overall, therefore, Dodd-Frank is unlikely to affect smaller fund managers based in Europe or Asia, but has the potential to encompass a multitude of larger fund advisers outside the United States that have until now enjoyed exempt status. For advisers now required to register, the SEC has stated that the registration deadline is 30 March 2012.

## Derivatives

Turmoil in the over-the-counter swaps markets around the world magnified the global financial crisis. The bilateral, customized nature of many of these instruments along with insufficient transparency within these markets exacerbated fears of widespread counterparty defaults. As a consequence, a fundamental goal of regulators in both the United States and European Union has been to mandate increased centralized clearing to eliminate counterparty risk. Pivotal to Dodd-Frank is its establishment of a general framework for the comprehensive regulation of and incremental clearing of swaps and security-based swaps (collectively, "swaps").

But Dodd-Frank left many of the details to the regulators which they are still working to fill in. For example, the Act provides that the Commodity Futures Trading Commission (CFTC) or the SEC—in consultation with the US Treasury Secretary—may prohibit an entity domiciled in a non-US jurisdiction from participating in any swaps activities in the United States if it determines that the regulation of swaps markets in that country undermines the stability of the US financial system. This potentially could mean that entities domiciled outside the United States whose home country's derivatives regulation is not considered as stringent as that in the United States may not have access to the US swaps market. These restrictions could apply to any swaps, not just financial derivatives, and therefore also may affect any commodity derivatives that are classified as swaps. At this time, neither the CFTC nor the SEC has issued any specific rules detailing which non-US jurisdictions would be prohibited from participating in the US swaps market. Nonetheless, the CFTC and the SEC did propose that in determining whether a parent entity is a "major participant" in the US swaps market, regulators would aggregate positions of subsidiaries at the parent's level. It is not clear at this time how these rules will apply to, for instance, a non-US parent that has significant swaps positions overseas but whose US subsidiaries do not have significant swaps positions in the United States. In addition, further clarity is needed on what it means for a swaps activity to be "in the United States."

In order to promote the effective and consistent global regulation of swaps, the Act requires the CFTC and the SEC to consult and coordinate with non-US regulatory authorities on the establishment of consistent international standards and permits them to agree to information-sharing arrangements. Once again, until the future rulemakings by the regulators put these reforms into practice, the true impact of the Act on non-US derivatives market participants is difficult to determine. Although a number of jurisdictions—such as those in Asia—have not made any commitment to similar reforms, the European Union appears to be moving in parallel with the United States with the shared intention to establish consistent regulatory standards on both sides of the Atlantic.

It is possible that large energy companies such as BP and Shell that enter into hedging arrangements could be affected by the derivatives rules under Dodd-Frank even if such activities are ancillary to their principal activities. Such companies may be "dealers" or "major participants" in the US swaps market and thus may become subject to the new rules. If large energy or other companies are not dealers or major participants and enter into swaps in the United States for purposes of hedging or mitigating commercial risk, they may be eligible to utilize the "end-user" exemption from mandatory clearing. Any swaps such companies enter into in the United States for purposes of speculation, trading, or investing, however, are not eligible for the end-user exemption.

Although it is difficult to draw definitive conclusions on the scope of the implementing regulations that must be proposed and adopted individually by each of the CFTC and the SEC, and jointly in the case of "mixed" or hybrid swaps (where the agencies' jurisdiction is concurrent), Dodd-Frank's provisions apply only to swaps activities in the United States, except where activities outside the United States have a "direct and significant" connection to activities in, or effect on, US commerce, or contravene any rules designed to prevent the evasion of US derivatives laws. Security-based swaps regulated by the SEC are subject to a somewhat more limited jurisdictional provision, which focuses on anti-evasion. It remains to be seen how the regulators will determine whether or not the connection between derivatives activities outside the United States and its commerce, or the effect of the former on the latter, is "direct and significant."

### Who Can Qualify for the End-User Exemption?

A swap is exempted from the mandatory clearing requirement if one of the counterparties:

- is not a dealer, major participant, commodity pool, private fund, employee benefit plan, or entity that predominantly engages in financial or banking activities
- is using the swap to hedge or mitigate commercial risks
- notifies the CFTC or the SEC, as applicable, how it generally meets its financial obligations associated with non-cleared swaps

This exemption is also available to an affiliate of an entity that meets the criteria above (a "Qualifying Entity") so long as such affiliate:

- is not a dealer, major participant, commodity pool, private fund or bank holding company with over US$50 billion in consolidated assets
- acts on behalf of the Qualifying Entity and as an agent
- is using the swap to hedge or mitigate the commercial risks of the Qualifying Entity or other affiliate of the Qualifying Entity

The CFTC and the SEC have proposed rules to require a party invoking the end-user exemption to deliver or cause to be delivered a notification to a swap data repository and the CFTC or the SEC, as applicable, stating that the criteria described in the box above are met. Notification is required each time a party enters into a non-cleared swap. If the party invoking the exemption is a public issuer under US securities laws, the notification also will need to state that an appropriate committee of the board of directors has reviewed and approved the decision to enter into a non-cleared swap.

## Securitisations

The sharp decline in housing prices in North America, Europe, and elsewhere was among the chief causes of the global financial crisis. The securitisation markets—particularly for residential mortgages—were consequently identified by policymakers as in need of reform. Unsurprisingly, increased regulation of the securitisation process was a major component of Dodd-Frank. The Act does so by imposing a so-called "skin-in-the-game" or risk-retention requirement on lenders and securitisers of certain asset-backed-securities

(ABS) and by requiring a host of new disclosures that issuers and others must make to potential purchasers of these securities. Dodd-Frank additionally mandates certain disclosures by rating agencies in the context of securitisations.

**Risk Retention Requirement**

Congress has directed federal bank regulators and the SEC jointly to prescribe rules requiring securitisers and possibly originators of ABS to retain an economic interest in the credit risk, generally 5%, of any asset transferred, sold, or conveyed to a third party through the issuance of an ABS. The retained interest may not be hedged or transferred to a third party. The Act defines an ABS as a fixed-income or other security collateralized by a self-liquidating financial asset (*i.e.*, a loan, lease, mortgage, or receivable) that allows the holder of the security to receive payments depending primarily on cash flows from the asset. Dodd-Frank's definition is broad enough to cover collateralized debt and mortgage obligations. On 29 March 2011, the regulators issued proposed risk-retention rules, which are broad and complex. The public comment period with respect to the proposed risk-retention rules ends on 1 August 2011. The Act does create a safe harbour provision applicable to certain non-US based securitisers.

**The risk retention requirements will not apply to a non-US securitised transaction if all of the following conditions are met:**

- the securitisation transaction is not required to be and is not registered under the US Securities Act
- no more than 10% of the value (by proceeds) of all classes of ABS interests sold in the securitisation transaction are sold to US persons or for their account or benefit
- neither the sponsor of the securitisation transaction nor the issuing vehicle is a US-located entity
- no more than 25% of the assets collateralizing the ABS sold in the securitisation transaction were acquired by the sponsor, directly or indirectly, from a US located affiliate

**Disclosures and Asset Reviews**

Apart from the "skin-in-the-game" requirement, Dodd-Frank imposes new disclosure requirements, a number of which may affect non-US based securitisers whose instruments are sold in the United States. The SEC now requires a securitiser of any registered or unregistered ABS to disclose publicly information relating to its history of fulfilled and unfulfilled repurchase requests if the underlying transaction agreements include a covenant to repurchase or replace a pool asset for breach of a representation or warranty. The first such disclosure is required to be made by 14 February 2012 and must cover repurchase requests during the three-year period ending 31 December 2011. After the first disclosure, further disclosures must be made on a quarterly basis and must cover repurchase requests made during the preceding quarter. In addition, non-US issuers that regularly comply with SEC Regulation AB must now provide disclosure of a sponsor's repurchase demand as well as its repurchase and replacement history for the last three years if the underlying transaction agreements provide a covenant to repurchase or replace an underlying asset for breach of a representation or warranty. This disclosure requirement will be phased in over the next two years, and after 13 February 2014, prospectuses will be required to include three years of repurchase activity. Issuers must also disclose demand, repurchase, and replacement history regarding the assets in the pool. Beginning on 26 September 2011, apart from the new requirements imposed on issuers, Dodd-Frank requires US recognized statistical rating organizations to describe in any report accompanying a credit rating of ABS a description of the representations, warranties, and enforcement mechanisms available to investors and how these differ from those in issuances of similar securities.

Another key feature of Dodd-Frank is its requirement that issuers of US publicly registered ABS perform a review of the assets underlying their registered ABS offerings. While the review of the assets must be designed and implemented to provide investors with reasonable assurance that the disclosure in the prospectus regarding the assets is accurate in all material respects, the level and type of review required to be performed by an issuer of registered ABS may vary depending on the facts and circumstances surrounding the assets being securitized. Applicable SEC regulations permit issuers to perform the review themselves or to hire a third party to do so. An issuer may attribute the findings and conclusions of the review to a third party it has hired. However, the third party must be named in the registration statement and, as a result, be subject to potential liability under US securities laws. Concomitant with the review requirement, issuers are also required to disclose both of the following:

- Information about how assets in the pool differ from the disclosure in the prospectus about the underwriting criteria (including data on the amount and characteristics of the assets that did not meet disclosed underwriting criteria)
- Information about the entity that made the determination that such assets should be included in the pool, despite not having met the disclosed underwriting standards and what factors were used to make the determination

## Credit Ratings for US-Registered Debt and Preferred Securities

A major change Dodd-Frank brings for non-US issuers of debt or preferred securities offered and sold pursuant to a US registration statement is the elimination of certain safeguards against strict liability for agencies rating the instruments. The practical import of this change is that companies must now obtain the consent of the rating agency to the inclusion of its rating in the company's registration statement or prospectus. Because credit rating agencies now face strict liability for that portion of any registration statement or prospectus they have in essence "expertised," they have routinely declined to provide the necessary consents since Dodd-Frank was enacted in July 2010. The good news for a number of non-US companies is that unregistered private offerings—conducted under the now-familiar Rule 144A or Regulation S offerings outside the United States—are not affected.

## Corporate Governance

Various provisions of Dodd-Frank require the SEC and the US stock exchanges to implement new corporate governance requirements applicable to public issuers under US securities laws. The Act also expands the executive compensation disclosures required of such companies. Included among the new requirements is an obligation to hold advisory shareholder votes to approve executive compensation—so-called "say-on-pay" votes—that have already been in place in the United Kingdom and elsewhere. As a corollary, the Act mandates—and the SEC has established via amendments to its proxy rules—advisory votes at least once every six years on whether such say-on-pay votes should be held annually, biennially, or triennially, and requires separate advisory votes in certain circumstances to approve change-in-control related compensation. Because the proxy rules do not apply to non-US companies, however, most companies headquartered outside the United states can avoid this corollary requirement.

Dodd-Frank further institutes measures, to be implemented by the SEC and the US stock exchanges, intended to bolster the independence of compensation committees and their choice of compensation advisers and to eliminate broker discretionary voting of customer shares on compensation matters. In addition, the Act provides for no-fault "clawbacks" on executive compensation in the event of a restatement of financial statements and enhances disclosure about any hedging of share holdings in which employees are permitted to engage. Dodd-Frank also imposes new disclosure obligations with respect to the ratio of the median annual compensation of a company's employees to the annual compensation of the chief executive, as well as compensation consultants' conflicts of interest. To date, it remains unclear whether—and if so, to what extent—the new clawback requirement, as well as the hedging, pay ratio, and consultant conflicts disclosure obligations, will apply to non-US companies that file reports with the SEC.

Finally, the Act specifically authorizes the SEC to require shareholder access to corporate proxy materials for shareholder nominees, an action which the SEC has already taken but the effectiveness of which has been delayed pending judicial review. Because shareholder access has been implemented through amendments to the SEC's proxy rules, non-US companies are not affected regardless of the outcome of the pending litigation.

## Whistleblower Protections

Among the most controversial of Dodd-Frank's reforms has been the establishment of a new bounty program for whistleblowers who provide the SEC with original information relating to a possible securities law violation (including a violation of the US Foreign Corrupt Practices Act) by any person or entity—regardless of whether that person or entity is otherwise subject to SEC registration and reporting requirements—that leads to a successful enforcement action resulting in the award of a monetary sanction in excess of $1 million. The bounties, which will be paid out of a newly created SEC fund, may range from a minimum of 10% to up to 30% of the total amount of monetary sanctions imposed in an SEC enforcement action, along with fines and penalties imposed in related state or federal criminal proceedings. The Act also protects a whistleblower from retaliation, including those instances where the whistleblower does not pass information along to the SEC or ultimately fails to qualify for an award. Both the individual whistleblower and the SEC may sue to enforce the new anti-retaliation protections.

In a much-criticized provision of the final implementing rule, the SEC decided not to require corporate whistleblowers to report internally before going to the SEC to qualify for an award, but did provide for enhanced incentives for whistleblowers to use internal compliance programs before reporting to the SEC by clarifying that, when determining the amount of an award, the SEC will take into account whether the whistleblower participated in or, alternatively, hindered a company's internal compliance program. It remains to be seen how the SEC will administer the new bounty program with respect to conduct that occurs outside the United States but is deemed to have an effect within the United States, particularly where a non-US company with no SEC registration or reporting obligation is the subject of a whistleblower complaint.

# Conflict Minerals and Extractive Industry Reporting

Apart from Dodd-Frank's core purpose of financial regulatory reform, the Act requires all public issuers to provide detailed disclosures annually regarding the use of certain enumerated "conflict minerals." Furthermore, Dodd-Frank compels disclosure of payments made by any public issuer to governmental authorities in connection with extracting oil, natural gas, or minerals in any country in the world (including the United States). Because these provisions of Dodd-Frank, which have yet to be implemented by the SEC, were largely included for political purposes, the US Congress has afforded the SEC little or no discretion in their implementation. Non-US companies that file annual reports with the SEC are well-advised to consult the SEC's proposals to determine whether those companies may be affected by the final rules to be adopted later this year and to begin developing controls and procedures necessary to comply in connection with their 2012 annual reports on Forms 20-F and 40-F, as applicable.

## FINANCIAL REGULATORY REFORM WORKING GROUP

Weil's Financial Regulatory Reform Working Group includes more than 40 subject matter experts from across the firm's 1200 attorneys in various departments, practice groups, and offices around the world. If you have questions regarding this document, please call Heath Tarbert, head of the Working Group, at +1 202 682 7177, or any of the members listed below.


### Systemic Risk

| | | |
|---|---|---|
| Arnold Buessemaker | +49 89 24243 175 | arnold.buessemaker@weil.com |
| Derrick Cephas | +1 212 310 8797 | derrick.cephas@weil.com |
| Marcia Goldstein | +1 212 310 8214 | marcia.goldstein@weil.com |
| Uwe Hartmann | +49 69 21659 691 | uwe.hartmann@weil.com |
| Gary Holtzer | +1 212 310 8463 | gary.holtzer@weil.com |
| Peter King | +44 20 7903 1011 | peter.king@weil.com |
| Robert Lemons | +1 212 310 8924 | robert.lemons@weil.com |
| Sylvia Mayer | +1 713 546 5087 | sylvia.mayer@weil.com |
| Harvey R. Miller | +1 212 310 8500 | harvey.miller@weil.com |
| Heath Tarbert | +1 202 682 7177 | heath.tarbert@weil.com |

### Banking Industry

| | | |
|---|---|---|
| Arnold Buessemaker | +49 89 24243 175 | arnold.buessemaker@weil.com |
| Derrick Cephas | +1 212 310 8797 | derrick.cephas@weil.com |
| Uwe Hartmann | +49 69 21659 691 | uwe.hartmann@weil.com |
| Heath Tarbert | +1 202 682 7177 | heath.tarbert@weil.com |
| Walter Zalenski | +1 202 682 7120 | walter.zalenski@weil.com |

### Derivatives

| | | |
|---|---|---|
| Robert Chiperfield | +1 212 310 8701 | robert.chiperfield@weil.com |
| Corey Chivers | +1 212 310 8893 | corey.chivers@weil.com |
| Ariel Kronman | +1 212 310 6741 | ariel.kronman@weil.com |
| Eric Peterman | +1 212 310 8373 | eric.peterman@weil.com |

### Hedge Funds and Private Equity

| | | |
|---|---|---|
| Joseph Basile | +1 617 772 8834 | joseph.basile@weil.com |
| Harvey Eisenberg | +1 212 310 8663 | harvey.eisenberg@weil.com |
| John Fadely | +852 3476 9288 | john.fadely@weil.com |
| Shukie Grossman | +1 212 310 8655 | shukie.grossman@weil.com |
| David Kreisler | +1 617 772 8340 | david.kreisler@weil.com |
| Jonathon Soler | +1 212 310 8278 | jonathon.soler@weil.com |
| Jeffrey Tabak | +1 212 310 8343 | jeffrey.tabak@weil.com |
| David Wohl | +1 212 310 8933 | david.wohl@weil.com |

### Securities Regulation

| | | |
|---|---|---|
| Christian Bartholomew | +1 202 682 7070 | christian.bartholomew@weil.com |
| Catherine Dixon | +1 202 682 7147 | cathy.dixon@weil.com |
| Paul Dutka | +1 212 310 8949 | paul.dutka@weil.com |
| Harvey Goldschmid | +1 212 310 8561 | harvey.goldschmid@weil.com |
| P.J. Himelfarb | +1 214 746 7811 | pj.himelfarb@weil.com |
| Ellen Odoner | +1 212 310 8438 | ellen.odoner@weil.com |

### Securitization & Capital Markets

| | | |
|---|---|---|
| John Dedyo | +1 212 310 8938 | john.dedyo@weil.com |
| David Lefkowitz | +1 212 310 8850 | david.lefkowitz@weil.com |
| Nancy Lynch | +1 212 310 8306 | nancy.lynch@weil.com |
| Richard Morrison | +1 305 577 3125 | richard.morrison@weil.com |
| Frank Nocco | +1 212 310 8918 | frank.nocco@weil.com |
| Jason Smith | +1 212 310 8914 | jason.smith@weil.com |
| Brian Waldbaum | +1 210 310 8706 | brian.waldbaum@weil.com |

### Insurance Industry

| | | |
|---|---|---|
| Thomas Roberts | +1 212 310 8479 | thomas.roberts@weil.com |
| Joseph Verdesca | +1 212 310 8838 | joseph.verdesca@weil.com |

### Consumer and Investor Protection

| | | |
|---|---|---|
| Christian Bartholomew | +1 202 682 7070 | christian.bartholomew@weil.com |
| Catherine Dixon | +1 202 682 7147 | cathy.dixon@weil.com |
| Paul Dutka | +1 212 310 8949 | paul.dutka@weil.com |
| Harvey Goldschmid | +1 212 310 8561 | harvey.goldschmid@weil.com |
| Carl Lobell | +1 212 310 8178 | carl.lobell@weil.com |
| Michael Lyle | +1 202 682 7157 | michael.lyle@weil.com |
| Steven Tyrrell | +1 202 682 7213 | steven.tyrrell@weil.com |
| Walter Zalenski | +1 202 682 7120 | walter.zalenski@weil.com |

### Corporate Governance and Executive Compensation

| | | |
|---|---|---|
| Howard Dicker | +1 212 310 8858 | howard.dicker@weil.com |
| Catherine Dixon | +1 202 682 7147 | cathy.dixon@weil.com |
| Holly Gregory | +1 212 310 8038 | holly.gregory@weil.com |
| P.J. Himelfarb | +1 214 746 7811 | pj.himelfarb@weil.com |
| Robert Messineo | +1 212 310 8835 | robert.messineo@weil.com |
| Ira Millstein | +1 212 310 8100 | ira.millstein@weil.com |
| Ellen Odoner | +1 212 310 8438 | ellen.odoner@weil.com |
| E. Norman Veasey | +1 302 656 6600 | e.normanveasey@weil.com |


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