

# Key Employment Law Issues for Financial Services Employers

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A Practice Note summarizing key employment issues for financial services employers, highlighting those rules applicable to registered representatives regulated by Financial Industry Regulatory Authority (FINRA). This Note covers employee hiring and background checks, registration requirements, such as Form U4, non-compete agreements and garden leave provisions, and compensation and benefit issues, including employee exemptions under the Fair Labor Standards Act (FLSA), independent contractor misclassification, bonus compensation, trailing commissions, and forgivable loans and promissory notes. This Note also covers workplaces policies and procedures, including discrimination, diversity, and pay equity, mandatory vacation policies, social media and bring your own device (BYOD) policies, and whistleblower protections and awards, and employment terminations and dispute resolution, including separation agreements, arbitration, and Form U5 expungement. This Note primarily covers federal law, but highlights issues where state law may impose different or additional requirements.

While all businesses must comply with federal, state, and local employment laws, financial services employers face many unique

challenges and issues because they operate in a regulated environment. Banks, broker-dealers, and investment advisers must comply with numerous regulatory schemes that affect various stages of the employment relationship, including hiring, workplace policies, termination, and dispute resolution.

This Practice Note covers key employment laws, regulations, and common practices that are unique to the financial services industries, including:

- Employee hiring and onboarding issues, such as:
  - background checks;
  - Financial Industry Regulatory Authority (FINRA) disclosures; and
  - registration requirements.
- Employee non-compete agreements and garden leave provisions.
- Compensation-related issues, including:
  - employee and independent contractor classification;
  - bonus and other incentive compensation;
  - trailing commissions; and
  - forgivable loans and promissory notes.
- Workplace policies and practices, including:
  - discrimination, diversity, and equal pay sensitivities.
  - mandatory vacation policies;
  - social media policies;
  - bring your own device (BYOD) policies; and
  - Securities and Exchange Commission (SEC) and FINRA personnel recordkeeping requirements.
- Whistleblower protections and awards.
- Employment terminations and dispute resolution, including:
  - settlement and separation agreements;
  - FINRA industry arbitration and private arbitration agreements; and
  - Form U5 expungement proceedings.

Executive compensation issues, including compliance with the pay ratio disclosures under the Dodd-Frank Act (Dodd-Frank) and clawback requirements under the Sarbanes-Oxley Act (SOX), and

severance benefits under Employee Retirement Income Security Act (ERISA) and Section 409A of the Internal Revenue Code, are beyond the scope of this Note. For more on these issues, see Practice Notes, *The Pay Ratio Rule: Preparing for Compliance* ([w-000-6887](#)) and *Severance Benefits, Plans, and Agreements: Overview* ([5-504-9367](#)).

This Note also does not cover the specific registration requirements of, or other regulations governing, employees in the derivatives industry covered by the Commodity Exchange Act (CEA), who must register with the Commodity Futures Trading Commission (CFTC) or the National Futures Association (NFA), including commodity trading advisors or pool operators, exempt non-US firms, futures commission merchants, introducing brokers, notice registered broker dealers, retail foreign exchange dealers, swap dealers, associated persons, floor brokers, floor traders, or futures principals. For general information, see Practice Note, *Federal Securities Regulators: Overview* ([w-000-7587](#)).

For more on the major employment laws governing employers in all industries, see *Employer Coverage Under Major Federal Labor and Employment Laws Chart* ([4-518-2984](#)) and *Federal Employment Laws by Employer Size Chart* ([w-008-1487](#)) and Practice Notes:

- *Employment Law Issues for Startups, Entrepreneurs, and Growing Businesses: Overview* ([5-572-3825](#)).
- *Wage and Hour Law: Overview* ([2-506-0530](#)).
- *Discrimination: Overview* ([3-503-3975](#)).
- *Family and Medical Leave Act (FMLA) Basics* ([9-505-1339](#)).
- *Hiring and Employing Foreign Nationals in the US: Overview* ([0-500-9967](#)).
- *Health and Safety in the Workplace: Overview* ([9-500-9859](#)).
- *Labor Law: Overview* ([6-500-9554](#)).
- *Employee Termination: Best Practices* ([3-503-9595](#)).

## OVERVIEW OF REGULATORY SCHEMES GOVERNING FINANCIAL EMPLOYERS

Banks, brokerage firms, and investment advisers are governed by complex regulatory schemes that impose many obligations beyond the employment laws covering employers in all industries. For example:

- The SEC administers the Securities Act of 1933 (Securities Act), which regulates the offer and sale of securities, and the Securities Exchange Act of 1934 (Exchange Act), which regulates various obligations of public (reporting) companies and the registration and conduct of broker-dealers. The SEC also regulates investment advisers under the Investment Advisers Act of 1940 (Advisers Act).
- FINRA, a self-regulatory agency, oversees exchange markets and brokerage firms, their branch offices, and registered representatives (those individuals associated with a broker-dealer who must register with FINRA), and regulates the conduct of its broker-dealer member firms. Section 15A of the Exchange Act:
  - gives FINRA the authority to discipline its member firms and certain individuals for violations of the securities laws and rules administered by FINRA (for more information on FINRA's regulatory scope, see FINRA Toolkit); and
  - requires individuals and entities that act as either brokers or dealers to register with the SEC as broker-dealers under the Exchange Act (see Practice Note, *Determining Broker-Dealer Status* ([9-602-6565](#))).

- Banks are chartered and regulated at both the federal and state level by regulators such as:
  - the Board of Governors of the Federal Reserve System (FRB or Fed).
  - the Office of the Comptroller of the Currency (OCC).
  - the Federal Deposit Insurance Corporation (FDIC).
  - the Consumer Financial Protection Bureau (CFPB).
  - the banking department or agency of the relevant state.
- The CFTC was created in 1974 primarily to administer and enforce the CEA. The CFTC regulates commodity futures and options markets.

Although beyond the scope of this Note, every state has its own securities laws known as blue sky laws. Although these laws vary from state to state, most state laws impose registration requirements on broker-dealers. State laws also require, with some exceptions, that the employees of brokers and dealers engaged in securities transactions register as agents (also known as salespersons).

For more on the federal regulatory schemes governing financial service providers in the US, see Practice Notes:

- *US Securities Laws: Overview* ([3-383-6798](#)).
- *Federal Securities Regulators: Overview* ([w-000-7587](#)).
- *US Banking Law: Overview* ([0-504-4367](#)).
- *Investment Adviser Regulation: Overview* ([1-610-6165](#)).
- *Summary of the Dodd-Frank Act: Regulatory Structure* ([4-502-7974](#)).

## EMPLOYEE HIRING AND AGREEMENTS

In addition to legal risks and challenges faced by all employers when hiring employees and entering into agreements with them, certain financial services employers must comply with several other laws, regulations, and restrictions governing, for example:

- Broker-dealer and investment adviser registration.
- Screening and disclosure, including:
  - background checks;
  - criminal background disclosures; and
  - fingerprinting.
- Non-compete agreements.

## EMPLOYEE REGISTRATION

### Form U4 (Uniform Application for Securities Industry Registration or Transfer)

Broker-dealers regulated by FINRA (member firms) must electronically file FINRA's Form U4 when registering associated persons (also known as covered persons) with FINRA or transferring their registration to another broker-dealer. Associated persons include any member firm employee involved with the firm's investment and securities operations, including:

- Partners.
- Officers.
- Directors.
- Branch managers.
- Department supervisors.
- Investment bankers.

- Brokers.
- Financial consultants.
- Salespeople.

A Form U4 includes personal and employment-related information about the individual, including:

- Administrative information, such as the associated person's:
  - name;
  - residential history;
  - employment address and history; and
  - outside business activities.
- Disclosure information, such as the associated person's:
  - criminal convictions;
  - regulatory proceedings or sanctions;
  - administrative proceedings;
  - civil actions;
  - financial disclosures (for example, liens or bankruptcies);
  - customer complaints; and
  - arbitration awards.

The information on the Form U4 is filed with the Central Registration Depository (CRD), FINRA's internet-based central licensing and registration system. Some of the information filed with the CRD is publically available on Broker Check, a free research tool with information about the background and experience of financial brokers, advisers, and firms.

Individuals have a continuing obligation to amend and update the information required by the Form U4 as changes occur. Failure to completely and accurately disclose information on the Form U4 can result in fines and sanctions, up to and including suspension of an individual's brokerage license or an industry ban. For more information on registration and licensing requirements, see Practice Note, *Broker-Dealers: Registration and Licensing of Associated Persons and Personnel* ([w-010-8254](#)).

Individuals signing a Form U4 agree to arbitrate certain claims arising out of their employment. The member firm must provide associated persons with a written disclosure about these predispute arbitration provisions. (FINRA Rule 2263; see also FINRA Industry Arbitration of Employment Disputes).

### Investment Adviser Registration

With certain exceptions and limitations, investment advisers must register with the SEC under the Advisers Act. An investment adviser initiates registration with the SEC under the Advisers Act by electronically submitting Form ADV using the Investment Adviser Registration Depository (IARD), an internet-based filing system operated by FINRA. (17 C.F.R. § 275.203-1.)

Although state requirements are beyond the scope of this Note, investment advisers also may initiate state registration by filing Form ADV using the IARD system.

For more information about registration requirements, see Practice Note, *Registration of Investment Advisers: Overview and SEC: FAQs on Form ADV and IARD* ([7-607-7886](#)).

### EMPLOYEE QUESTIONNAIRES

SEC Rule 17a-3 requires that every member firm, broker, or dealer obtain a questionnaire or application for employment that:

- Is executed by each associated person.
- Is approved in writing by an authorized representative of the broker-dealer.
- Includes the associated person's:
  - name, address, Social Security number, and employment starting date;
  - internal identification number or code assigned to that person (such as an employee ID) and assigned CRD number;
  - date of birth;
  - ten-year employment history; and
  - office where the person regularly conducts business.
- Also includes, regarding the associated person, the record of any:
  - denial of membership or registration and disciplinary actions taken or sanctions imposed on the person by any federal or state agency or by any national securities exchange or FINRA;
  - denial, suspension, expulsion, or revocation of membership or registration of any broker-dealer with which the person was associated in any capacity when the action was taken;
  - permanent or temporary injunction entered against the associated person or any broker-dealer with which the associated person was associated in any capacity at the time the injunction was entered;
  - arrest or indictment for any felony or any misdemeanor of a financial nature; and
  - other name or names by which the person has been known or which the person has used.

(17 C.F.R. § 240.17a-3(a)(12)(i).)

An individual's Form U4 used for registration with FINRA, or similar materials required for registration with other enumerated stock exchanges, satisfies the requirements of this rule.

### BACKGROUND CHECKS AND FINGERPRINTING

All employers conducting background checks must comply with the procedures required by the Fair Credit Reporting Act (FCRA) and applicable state and local laws (for more on background check laws generally, see Practice Note, *Background Checks and References* ([6-500-3948](#)) and *Background Check Laws: State Q&A Tool*).

Although most private employers are not required to conduct background checks, financial services employers and their applicants for employment have heightened screening and disclosure obligations under various federal and administrative laws and regulations.

### FINRA Rule 3110(e)

Effective July 1, 2015, FINRA Rule 3110(e) requires that broker-dealers investigate each person they plan to register with FINRA regarding that person's good character, business reputation, qualifications, and experience. If the applicant previously has been registered with FINRA or another self-regulatory organization (SRO), the member must either:

- Review a copy of the applicant's most recent termination of registration Form U5 (also known as FINRA's Uniform Termination Notice for Securities Industry Registration), including amendments, and CFTC Form 8-T (for applicants previously registered with a CFTC-registered firms) within 60 days of the filing date of an application for registration with FINRA.
- Demonstrate to FINRA that it has made reasonable efforts but has been unable to do so (such as where an applicant's previous employer fails to file a Form U5 or goes out of business before filing it).

A broker-dealer must create and implement written procedures reasonably designed to verify the accuracy and completeness of the information on an applicant's Form U4 no later than 30 calendar days after the form is filed with FINRA. The procedures must, at a minimum, require that the broker-dealer either:

- Search reasonably available public records.
- Use a third-party service provider to verify the accuracy and completeness of the information.

For more information, see Legal Update, *FINRA Issues Regulatory Notice on FINRA Rule 3110(e) Concerning Background Checks on Registration Applicants* ([5-603-7405](#)).

#### Form U4 Criminal Disclosures

FINRA-registered applicants must disclose information about certain criminal charges and convictions in their Form U4 filings, including all felony and certain misdemeanor convictions (Form U4 Section 14). Applicants must disclose whether they have been "charged," which is defined as being formally accused of a crime in a formal complaint or indictment or other similar proceeding. An arrest alone is not a charge for purposes of completing the Form U4. (See FINRA Form U4 and U5 Interpretive Q&A, Questions 14A and 14B.) There is no time limit on these disclosures.

#### Background Checks for Bank Employees (12 U.S.C. § 1829)

Certain criminal events may statutorily disqualify an applicant from employment by certain banking institutions. Federal law prohibits any person who was convicted of a criminal offense involving dishonesty or breach of trust (or has entered into a pretrial diversion or similar program regarding such an offense) from serving as a director, officer, or employee of an FDIC-insured bank (12 U.S.C. § 1829). Banks must conduct reasonable inquiries into applicants' backgrounds to avoid hiring persons barred from employment by this law.

Financial institutions covered by this provision that make hiring decisions based on an applicant's criminal conviction involving dishonesty or breach of trust may be protected against claims under applicable state or local ban-the-box laws that restrict employers from considering an applicant's criminal background in the hiring process. These laws generally contain exceptions for any inquiries that are otherwise required by law (see, for example, *Smith v. Bank of Am. Corp.*, 865 F. Supp. 2d 298, 305-06 (S.D.N.Y. 2010)). Nevertheless, given the various legal requirements, it is important for employers to proceed carefully when taking these actions and ensure they fully document their actions and comply with the regulations and laws.

The FDIC also has provided guidance about pre-employment background screening (see FDIC: Financial Institution Letters, *Guidance on Developing an Effective Pre-Employment Background Screening Process*).

For more on state law requirements and restrictions, see *Background Check Laws: State Q&A Tool*.

#### Fingerprinting

With certain exceptions, individuals who are partners, directors, officers, or employees must be fingerprinted if they work for a:

- National securities exchange.
- Broker-dealer.
- Registered transfer agent.
- Registered clearing agency.

(15 U.S.C. § 78q(f)(2); 17 C.F.R. § 240.17f-2.)

SEC Rule 17f-2 exempts, among others, individuals working for a national securities exchange, broker-dealer, or registered clearing agency from the fingerprinting requirement if they do not:

- Sell securities.
- Regularly have access to the keeping, handling, or processing of securities, monies, or the original books and records relating to the securities or monies.
- Have direct supervisory responsibility over those who sell securities or have access to securities, monies, or the original books and records.

(17 C.F.R. § 240.17f-2; see also *Broker-Dealer Recordkeeping Requirements*.)

Rule 17f-2 also contains exemptions for specified individuals working for a registered transfer agent. There is no express fingerprinting requirement for bank employees.

For more information regarding broker-dealer fingerprinting procedures and guidance, see Practice Note, *Broker-Dealers: Registration and Licensing of Associated Persons and Personnel: Box, Fingerprinting and Background Checks* ([w-010-8254](#)) and FINRA: *Frequently Asked Questions (FAQ) About Fingerprint Processing*.

Employers also must comply with relevant state fingerprinting laws. For example, in New York:

- State law generally prohibits fingerprinting of employees, except as required by law (N.Y. Lab. Law § 201-a). However, both federal and state law require fingerprinting for certain financial services employers and employees.
- Persons who are regularly employed in New York and are in the business of buying and selling securities must be fingerprinted as a condition of employment. Every set of fingerprints taken must be promptly submitted to the Attorney General for appropriate processing. (N.Y. Gen. Bus. Law § 359-e(12).)

For more on fingerprinting and background checks generally, see:

- Practice Note, *Background Checks and References* ([6-500-3948](#)).
- *Background Check Laws: State Q&A Tool*.
- *Hiring Requirements: State Q&A Tool*.

## NON-COMPETE AND GARDEN LEAVE PROVISIONS

The success of a financial services firm often depends on the firm's relationships with its customers and the employees and brokers who interact with them. Firms regularly compete for the same pool of talent and client relationships. Many employers seek to protect those relationships through various post-employment restrictive covenants, such as non-compete, non-solicitation, or garden leave provisions (see Practice Notes, Non-Compete Agreements with Employees ([7-501-3409](#)) and Garden Leave Provisions in Employment Agreements ([w-007-3506](#))).

FINRA-regulated firms entering into these agreements must comply with applicable regulations and protocols, including:

- FINRA Rule 2140.
- FINRA Rule 11870.
- The Protocol for Broker Recruiting, if the firm is a signatory to it.

### FINRA Regulations (Rules 2140 and 11870)

FINRA rules limit the ability of broker-dealers to prevent departing employees from servicing their former clients. FINRA Rule 2140 prohibits the interference with a customer's request to transfer an account in connection with a representative's change in employment where there is no existing dispute with the customer about the account (FINRA R. 2140). FINRA-registered agents also must help transfer a customer's account if that customer chooses to follow a registered representative to another broker (FINRA R. 11870). Employers must be careful to avoid restrictions on employees that interfere with customer rights. However, a covenant that prohibits the registered representative from soliciting customers or sending an announcement about a new position may be enforceable because the rules only address transfer requests initiated by the customer and not solicitation by the representative (see, for example, *Charles Schwab & Co, Inc. v. Gonzalez*, 2015 WL 11201182, at \*8 (S.D. Fla. Dec. 7, 2015) (a prohibition against sending announcements does not violate FINRA Rule 2140); *Hilliard v. Clark*, 2007 WL 2589956, at \*7 (W.D. Mich. Aug. 31, 2007) (Rule 11870 is incompatible with a non-compete provision but not a non-solicitation provision); see also *UBS Fin. Servs. Inc. v. Fiore*, 2017 WL 3167321, at \*5-6 (D. Conn. July 24, 2017) (identifying conduct that constitutes solicitation)).

For more on non-compete and non-solicit provisions generally, see:

- Practice Note, Non-Compete Agreements with Employees ([7-501-3409](#)).
- Standard Document, Employee Non-Compete Agreement ([7-502-1225](#)).
- Standard Clause, Non-Solicitation Clause ([4-589-5271](#)).
- Non-Compete Laws: State Q&A Tool.

### Protocol for Broker Recruiting

In the financial services industry, approximately 1700 broker-dealers are signatories to the Protocol for Broker Recruiting (Protocol). The Protocol limits the restrictions a signatory firm can place on its registered representatives who move to another signatory firm. The principal goal of the Protocol is "to further the clients' interests of privacy and freedom of choice" regarding the movement of brokers between firms (see Read the Broker Protocol).

Under the Protocol, both the departing employee and the new employer have no monetary or other liability if the departing employee both:

- Is leaving one signatory firm to join another signatory firm (see Broker Protocol Directory).
- Follows the procedures in the Protocol.

Under the Protocol, a departing employee may take certain information regarding clients they serviced while at the firm to a new employer and use that information to solicit clients. This information is limited to:

- Client name.
- Client phone number.
- Client email address.
- Account title.

Departing employees are expressly prohibited from taking any other documents or information and must provide written notice to their current employer about what information they are taking. Under the Protocol, departing employees are free to solicit their former clients only after they join their new firm. However, a firm may still enforce whatever contractual, statutory, or common law restrictions exist on the solicitation of customers before they left their old firm. In addition, the Protocol generally does not supersede team or partnership agreements regarding what documents departing employees can take or clients they can solicit (see *UBS Fin. Servs. v. Christenson*, 2013 WL 2145703, at \*5 (D. Minn. May 15, 2013)).

Courts have enforced parties' agreement to the Protocol when faced with challenges to the conduct of departing employees (see, for example, *UBS Fin. Servs. Inc. v. Fiore*, 2017 WL 3167321, at \*15-19 (D. Conn. July 24, 2017) (denying injunction against departing employees covered by the protocol despite some evidence of questionable behavior that did not rise to the level of bad faith); *A.G. Edwards & Sons, Inc. v. Martin*, 2007 WL 4180943, at \*1 (N.D. Fla. Nov. 21, 2007) (denying request for injunctive relief where brokers departing from one signatory firm to another substantially complied with the Protocol)). However, departing brokers generally are not protected by the Protocol when they act in bad faith or violate the Protocol's letter or spirit (see, for example, *Ameriprise Fin. Servs., Inc. v. Koenig*, 2012 WL 379940, at \*5 (D.N.J. Feb 6, 2012)). The Protocol also does not protect a signatory firm against claims that it raided the employees or clients of another signatory firm or related liability (though it does not define "raiding").

Non-signatory firms are not bound by the Protocol and therefore can sue departing brokers for violating the terms of otherwise enforceable restrictive covenants or trade secrets laws (see, for example, *Hilliard*, 2007 WL 2589956, at \*6; *Wachovia Secs. v. Stanton*, 571 F. Supp. 2d 1014, 1039-40 (N.D. Iowa 2008) (non-solicitation agreement was not unreasonable as applied to employee who left a signatory firm to move to a non-signatory firm because Protocol didn't apply)). Courts and arbitrators alike generally have rejected arguments by brokers departing from non-signatory firms that the Protocol establishes an industry standard allowing them to take client information that they would have been allowed to take if departing from one signatory firm to join another (see, for example, *Fidelity Brokerage Servs., LLC v. Wilder*, FINRA No. 11-03937, at pp 10-12 (Sept. 21, 2012) (an employee departing from a non-signatory firm (Fidelity) is not entitled to bring client information to his new

signatory firm employer (Morgan Stanley) in violation of his Fidelity confidentiality and non-solicitation agreement, rejecting Morgan Stanley's argument that the Protocol has become industry standard); *Fidelity Brokerage Servs., LLC v. Clemens*, 2013 WL 5936671 (E.D. Tenn. Nov. 4, 2013) (Protocol by its own terms applies only to signatory firms and does not supply an "industry standard").

However, some courts have found that a signatory firm's participation in the Protocol affects the irreparable harm analysis when seeking an injunction against a broker leaving for a non-signatory firm. The reasoning is that the firm's participation indicates that it understands the "fluid nature of the industry" and "tacitly accepts" that brokers switching firms and taking client lists with them does not cause irreparable harm. (*Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Brennan*, 2007 WL 632904, at \*2 (N.D. Ohio Feb. 23, 2007); see also *UBS Fin. Servs. Inc. v. Fiore*, 2017 WL 3167321, at \*19 (D. Conn. July 24, 2017); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Baxter*, 2009 WL 960773, at \*5 (D. Utah Apr. 8, 2009).)

Morgan Stanley and UBS, two of the Protocol's four founding firms, both withdrew from the Protocol in 2017 causing questions regarding its future viability.

For more information on the Protocol, see Broker Protocol FAQs.

### Garden Leave

Many financial services employers use garden leave provisions for certain high-level or valuable sales employees. Garden leave may be used as an alternative to or in conjunction with traditional non-compete provisions (if not otherwise prohibited by FINRA rules). These provisions require departing employees to give advance notice of their resignation, typically 30 to 90 days, known as the garden leave period. During garden leave, they remain employed and continue to receive compensation, and therefore are not permitted to work elsewhere, but typically are not required to perform much if any work (they can "tend to their gardens").

Garden leave provisions are increasingly common in the financial services industry. Because these provisions are accepted, and often respected, by hiring employers and departing employees alike, little case law addressing enforceability exists.

In the relatively few published decisions considering pure garden leave provisions, courts have reached conflicting conclusions about their enforceability. Courts have been particularly reluctant to specifically enforce these provisions, because doing so would require the court to order employees to continue an at-will employment relationship against their will. However, garden leave provisions are often enforced when they are ancillary to a non-compete or non-solicit provision because the employee is being paid during the restricted period.

For more on garden leave, see Practice Note, Garden Leave Provisions in Employment Agreements: Judicial Treatment of Garden Leave Provisions ([w-007-3506](#)). For a sample provision, see Standard Clause, Garden Leave Provision ([w-008-3138](#)).

## EMPLOYEE CLASSIFICATIONS AND EXEMPTIONS UNDER THE FLSA

Like employers in other industries, financial services employers generally must pay their employees minimum wage and overtime

pay unless they qualify for an exemption under the Fair Labor Standards Act (FLSA). To qualify for an exemption, employees generally must satisfy the:

- Duties test.
- Salary test (except for certain commissioned employees), which requires that employees are paid:
  - on a salary basis; and
  - at least a minimum threshold annual salary.

Employers also should monitor potential changes to the minimum salary threshold required for most exemptions. For information on the Department of Labor's (DOL) 2016 efforts to increase the minimum salary threshold, for example, see Practice Note, Latest Developments: DOL's Final Rule Increasing Minimum Salary for EAP Exemptions Under FLSA ([w-005-0644](#)).

Some state laws, such as New York and California, have higher minimum salary requirements to qualify for certain exemptions (see, for example, New York and Federal Wage and Hour Law Comparison Chart ([3-558-4726](#)) and California and Federal Wage and Hour Law Comparison Chart ([3-596-9026](#))). State law also may impose different tests for certain exemptions, or offer fewer exemptions than are available under the FLSA. For more on state law requirements, see Wage and Hour Laws: State Q&A Tool.

Employee classification is a high-stakes decision. Violations of wage and hour laws carry substantial penalties, including liquidated (double) damages and attorneys' fees under the FLSA and many state laws. For resources discussing these issues generally, see Wage and Hour Claims Toolkit.

Financial services employers have paid significant sums to settle class action lawsuits challenging certain employees' exempt classification and the failure to pay them overtime, many of which had multi-million dollar price tags (see, for example, *Devries v. Morgan Stanley & Co., LLC*, 2016 WL 6090554 (S.D. Fla. July 11, 2016) (\$6 million settlement for unpaid training time) and (*Bland v. PNC Bank, N.A.*, 2017 WL 4652705 (W.D. Pa. Apr. 11, 2017) (\$16 million settlement for misclassification of mortgage loan officers)).

Employers also must ensure that they do not implement policies that improperly reduce exempt employees' salaries. For example, an agreement requiring that employees reimburse the employer for a training program if they resigned or were terminated within five years of commencing employment was an improper salary reduction proscribed by the salary basis test for exempt employees (*Ketner v. Branch Banking & Tr. Co.*, 143 F. Supp. 3d 370, 377-79 (M.D. N.C. 2015)).

Financial services employers should be aware of common misclassification risks within the industry, including the misclassification of:

- Administrative employees (see Administrative Employees in Financial Services and Common Classification Issues).
- Sales professionals (see Sales Professionals in Financial Services).
- Highly compensated employees (see Highly Compensated Financial Services Employees).

For more on other employee exemptions, see:

- Practice Note, Wage and Hour Law: Overview ([2-506-0530](#)).
- Practice Note, Sales Exemptions Under the FLSA ([w-005-3710](#)).
- Standard Document, Questionnaire to Determine Exempt Status Under the FLSA ([8-510-2631](#)).

### ADMINISTRATIVE EMPLOYEES IN FINANCIAL SERVICES AND COMMON CLASSIFICATION ISSUES

Employees in the financial services industry commonly are exempt from the minimum wage and overtime requirements as administrative employees. To qualify for the administrative exemption under the FLSA, an employer must show that:

- The employee is compensated:
  - on a salary or fee basis; and
  - at a rate at least equal to the minimum required threshold (see Practice Note, Latest Developments: DOL's Final Rule Increasing Minimum Salary for EAP Exemptions Under FLSA ([w-005-0644](#))).
- The employee's primary duty:
  - is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
  - includes the exercise of discretion and independent judgment on significant matters.

Work "directly related to the management or general business operations" includes, among others, work in finance, accounting, and insurance (29 C.F.R. §541.201(b)). Employees acting as advisers or consultants to their employer's clients or customers (such as tax experts or financial consultants) also may be exempt (29 C.F.R. §541.201(c)).

Financial services employees may qualify for the administrative exemption (assuming they meet the minimum salary threshold) if their duties include work such as:

- Collecting and analyzing information regarding the customer's income, assets, investments, or debts.
- Determining which financial products best meet the customer's needs and financial circumstances.
- Advising the customer regarding the advantages and disadvantages of different financial products.
- Marketing, servicing, or promoting the employer's financial products.

(29 C.F.R. § 541.203(b); see also DOL Financial Services Industry Fact Sheet (DOL: Fact Sheet #17M).)

In applying the administrative exemption, it does not matter whether the employee's activities are aimed at an end user or an intermediary. The exempt status of financial services employees is based on the duties they perform, not on which customers they serve.

Despite the DOL guidance, financial services employers have faced several costly challenges based on the misclassification of workers, especially when applying the administrative and other white collar exemptions to job titles such as:

- Registered representative (including stock brokers).
- Financial advisor.

- Loan underwriter.
- Mortgage loan officer.

### Registered Representatives and Financial Advisors

There is some dispute about whether registered representatives, including financial advisors, qualify for the administrative exemption because their duties generally include selling financial products, though to varying degrees. The DOL regulations clarify that an employee whose primary duty is selling financial products does not qualify for the administrative exemption (29 C.F.R. § 541.203(b)).

In 2006, the DOL published an opinion letter addressing the application of the administrative exemption to certain registered representatives, including:

- Account executives.
- Broker-representatives.
- Financial executives.
- Financial consultants and advisors.
- Investment professionals.
- Stockbrokers.

(DOL Wage & Hour Div. Op. Ltr., No. FLSA 2006-43, 2006 WL 3832994 (Nov. 27, 2006)).

The DOL concluded that registered representatives **are exempt** because they:

- Have a primary duty other than sales that includes:
  - collecting and analyzing a client's financial information;
  - advising the client about the risks, advantages, and disadvantages of various investment opportunities in light of the client's individual financial circumstances; and
  - recommending to the client only those securities that are suitable for the client's particular circumstances.
- Exercise discretion and independent judgment because they:
  - assess the client's investment objectives, investment experience, and tolerance for risk; and
  - compare and evaluate possible investment options and provide advice only after considering all the various possibilities.

(Op. Ltr., 2006 WL 3832994 at \*5.)

Courts have found that this opinion letter is well reasoned and constitutes persuasive authority (see, for example, *In re RBC Dain Rauscher Overtime Litigation*, 703 F. Supp. 2d 910, 927 (D. Minn. 2010)).

Other courts have similarly concluded that financial advisors are properly classified as exempt administrative employees. For example, in *Tsyn v. Wells Fargo Advisors, LLC*, the US District Court for the Northern District of California analyzed the duties of licensed financial advisors who claimed they were improperly classified as exempt employees. The advisors argued that:

- Their primary duty was sales.
- Although they collected and analyzed customer information, assessed which financial products best suited their clients, and advised their clients, these duties were secondary to their sales responsibilities.

(2016 WL 612926, at \*2-3 (N.D. Cal. Feb. 16, 2016).)

The court disagreed and found that the financial advisors' primary duties were "those things that governing regulations say will bring a financial-services employee within the FLSA's administrative exemption." (*Tsyn*, 2016 WL 612926, at \*2-3) (giving deference to the DOL's opinion letter and regulations); see also *In re Morgan Stanley Smith Barney LLC Wage and Hour Litigation*, 2017 WL 772904 (D.N.J. Feb. 28, 2017) (same); *Hein v. PNC Fin. Servs. Grp., Inc.*, 511 F. Supp. 2d 563, 571-75 (E.D. Pa. 2007) (securities broker was properly classified as exempt because his primary duty involved advising clients and managing multi-million dollar accounts.)

Registered representatives and financial advisors who have challenged their exempt status generally do not dispute that they performed duties such as collecting and analyzing client information and advising clients, but rather argue that these duties were secondary to their primary duty of making sales. The outcome of these cases depends on the characterization and importance of their various duties (compare *Tsyn*, 2016 WL 612926, at \*13 (finding that financial advisors' primary duties were those described in the DOL opinion letter, even though they also sold financial products) with *Takacs v. A.G. Edwards & Sons, Inc.*, 444 F. Supp. 2d 1100 (S.D. Cal. 2006) (denying summary judgment, in part, because as financial consultants they spent most of their time cold-calling clients)).

### Mortgage and Loan Officers and Underwriters

The classification of mortgage and loan officers and underwriters has been particularly challenging for employers because of inconsistent and changing guidance, both from the DOL and the courts. For example, in 2010, the DOL issued an administrative interpretation (AI), directly contrary to a prior opinion letter, stating that that mortgage loan officers do not qualify for the administrative exemption. The AI reasoned that their duties do not qualify for an exemption because mortgage loan officers:

- Receive and act on internal leads.
- Collect required financial information.
- Run credit reports.
- Discuss loan terms with customers.
- Compile customer documents for forwarding to an underwriter or loan processor.
- Finalize documents for closings.

(DOL Administrator's Interpretation No. 2010-1 (March 24, 2010).)

The US Supreme Court found the DOL had the authority to issue this interpretation without engaging in the notice and rulemaking procedure, even though the new interpretation was directly contrary to its prior interpretation of the exemption (*Perez v. Mtg. Bankers Ass'n*, 135 S. Ct. 1199 (2015); see also Legal Update, SCOTUS: DOL Permitted to Change Interpretation Rules Without Notice and Comment Rulemaking ([2-603-7987](#))).

The courts have been similarly inconsistent. There is currently a circuit split about the proper classification of loan and mortgage underwriters. The US Court of Appeals for the Sixth Circuit found that loan underwriters were exempt because they both:

- Collect and analyze customer financial information.
- Determine which financial products best meet a customer's needs and financial circumstances while exercising discretion to go beyond the underwriting guidelines.

(*Lutz v. Huntington Bancshares, Inc.*, 815 F.3d 988 (6th Cir. 2016).)

Reaching the opposite conclusion, the US Court of Appeals for the Second Circuit found that mortgage underwriters did not qualify for the administrative exemption because their work constitutes the "production" of loans (*Davis v. J.P. Morgan Chase & Co.*, 587 F.3d 529 (2d Cir. 2009)).

The US Court of Appeals for the Ninth Circuit agreed with the Second Circuit and held that mortgage underwriters are nonexempt. In concluding that the administrative exemption did not apply, the court reasoned that:

- Their primary job duty, which involved analyzing customers' mortgage loan applications and determining their creditworthiness in order to decide whether the bank would approve the loan, did not relate to the bank's management or general business operations.
- Underwriters used set guidelines and criteria to assess whether loans fell within range of acceptable risk as determined by the bank and did not assess or determine the bank's business interests.
- They did not perform work involving the bank's future strategy, business direction, or mode of operation.

(*McKeen-Chaplin v. Provident Savings Bank, FSB*, 862 F.3d 847 (9th Cir. 2017).)

The Second and Ninth Circuit decisions are consistent with the DOL's most recent interpretation (though the Second Circuit decision predates the DOL interpretation). The Supreme Court has not yet granted review of any case to resolve this split and denied certiorari in the *McKeen-Chaplin* case (2017 WL 4012266 (Nov. 27, 2017)).

In some circumstances, mortgage loan officers may qualify for the outside sales exemption (see Sales Professionals in Financial Services).

For more on these decisions, see Legal Updates:

- Sixth Circuit Holds Mortgage Underwriters Are Exempt Administrative Employees Under the FLSA ([w-001-4992](#)).
- FLSA's Administrative Exemption Does Not Apply to Mortgage Underwriters: Ninth Circuit ([w-009-0886](#)).

### SALES PROFESSIONALS IN FINANCIAL SERVICES

Some financial advisors primarily sell products and therefore do not qualify for the administrative exemption. However, if their primary duty is making sales away from the employer's place of business, they may qualify for the outside sales exemption.

This exemption applies if both:

- The employee's primary duty is:
  - making sales (as defined by the FLSA); or
  - obtaining orders or contracts for services or for the use of facilities in exchange for consideration paid by the client or customer.



- The employee is customarily and regularly engaged away from the employer's place (or places) of business.  
(29 C.F.R. § 541.500(a).)

Courts have found that bank mortgage loan officers who spend significant time outside the office qualify for the outside sales exemption (see, for example, *Dixon v. Prospect Mtg., LLC*, 11 F. Supp. 3d 605, 610-12 (E.D. Va. 2014) (employee spent 50% outside the office in work related to generating sales); *Hartman v. Prospect Mtg., LLC*, 11 F. Supp. 3d 597 (E.D. Va. 2014) (employee who worked outside the office 25-30% of her time qualified for the exemption)).

Financial advisors who primarily sell financial products by cold calling from an office or from home, however, rather than visiting customers, do not qualify for this exemption.

For more on sales exemptions, see Practice Note, Sales Exemptions Under the FLSA ([w-005-3710](#)).

### HIGHLY COMPENSATED FINANCIAL SERVICES EMPLOYEES

Many financial services employees who do not qualify for the administrative or outside sales exemptions may be exempt as highly compensated employees (29 C.F.R. § 541.601). To qualify for this exemption individuals must:

- Earn at least \$100,000 in total annual compensation, including commissions and non-discretionary bonuses, but at least \$455 per week must be paid on a salary basis.
- Perform office or non-manual work as part of their primary duty.
- Customarily and regularly perform one or more exempt duties of an administrative, executive, or professional employee (29 C.F.R. §§ 541.100 and 541.300).

However, employers should be cautious in relying on this exemption because:

- For many highly compensated financial services employees, their compensation is derived in large part from bonuses which may be classified as discretionary, and therefore do not count toward the \$100,000 threshold.
- Some state laws do not recognize this exemption or require a higher salary threshold.

For more on state law requirements, see Wage and Hour Laws: State Q&A Tool.

For more on cases applying FLSA exemptions in the financial services industry, see Chart of FLSA Exemption Case Law by Industry: Banking and Financial Services ([w-005-6748](#)).

For more on classification and exemptions under the FLSA generally, see:

- Practice Note, Wage and Hour Law: Overview ([2-506-0530](#)).
- Standard Document, Questionnaire to Determine Exempt Status Under the FLSA ([8-510-2631](#)).
- FLSA White Collar Exemptions Checklist ([5-507-2555](#)).

### INDEPENDENT CONTRACTOR MISCLASSIFICATION

Financial services companies can sometimes avoid significant wage, tax, and other obligations by engaging independent contractors

instead of employees. Using independent contractors can result in considerable cost savings and increased workforce flexibility. In many situations, independent contractors are also advantageous to financial services companies for their specialized knowledge.

While using independent contractors can be advantageous, the risks of misclassification are high and can be costly. The burden is on the company to prove that an independent contractor is properly classified. Simply referring to a worker as an independent contractor, even in a written agreement, does not prevent legal challenges to that classification by workers, the DOL, the Internal Revenue Service (IRS), or state and local authorities. Misclassification creates exposure to liability in several areas, including potential liability for unpaid overtime pay, taxes, and employee benefits.

In the financial services industry, independent contractors most commonly are engaged in the information technology or information services departments, and to a lesser extent other back office functions, such as operations, finance, and risk management.

In addition, many independent financial advisors, who are true small business owners and only affiliated with their broker-dealers, also function as independent contractors rather than employees of broker-dealer firms (see, for example, *Taylor v. Waddell & Reed, Inc.*, 2013 WL 435907 (S.D. Cal. Feb. 1, 2013)).

Various tests are used to determine independent contractor status, depending on the jurisdiction and the statute at issue. While most tests examine the degree of control a company exercises over the purported contractor, the focus of each test varies and may examine:

- The economic realities of the parties' relationships, such as under the FLSA.
- Three broad categories of factors, each measuring the degree of control, a test used by the IRS (based on the agency's former 20-factor test).
- Common law agency principles to determine the degree of control, used for claims under Title VII, the ADA, and the ADEA.
- Other factors under various state laws.

For more about independent contractor tests, see:

- Practice Note, Independent Contractor Classification: Tests for Independent Contractor Status ([4-503-3970](#)).
- Standard Document, Questionnaire to Determine Independent Contractor Status Under the FLSA ([w-001-6336](#)).
- Independent Contractors: State Q&A Tool.

To minimize the risk of misclassification, employers that use independent contractors should periodically audit the classification to determine if they comply with applicable law. After applying the appropriate tests, employers must decide how to address any misclassification they uncover.

For more about minimizing misclassification risks, see:

- Practice Note, Independent Contractor Classification: Mitigating Misclassification Problems ([4-503-3970](#)).
- Standard Document, Classifying Independent Contractors: Presentation Materials ([w-004-9267](#)).
- Standard Document, Questionnaire to Determine Independent Contractor Status Under the FLSA ([w-004-9267](#)).

- Evaluating and Engaging Independent Contractors Checklist ([w-001-0790](#)).
- Independent Contractors: State Q&A Tool.
- Independent Contractors Toolkit ([7-572-4225](#)).

## INCENTIVE COMPENSATION AND BENEFITS

In addition to worker classification issues, financial services employers also must be mindful of other unique compensation and benefits issues within the industry, including:

- Bonus agreements and plans (see Bonus Compensation).
- Trailing commission payments (see Commissions for FINRA-Registered Retiring Representatives).
- Forgivable loans and promissory notes (see Forgivable Loans and Promissory Notes).

Many financial services employees also receive some form of deferred compensation, which must meet specific requirements under the tax code that are beyond the scope of this Note. For more on deferred compensation rules, see Practice Note, Section 409A: Deferred Compensation Tax Rules: Overview ([6-501-2009](#)).

### BONUS COMPENSATION

For many financial services employees, a substantial portion of their compensation (sometimes upwards of 50%, and even more for revenue generators) may be comprised of an annual bonus or other incentive payment which may be awarded only once a year, often with payouts deferred over several years. The characterization of these bonuses varies greatly and is generally determined by the employer's agreement with the employees and bonus plan provisions, if any. An employee's right to recover a bonus payment after a separation of employment often depends on:

- Whether the bonus is mandatory or discretionary.
- When the bonus is earned.
- Whether the bonus is considered wages under applicable state law.
- Whether the bonus has been paid as deferred compensation subject to a vesting requirement.

For employees who are FINRA-registered representatives, disputes about bonus payments likely will be determined in arbitration (see FINRA Industry Arbitration of Employment Disputes).

### Mandatory Versus Discretionary Bonuses

The bonus structure, as defined by the parties' agreement in an offer letter, employment agreement, or bonus plan, typically is either:

- Discretionary.
- Nondiscretionary (mandatory) either as a fixed or guaranteed number or based on the performance of:
  - the employer;
  - the employee; or
  - a combination of the employer and the employee.

As a general rule, an employee has no legal right to compensation under a discretionary bonus plan or contract. A bonus is deemed discretionary if both:

- The fact and amount of the payment are determined in the sole discretion of management.
  - The payments are not made under any contract, agreement, or promise (whether oral or written) causing the employee to expect the payments regularly.
- (29 U.S.C. § 207(e)(3); 29 C.F.R. §§ 778.200(a)(3), 778.211.)

State laws may vary about how discretionary bonuses are defined (see Bonuses as Wages Under State Law).

A discretionary bonus has several benefits, including that:

- It need not be included in the regular rate of pay when calculating a nonexempt employee's overtime pay (29 U.S.C. § 207(e)(3); 29 C.F.R. §§ 778.200(a)(3), 778.211).
- Discretionary bonus payments generally do not constitute wages under state law (see Bonuses as Wages Under State Law).
- The employer need not make any bonus payment if the employee leaves before the bonus is earned or paid (see, for example, *O'Grady v. BlueCrest Capital Mgmt. L.L.P.*, 646 F. App'x 2, 3 (2d Cir. 2016) (dismissing claim for nonpayment of bonus where agreement clearly stated that the bonus program and awards made under it were in company's "sole and absolute discretion"); *Hunter v. Deutsche Bank AG*, 866 N.Y.S.2d 670, 671 (1st Dep't 2008) (granting employer's motion for summary judgment on breach of contract claim where contract and handbook language clearly stated bonuses were discretionary)).
- If the language in a contract or employee handbook unambiguously provides that the bonus is discretionary, it generally precludes employee claims of entitlement to a bonus based on alleged oral promises (*Kaplan v. Capital Co. of Am. LLC*, 747 N.Y.S.2d 504, 505 (1st Dep't 2002)).

Clear contract language avoids ambiguity and can help employers defeat unpaid bonus claims (see, for example, *De Madariaga v. Union Cancaire Privee*, 961 N.Y.S.2d 50, 51 (1st Dep't 2013); *Kaplan*, 747 N.Y.S.2d at 505). Employers drafting employee contracts and handbooks that want the flexibility of discretionary bonuses should:

- Clearly state that the employer has the sole and absolute discretion to decide:
  - whether to pay a bonus, if any; and
  - the bonus amount.
- Condition the right to receive any bonus on the employee's continuing employment at the time the bonus is to be paid.
- Have employees acknowledge in writing that they understand the policy or contract.

Sometimes employees (generally more senior executives or valuable salespeople) have sufficient leverage to negotiate for a sign-on bonus, or a guaranteed bonus, at least for a few years (see *In re Lehman Bros. Holdings Inc.*, 2015 WL 247403, at \*4-5 (S.D.N.Y. Jan. 20, 2015) (distinguishing between signing bonus and performance bonus)). For example, financial advisors or brokers who are recruited from another firm often receive a minimum guaranteed bonus for one or more years to compensate for lost earnings or forfeited incentive pay with their prior employer (see, for example, *Ryan v. Kellogg Partners Inst. Servs.*, 19 N.Y.3d 1, 14 (2012) (enforcing oral agreement to pay guaranteed

sign-on bonus of \$175,000)). Alternatively, brokers and other sales personnel often receive an upfront lump sum payment in the form of a forgivable loan (see *Forgivable Loans and Promissory Notes*).

### Bonuses as Wages Under State Law

Applicable state and local wage and hour laws may impose different or additional requirements regarding bonuses. For example, some state wage and hour laws define:

- Discretionary bonuses differently than the FLSA.
- Wages as including certain bonuses, meaning that those bonuses are subject to applicable state wage and hour laws, including wage payment laws and penalties for non-payment.

For example, in Connecticut, whether a bonus is a wage depends on several factors, including whether:

- A contractual obligation to pay the bonus exists.
- The amount of the bonus is discretionary.
- The bonus is linked exclusively to the employee's performance.

(See Conn. Gen. Stat. §§ 31-71a to 31-72; *Ass'n Res., Inc. v. Wall*, 2 A.3d 873, 892-97 (Conn. 2010); *Weems v. Citigroup, Inc.*, 961 A.2d 349, 355-57 (Conn. 2008)).

In New York, discretionary bonuses are not part of the regular rate of pay for overtime purposes. They also are not considered wages if they are more like a profit-sharing arrangement than compensation for labor or services rendered and both:

- The employer has the discretion to determine the amount.
- The bonus is based on the employer's performance, not the employee's individual performance or productivity.

(*Truelove v. Ne. Capital & Advisory, Inc.*, 95 N.Y.2d 220, 224 (2000).)

Similarly, discretionary bonuses that are conditioned on continued at-will employment are not considered wages under the Massachusetts Wage Act (see, for example, *Lelio v. Marsh USA, Inc.*, 2017 WL 3494214, at \*10 (D. Mass. Aug. 14, 2017)).

Conversely, a guaranteed bonus can be considered wages, however, and failure to pay it may subject the employer to penalties under other state laws (see, for example, *Ryan*, 19 N.Y.3d at 14) (bonus deemed wages under New York Labor Law)). Under California law, bonuses and other incentive compensation, such as restricted stock and profit-sharing plans, may also constitute wages (Cal. Lab. Code § 200; *Schachter v. Citigroup, Inc.*, 2018 P.3d 262, 268 (Cal. 2009)).

Once a payment is considered wages, employers generally lose the ability to recover or claw back any payment from the employee (see Practice Note, *Clawbacks of Bonuses and Commissions: Wage and Hour Considerations* (6-527-3445)). Withholding payment of a bonus that is deemed wages also may violate state wage payment laws (see, for example, *Riseman v. Advanta Corp.*, 39 F. App'x 761, 765 (3d Cir. 2002) (holding that the Pennsylvania Wage Payment and Collection Law applies to a discretionary bonus that was fully earned before termination of employment)).

Many cases are litigated based on ambiguities about when bonuses are earned or to be paid. For example, in *DeMonaco v. Czech Asset Management*, the court found that the bonus plan requirement that an employee be employed on the "bonus payment date" was

ambiguous, and denied summary judgment on that basis (2016 WL 4536442, at \*4 (D. Conn. Aug. 30, 2016)). Courts generally honor the terms of the parties' agreement in determining when a bonus is deemed earned (see, for example, *Pachter v. Bernard Hodes Grp., Inc.*, 861 N.Y.S.2d 246 (N.Y. 2008)). Employers therefore should clearly define in any bonus agreement or plan when the bonus is earned, which may or may not be the same date on which it is paid.

For a sample bonus plan, see Standard Document, Annual Cash Bonus Plan (2-507-0586).

### Bonus Payout on Termination

Any bonus agreement or plan should specify how the employee's bonus eligibility is affected by an employment termination. This is often a hotly contested issue at the time of termination (especially for employees terminated near the end of a bonus cycle) because the bonus often comprises a large percentage of the employee's annual compensation.

For purely discretionary bonuses, the employer generally has the option of how much bonus to pay, if anything, following an employment termination. Courts have held that compensation conditioned on an employee remaining employed as of a certain date or the occurrence of some other event is not wages (*Bader v. Wells Fargo Home Mtg. Inc.*, 773 F Supp. 2d 397, 417 (S.D.N.Y. 2011)). Best practice therefore is to specifically state that the employee must be employed, and not have given notice of resignation or received notice of termination by the employer, on the date the bonus is paid to be eligible for any payment at all.

For executives and other employees with performance-based bonus plans, employers typically structure these agreements so that employees are only entitled to payment if they are employed on either or both:

- The last day of the performance period (often the last day of the calendar year).
- The bonus payment date (which can be months later).

Some agreements or plans provide that if employer terminates the relationship without cause or the employee triggers a termination for good reason (if defined in a contract) and the business meets its performance goals at the end of the performance period, the employee is entitled to a prorated portion of the bonus that would have been paid had the employee remained employed for the entire performance period.

Many large investment banks and brokerage firms pay employee bonuses with a mix of stock and cash. The stock (and sometimes a portion of the cash award) typically is deferred and vests over several years. Employees who leave voluntarily or are terminated for cause generally forfeit any unvested bonus amounts. Deferred payments may have significant tax consequences for both the employer and the employee, although a detailed discussion of these topics are beyond the scope of this Note (see Practice Note, *Overview of the Taxation of Equity Compensation Awards* (7-505-9204) and *Taxation of Equity Compensation Awards Chart* (9-518-2627)).

Employers should be aware that seeking repayment of or clawing back compensation already paid implicates various legal issues under state and federal law, such as wage and hour considerations, taxation, and regulatory schemes. For more on clawbacks, see:

- Practice Note, Clawbacks of Bonuses and Commissions: Wage and Hour Considerations ([6-527-3445](#)).
- Practice Note, Taxation of Clawbacks ([w-004-7935](#)).
- Standard Document, Clawback Policy ([9-578-1045](#)).
- Article, What's Market: Clawback Provisions in Executive Employment Agreements ([9-583-0866](#)).

### COMMISSIONS FOR RETIRING FINRA-REGISTERED REPRESENTATIVES

FINRA generally prohibits paying commissions to unregistered persons. However, FINRA Rule 2040, which became effective on August 24, 2015, allows retired representatives to continue receiving trailing commissions under certain conditions.

Under Rule 2040, a broker-dealer can pay continuing commissions on existing brokerage accounts to its retiring registered representatives after their association with the firm ends if both:

- A bona fide contract between the broker-dealer and the retiring registered representative provides for the payments and the contract:
  - was entered into in good faith while the person was a registered representative of the firm; and
  - among other things, prohibits the retiring registered representative from soliciting new business, opening new accounts, or servicing the accounts generating the continuing commission payments.
- The arrangement complies with applicable federal securities laws, Exchange Act rules, and regulations.

(FINRA R. 2040(b)(1).)

“Retiring registered representative” means an individual who retires from a broker-dealer (including as a result of a total disability) and leaves the securities industry. In the case of death of the retiring registered representative, the retiring registered representative’s beneficiary designated in the written contract, or the retiring registered representative’s estate if no beneficiary is designated, may be the beneficiary of the respective member’s agreement with the deceased representative. (FINRA R. 2040(b)(2).)

For more on payments to unregistered persons, see Legal Update, FINRA Issues Regulatory Notice on Payments to Unregistered Persons ([8-605-7425](#)).

### FORGIVABLE LOANS AND PROMISSORY NOTES

As part of the competition for a finite talent pool, financial services firms must incentivize brokers, traders, and other employees to move from what is often a lucrative position at competitor. Many firms use a combination of forgivable loans secured by promissory notes as the functional equivalent of a signing (or retention) bonus to provide a newly recruited employee with upfront cash (see Standard Document, Employee Retention Bonus Agreement ([8-519-2962](#))). This compensation technique in turn incentivizes employees to remain with the new employer, because significant financial consequences are involved if they jump ship again too soon.

Forgivable loan arrangements typically condition the employee’s repayment obligations on their continued employment with the new employer for a period of time. The employer makes the loan when

employment begins and typically forgives the loan balance in equal annual installments over a number of years. (The structure of the loan forgiveness may have tax consequences which are beyond the scope of this Note.) The employee generally signs a promissory note that memorializes the terms of the loan and gives the employer a simple mechanism for enforcement.

Forgivable loan amounts vary, but generally are calculated based on a percentage (often more than 100%) of the revenues generated by the broker in the last year.

If the employee leaves or is fired for certain reasons before the full loan amount is forgiven, the unforgiven prorated share of the principal, with interest, becomes immediately due and payable. The outstanding amount is secured by a promissory note signed by the employee in connection with the initial loan and begins to accrue interest and penalties according to the terms of the note. The promissory note aids the employer if it needs to pursue legal action to collect repayment. These actions are arbitrated before FINRA and governed by specific rules for promissory note proceedings (see FINRA R. 13806 and FINRA Industry Arbitration of Employment Disputes).

Employers should be aware that federal, state, and local laws may impose restrictions on the ability to recover payments from an employee’s paycheck or from any other payment deemed wages under applicable law. For more information on recovering advance payments and loans made to employees, see Practice Notes:

- Clawbacks of Bonuses and Commissions: Wage and Hour Considerations: Alternative Payment Structures ([6-527-3445](#)).
- Recovering Money and Property from Employees ([w-003-2962](#)).

### WORKPLACE POLICIES AND PRACTICES

Financial services employers typically implement many policies and workplace practices used by employers in other industries. For more on employee handbooks and workplace policies generally, see Practice Note, Employee Handbooks: Best Practices ([4-513-9448](#)) and Employee Handbook Toolkit ([0-517-9417](#)). However, because of the complex regulatory environment in which they operate, some types of policies require special consideration, such as:

- Discrimination, diversity, and pay equity (see Discrimination, Diversity, and Pay Equality).
- Vacation and time off policies (see Mandatory Two-Week Vacation Policies).
- Social media policies (see Social Media Policies).
- Bring your own device (BYOD) policies (see BYOD Policies).
- Personnel-related recordkeeping policies (see Broker-Dealer Recordkeeping Requirements).

### DISCRIMINATION, DIVERSITY, AND PAY EQUALITY

Sex discrimination claims are unfortunately common in the historically male-dominated financial services industry. These claims can be premised on numerous forms of discrimination, including:

- Sex stereotyping.
- Sexual harassment.
- Pay inequities.

- Double-standards in workplace discipline (see National Bureau of Economic Research, NBER Working Paper No. 23242 Summary (Mar. 2017, rev'd Jan. 2018)).

Financial services employees also complain of discrimination based on other protected categories, including, but not limited to:

- Age.
- Race.
- Religion.
- Disability.

Lawsuits against major financial services employers include claims by the Equal Employment Opportunity Commission (EEOC) for sexual harassment and class action lawsuits for sex discrimination and race discrimination, some of which settled for more than \$30 million each (see, for example, *Slaughter v. Wells Fargo Advisors, LLC*, 2017 WL 3128802 (N.D. Ill. May 4, 2017) (order approving class settlement)).

For more on sexual harassment verdicts and settlements generally, see Individual Sexual Harassment Jury Awards and Settlements Chart: Overview ([3-589-7845](#)).

Some have blamed the prevalence of sex discrimination and harassment claims in this industry on the secrecy provided by FINRA's mandatory arbitration provisions. However, FINRA eliminated sex discrimination claims from its mandatory arbitration requirements in 1999. Rule 13201 of the FINRA Code of Arbitration for Industry Disputes now provides:

A claim alleging employment discrimination, including sexual harassment, in violation of a statute, is not required to be arbitrated under the Code. Such a claim may be arbitrated only if the parties have agreed to arbitrate it, either before or after the dispute arose. If the parties agree to arbitrate such a claim, the claim will be administered under Rule 13802 [governing statutory employment discrimination claims].

For more on FINRA arbitration, see FINRA Industry Arbitration of Employment Disputes.

In addition, the Tax Cuts and Jobs Act of 2018 further disincentivizes secrecy in settling sexual harassment claims. Under this law, employers settling claims alleging sexual harassment or abuse that include a confidentiality or nondisclosure provision in the settlement agreement cannot take a tax deduction for that settlement payment or related attorneys' fees. (26 U.S.C. § 162(q).)

For more on discrimination and harassment generally, see Practice Notes:

- Discrimination: Overview ([3-503-3975](#)).
- Sex Discrimination Under Title VII and the EPA ([9-601-1465](#)).
- Harassment ([9-502-7844](#)).
- Bullying in the Workplace ([1-518-8850](#)).

### SEC Diversity Initiatives

Effective June 10, 2015, the SEC and other administrative agencies issued an interagency policy statement establishing joint standards for assessing the diversity policies and practices of the entities they regulate, as required by Dodd-Frank (80 FR 33016) (Joint Standards).

The Joint Standards cover all entities with more than 100 employees that are regulated by the SEC (and the other agencies issuing the statement), and address:

- Organizational commitment to diversity and inclusion.
- Workforce profile and employment practices.
- Supplier diversity in procurement and business practices.
- Practices to promote transparency of organizational diversity and inclusion.

The Joint Standards do not impose a new obligations on employers and are voluntary. They are designed to encourage the voluntary self-assessment of a covered employer's own diversity policies and practices. The SEC further encourages, but does not require, annual reporting of this information to their regulating agencies through a Diversity Assessment Report.

For more information, see SEC: Joint Standards FAQs.

### Efforts to Remedy Pay Inequities

Although equal pay for equal work has been required for many years, pay inequity has become a hot-button issue for regulators, state and local governments, and activists. Studies have shown that the financial services and insurance industries have some of the highest pay gaps. For example, an April 2017 study by the Institute for Women's Policy Research reports that the occupation with the largest gender wage gap is "personal financial advisor," with women earning just over half of what their male counterparts make (IWPR #C456, Apr. 2017).

Recent efforts to address pay inequities include:

- **Eliminating pay secrecy.** The NLRB has long taken the position that employers cannot restrict employees from discussing their terms and conditions of employment, including compensation, with other employees. Recently several states and localities have passed equal pay laws addressing pay secrecy, such as :
  - The California Fair Pay Act, effective January 1, 2016 (Cal. Labor Code § 1197.5), which prohibits policies or practices that prevent employees from discussing or disclosing their own compensation, discussing the wages of others, inquiring about another employee's wages, or aiding or encouraging other employees in exercising their rights under the law (see Article, Expert Q&A on the Impact of California's Fair Pay Act ([w-001-8325](#)));
  - Connecticut's Act Concerning Pay Equity and Fairness, effective October 1, 2015 (Public Act No. 15-196), which makes it illegal for employers to prevent employees from sharing wage information, or retaliating against anyone who asks about, discusses, or discloses this information (see Legal Update, Epstein Becker: Connecticut Passes Pay Equity Act and Intern Protections ([w-001-8325](#)));
  - Massachusetts' Act to Establish Pay Equity, effective January 1, 2018 (see Legal Update, Fisher Phillips: Massachusetts Pay Equity Law Passed ([w-002-9154](#))), a broad pay equity law which, among other things, bans any pay secrecy policy or practice that prohibits employees from asking about, discussing, or disclosing wage information (but does not require employees to disclose pay information); and

- New York's Achieve Pay Equity Act, effective January 19, 2016, which makes it unlawful for an employer to pay an employee less than an employee of the opposite sex for equal work, or to prohibit employees from inquiring about, discussing, or disclosing their own wages or the wages of another employee (N.Y. Lab. Law § 194) (see NYSDOL: Guidance on Pay Equity for Employers in New York State).
- **Investor activism.** In an effort to promote pay equality, activist investors have begun to exert pressure on large financial institutions to disclose compensation information. Some of these investors have filed proposals with large financial services institutions demanding that they publish statistics about the race and gender of employees and their respective compensation information. Goldman Sachs, Citigroup, and Bank of New York Mellon committed to either disclose the results of gender pay assessment or enhance pay equity disclosure. However, in 2017, Bank of America, Wells Fargo, and JP Morgan Chase each rejected similar proposals.
- **Banning salary history inquiries.** Several state and local laws restrict employers from inquiring about salary histories in the interview and hiring process to prevent wage gaps from following women from job to job. These laws generally prohibit employers from asking about or considering past salaries and typically allow those inquiries only after the employer has made an employment offer that includes compensation. Compliance with salary history bans requires a dramatic departure from what has been common practice in the industry. Bans exist in several jurisdictions where financial services employers have substantial operations, such as New York City and California.
- For more information on salary history bans, see Practice Note, State and Local Salary History Bans ([w-005-9410](#)) and State and Local Salary History Laws Chart: Overview ([w-011-0681](#)). For a sample policy designed to comply with salary history ban laws, see Standard Document, Salary History Inquiry Policy ([w-010-9908](#)). For more information on hiring requirements and restrictions, see Hiring Requirements: State Q&A Tool.
- employees with the ability to change official records of the institution.
- Requires covered employees to take an uninterrupted vacation of two weeks (or ten business or trading days) annually for risk management purposes (or alternatively, take off one week combined with a one-week rotation of duties with another employee).
- Prohibits covered employees from physically or electronically entering the workplace or conducting business for the employer during the vacation period.
- Requires others to assume the absent employee's duties as a critical part of the employer's internal controls and fraud prevention efforts (see, for example, FDIC Manual of Examination Policies, Internal Routine and Controls: Vacation Policies).

Regulators that have endorsed and recommended mandatory two-week vacation or leave, the rotation of assignments, or a combination of both, include:

- **The FDIC.** The FDIC issued a Financial Institution Letter in 1995 restating the agency's long-standing position that vacation policies that encourage executives and employees to be absent from their positions for uninterrupted two-week periods each year are an effective internal control against fraudulent activities (FDIC, FIL-52-95, Aug. 3, 1995).
- **The Fed.** The Fed issued a Supervisory Guidance reemphasizing the importance of requiring a minimum of two consecutive weeks of vacation, rotation of duties, or combination of both, for sensitive employees, with a particular focus on employees who:
  - have authority to execute transactions;
  - have signing authority;
  - have access to the bank's books and records;
  - have the ability to influence the above activities;
  - are engaged in trading and wire transfer operations; and
  - have reconciliation or other back office responsibilities.
- (DRB: Supervisory Letter SR 96-37 (SUP), Dec. 20, 1996.)
- Many state Federal Reserve Banks, including the Federal Reserve Bank of New York (FRBNY), issued circulars to the CEOs of their regulated institutions communicating the Fed's guidance (see, for example, FRBNY Circular No. 10923, Feb. 10, 1997).
- **The OCC.** The OCC's handbook on internal controls recommends that internal risk control policies require that officers and employees in sensitive positions be absent for two consecutive weeks each year (OCC, Internal Controls, Comptroller's Handbook (2001)).
- **FINRA.** FINRA's regulatory notice highlights sound practices for preventing and detecting unauthorized proprietary trading and urges that FINRA-regulated firms to:
  - consider a mandatory vacation policy as part of their internal controls; or
  - if a mandatory vacation policy is not feasible, implement a system to identify and review the trading activity of traders who did not take an extended vacation in the last year.
- (FINRA Reg. Notice 08-18, Unauthorized Proprietary Trading, April 2008.)

## MANDATORY TWO-WEEK VACATION POLICIES

Regulated financial institutions must implement internal controls to detect and prevent fraudulent practices, such as embezzlement or unauthorized (rogue) securities trading. Though not mandated by law, federal and state bank and securities regulatory agencies recommend implementing mandatory vacation policies as part of an effective internal control protocol. The regulating bodies recommend these policies to deter fraud or other illegal schemes of any substantial size that generally require the perpetrator's constant presence to manipulate records, respond to inquiries from customers or others, and otherwise cover their tracks.

Many regulators include an evaluation of a company's mandatory vacation policy in their written agency or examiner guidance. Although the recommendations vary by agency, they generally recommend a mandatory vacation policy that:

- Covers, at a minimum, those employees in sensitive positions, including:
  - officers;
  - employees involved in trading or other transactional business; and

- **The SEC Office of Compliance, Inspections, and Examinations (OCIE).** An OCIE 2012 Risk Alert recommends mandatory vacations for traders and certain other personnel as a starting point of unauthorized trading detection. The SEC suggests that the employer combine the employee's absence with a carefully considered reassignment of the employee's duties and denial of firm access (physically and electronically) during the time away. (OCIE, National Examination Risk Alert, Vol. II, Issue 2, Feb. 27, 2012.)

This collective agency guidance informs best practice in the financial services industry. Many banks, broker-dealers, and other regulated financial institutions have implemented mandatory vacation policies that conform, at least in part, to the regulators' recommendations.

For a sample mandatory vacation policy with detailed drafting notes, see Standard Document, Mandatory (Two-Week) Vacation Policy ([w-005-7019](#)).

### SOCIAL MEDIA POLICIES

Employers often adopt social media policies to limit employees' personal use of the employer's computer systems and protect the employer from various associated risks. A social media policy can be drafted as a comprehensive stand-alone document (see, for example, Standard Document, Social Media Policy (US) ([5-501-1524](#))) or as a more concise section of a general IT resources and communications systems policy (see, for example, Standard Document, IT Resources and Communications Systems Policy ([8-500-5003](#))).

Employers that actively encourage or require their employees to use social media for marketing, recruiting, or other business purposes should also set guidelines for this use, in addition to adopting a social media policy (see, for example, Standard Document, Company Social Media Use Guidelines ([9-501-1640](#)) and Standard Clauses, Employer Ownership of Social Media Accounts Clauses ([3-531-8025](#))).

Beyond the standard social media policy and guideline recommendations, financial services employers must be aware of other requirements and recommendations when their employees use social media to communicate with their customers and the public, including guidance from:

- FINRA.
- The SEC.
- The Federal Financial Institutions Examination Council (FFIEC).

### FINRA Regulatory Notices

FINRA has issued several regulatory notices with guidance about how FINRA rules governing communications with the public apply to social media sites that are sponsored by a firm or its registered representatives. In 2010, it issued a notice with the goal of allowing firms to communicate with clients and investors using social media technology while ensuring that:

- Investors are protected from false or misleading claims and representations.
- Firms can effectively and appropriately supervise their associated persons' participation in social media sites.

(FINRA Reg. Notice 10-06, 2010 WL 454615 (Jan. 25, 2010)).

The notice only addresses the social media use by a firm or its employees for business purposes, not for purely personal reasons. It confirms that FINRA and Exchange Act rules regarding communications apply to communications made on social media sites, noting that the content of the communication, and not the medium, determines the applicability of the rules.

Among those directives relevant to financial services firms as employers, the notice provides that firms:

- Are required to retain records of communications related to the broker-dealer's business that are made through social media sites as required under:
  - Rules 17a-3 and 17a-4 of the Exchange Act (17 C.F.R. §§ 240.17a-3, 240.17a-4); and
  - FINRA Rule 3110.
- (See Broker-Dealer Recordkeeping Requirements.)
- Must adopt policies and procedures reasonably designed to ensure that their associated persons who participate in social media sites for business purposes:
  - are appropriately supervised;
  - have the necessary training and background to engage in these activities; and
  - do not present undue risks to investors.

(See also FINRA Reg. Notice 11-29 (Aug. 2011).)

FINRA has since issued additional guidance about social media and digital communications, addressing issues such as:

- Text messaging.
- Business versus personal communications.
- Hyperlinking.
- Native advertising.
- Testimonials.

(FINRA Reg. Notice 17-18 (Apr. 2017).)

For more on FINRA requirements, see Practice Note, Broker-Dealers Use of Social Media: FINRA Rule 2210 ([w-000-6136](#)) and FINRA Guidance on Use of Social Media ([w-000-6136](#)).

### 2012 SEC Risk Alert

Registered investment advisers' social media use must comply with various provisions of the federal securities laws, including provisions concerning:

- Antifraud.
- Compliance.
- Recordkeeping.

The SEC has recognized the growing use of social media by investment firms and issued guidance to firms that allow its use (see SEC Risk Alert: Investment Adviser Use of Social Media (Jan. 4, 2012)).

In the Risk Alert, the SEC reports its observations about various social media policies and practices and how they intersect with firms' securities compliance obligations. The SEC recommends, for example, that:

- Many firms have conflicting policies regarding electronic communications (internal and external) that may specifically cover social media usage and therefore are confusing. The SEC identifies a list of non-exhaustive factors to consider when evaluating a compliance program regarding social media use.
- Firms may want to establish policies governing third-party postings on their social media sites to avoid any violation of securities laws regarding investment adviser advertising. For example, a customer “liking” a post may be viewed as a testimonial, which is prohibited under the Adviser Act (see Practice Note, Investment Adviser Advertising: Testimonials ([w-002-2408](#)) and SEC Division of Investment Management Guidance Update 2014-04 Guidance on the Testimonial Rule and Social Media (Mar. 2014)).
- Investment advisers should review their document retention policies to ensure that they retain records created by social media communications as required by the federal securities laws, including in a manner that is easily accessible for a period not less than five years. For a sample policy, see Standard Document, Document Retention Policy ([0-503-1765](#)).

In addition, the SEC adopted amendments to several Advisers Act rules and investment advisor registration and reporting forms to enhance reporting and disclosure of information by investment advisers. Among other things, investment advisers are now required to disclose all the adviser’s websites and all publicly available social media platforms where the adviser has a presence for which it controls the content (such as Twitter, Facebook, or LinkedIn).

For more on broker-dealer social media communications, see Practice Note, Broker-Dealers Use of Social Media ([w-000-6136](#)). For more on broker-dealer communications generally, see Practice Note, FINRA Communications with the Public Rules ([8-609-5540](#)).

### March 2013 SEC Risk Management Guidance

Though not directly related to employment practices, in March 2013, the SEC issued further guidance about what content must be filed with the SEC. The guidance clarifies the obligations of mutual funds and other investment companies to seek review of materials posted on their social media sites. (SEC: IM Guidance Update: Filing Requirements for Certain Electronic Communications, No. 2013-01 (March 2013).)

### December 2013 FFIEC Guidance

In December 2013, the FFIEC issued its Social Media: Consumer Compliance Risk Management Guidance (Guidance). The Guidance addresses the applicability of federal consumer protection and compliance laws, regulations, and policies to financial institutions’ social media activities. The Guidance is used by the principal financial institution regulatory agencies, including:

- The OCC.
- The Fed.
- The FDIC.
- The CFPB.
- The National Credit Union Administration (NCUA).

These agencies apply the Guidance in supervising the financial institutions they regulate, including:

- Banks.
- Savings associations.

- Credit unions.
- Nonbank entities supervised by the CFPB.

The FFIEC also encourages state financial institution regulatory agencies to adopt the Guidance.

Under the Guidance, each financial institution is expected to:

- Carry out an appropriate risk assessment that takes into consideration its social media activities.
- Maintain a risk management program that is appropriate and tailored to the financial institution’s size, activities, and risk profile.

A financial institution’s social media risk management program should include:

- A governance structure with clear roles and responsibilities for the institution’s board of directors or senior management to:
  - explain how social media use contributes to the strategic goals of the institution; and
  - establish controls and ongoing risk assessment for social media activities.
- Policies and procedures:
  - on the use and monitoring of social media and compliance with all applicable consumer protection laws and regulations and regulatory guidance; and
  - incorporating methodologies to address risks from online postings, edits, replies, and retention.
- A process for selecting and managing third-party relationships in connection with social media.
- An employee training program that incorporates:
  - the institution’s policies and procedures for official, work-related use of social media; and
  - other uses of social media, including defining impermissible activities.
- An oversight process for monitoring information posted to proprietary social media sites administered by the financial institution or a contracted third party.
- Audit and compliance functions to ensure ongoing compliance with internal policies and all applicable laws and regulations and incorporation of guidance as appropriate.
- Parameters for providing appropriate reporting to the financial institution’s board of directors or senior management that enable periodic evaluation of the effectiveness of the social media program and whether the program is achieving its stated objectives.

For more on managing social media risks, see Practice Note, Financial Institutions’ Guide to Managing Social Media Risks ([w-001-7621](#)) and Standard Document, Financial Institutions’ Guide to Managing Social Media Risk: Presentation Materials ([w-011-1162](#)).

### BYOD POLICIES

Financial service employers routinely use bring your own device (BYOD) policies. Mobile devices are especially attractive for employees who travel frequently, such as salespeople, insurance brokers, and senior executives. Many firms have started using tablets, such as iPads, to access spreadsheets and other financial documents that are not easily viewed on a mobile phone.



The widespread use of mobile devices presents key challenges for financial services employers, including:

- Compliance with FINRA regulations regarding social media communications.
- Data security.
- Wage and hour issues.

### Accessing Social Media Sites from Personal Devices

FINRA allows associated persons to use personal communication devices to access firm business applications only if the firm uses technology that enables it to retain, retrieve, and supervise business communications. FINRA suggests that the firm be able to separate business and personal communications with the use of applications. FINRA further states that if the firm can separate business and personal communications and has adequate electronic communications policies and procedures regarding usage, the firm is not required to supervise the personal emails on these devices. It can, however, if it chooses, treat all communications made on those personal devices as business related.

For more information, see FINRA Reg. Notice 11-39 (Aug. 2011).

### Data Security

Because of the nature of the financial data and information that flows through their systems, employees' personal devices remain particularly vulnerable to and are often targeted in hacking attacks. Financial services employers must balance the benefits of a mobile and ever-available workforce with risk management regulations and the challenges of maintaining secure systems and applications. Employers that want employees to use their own mobile devices must implement policies, procedures, and applications that protect their customers' sensitive personal and financial information. This is especially true given data breach regulations that apply to financial services employers. For more on data security, see Practice Notes, US Privacy and Data Security Law: Overview ([6-501-4555](#)) and Data Security Risk Assessments and Reporting ([w-002-2323](#)).

### Wage and Hour Issues

Although not unique to the financial services industry, employers also must ensure that their policies comply with state and local laws regarding the reimbursement of cell and data expenses. For example, in California, an employer must indemnify an employee for all necessary expenses or losses incurred due to the discharge of the employee's duties (Cal. Lab. Code § 2802). This includes reimbursing employees for personal cell phone usage if they use their phones for work, even if the employee has unlimited minutes (*Cochran v. Schwan's Home Serv., Inc.*, 228 Cal. App. 4th 1137, 1144 (2014); see Practice Note, Managing Wage and Hour Issues Under California Law: Overview ([w-006-6630](#))).

Another challenge (though also not unique to financial services firms) stems from the after-hours use of mobile devices by nonexempt employees. If employees actually use their devices for work, the employers must compensate them for this time, which in turn may trigger overtime obligations. Employers should consider how they will manage (or prohibit) after-hours use and record all compensable working time if nonexempt workers use mobile devices for business purposes.

For a sample BYOD policy, see Standard Document, Bring Your Own Device (BYOD) to Work Policy ([1-521-3920](#)). For more on employer's obligations to compensate employees for all hours worked, see Practice Note, Compensable Time ([9-508-0191](#)).

### BROKER-DEALER RECORDKEEPING REQUIREMENTS

SEC Rules 17a-3 and 17a-4 implemented under Section 17(a)(1) of the Exchange Act require broker-dealers to create and maintain certain records relating to their business (17 C.F.R. §§ 240.17a-3, 240.17a-4). Other SEC and FINRA rules also require the creation and maintenance of specific records.

For example, broker-dealers must create and retain certain information concerning their employees, including:

- **Employee questionnaires.** Broker-dealers must maintain these records for all employees except for clerical and ministerial personnel for at least three years until after the termination of employment (17 C.F.R. §§ 240.17a-3(a)(12), 240.17a-4(e)(2); see Employee Questionnaires).
- **Form U4.** Broker-dealers must maintain a copy of each registered person's Form U4 registration form, filed with FINRA using the CRD system, including all amendments (see Form U4 (Uniform Application for Securities Industry Registration or Transfer)).
- **Fingerprinting records.** Rule 17a-3(a)(13) requires that broker-dealers obtain a processed fingerprint card for each partner, director, officer, and employee unless an exemption applies under SEC Rule 17f-2 (17 C.F.R. §§ 240.17a-3(a)(13) (see Fingerprinting)). If the firm claims an exemption from the fingerprinting requirement, it must retain in its files a current statement entitled Notice Under Rule 17f-2 containing specified information about why it is exempt.
- Employers must keep fingerprint records for at least three years after termination of employment. These records may be:
  - maintained and preserved on behalf of the covered employer by an SRO that is also the designated examining authority for that member, broker, or dealer; or
  - produced or reproduced on microfilm and preserved in that form.
- **Compensation information.** Under SEC Rule 17a-3(a)(19), broker-dealers must make a record of all agreements, written and oral, regarding the employment or contractual relationship between the firm and each of its associated persons, including a summary of each person's compensation arrangements (17 C.F.R. §§ 240.17a-3(a)(19)). These include, where applicable:
  - commission schedules;
  - a record describing the method by which compensation is determined, if other than on a per trade basis;
  - a record listing all purchases and sales of securities attributable to the person for compensation purposes, including the amount of compensation, all commissions, concessions, overrides, and other compensation to the extent earned or accrued; and
  - a description of any non-monetary compensation and an estimate of its value.
- Certain social media communications (see Social Media Policies).

For more on broker-dealer recordkeeping requirements, see Practice Note, Broker-Dealer Recordkeeping ([w-000-4869](#)) and Broker-Dealer Recordkeeping Checklist ([w-000-4517](#)).

For more about employers' recordkeeping requirements generally, see:

- EEOC Record Retention Schedule ([2-520-7570](#)).
- OSHA Record Retention Schedule ([0-520-8617](#)).

## WHISTLEBLOWER ANTI-RETALIATION PROTECTIONS AND BOUNTY AWARDS

### SOX AND DODD-FRANK

SOX was enacted in response to corporate and accounting scandals at major public companies like Enron and WorldCom. It aims to promote corporate accountability, protect investors, and protect whistleblowers (for example, employees who report certain misconduct). Dodd-Frank amended SOX in 2010 and created new protections and incentives for whistleblowers to report corporate wrongdoing to regulators (see SOX and Dodd-Frank Anti-Retaliation Provisions).

On May 25, 2011, the SEC released a set of finalized rules to implement the whistleblower provisions in Section 922 of Dodd-Frank (15 U.S.C. § 78u-6; 17 C.F.R. §§ 240.21F-1 to 240.21F-17). OSHA released final regulations revising the procedures for handling SOX whistleblower claims that became effective March 5, 2015 (29 C.F.R. §§ 1985.100 to 1985.115). Dodd-Frank also includes additional whistleblower protections for certain financial services employees (see Section 1057 Anti-Retaliation Protections for Financial Services Employees).

Dodd-Frank mandates that the SEC provide a monetary award to individuals who voluntarily provide original information to the SEC that results in a successful action (as defined by the statute) in which the SEC collects over \$1 million in monetary sanctions.

(15 U.S.C. §§ 78u-6(a)(1), (b)(1).)

The whistleblower's original information must relate to a possible past, ongoing, or imminent future violation of the federal securities laws, including any of their rules and regulations (17 C.F.R. § 240.21F-2(a)(1); see also 15 U.S.C. § 78u-6(a)(6)). SOX is included among the "federal securities laws."

Although a full discussion of these provisions are beyond the scope of this Note, the CFTC has a similar bounty award program implemented by Section 748 of Dodd-Frank (7 U.S.C. § 26).

For more on SOX and Dodd-Frank generally, see Practice Note, *Whistleblower Protections Under Sarbanes-Oxley and the Dodd Frank Act* ([7-501-7799](#)).

Congress has proposed legislation (not yet passed in the Senate) that would prohibit whistleblowers from obtaining an award if they are "responsible for, or complicit in, the violation of the securities laws for which the whistleblower provided information to the SEC" (Financial Choice Act of 2017 (H.R. 10), Section 828 (amending 15 U.S.C. § 78u-6(c))).

### SOX AND DODD-FRANK ANTI-RETALIATION PROVISIONS

SOX Section 806 prohibits adverse employment actions against whistleblowers (18 U.S.C. § 1514A).

SOX provides whistleblower protections for individuals who report about any action or inaction that the individual reasonably believes is a violation of a covered law to:

- Federal regulatory bodies or law enforcement agencies.
- Members of Congress or congressional committees.
- Supervisors or persons authorized by the employer to investigate, discover, or terminate misconduct.

(18 U.S.C. § 1514A(a)(1).)

Unlike other whistleblower laws, SOX does **not** include a monetary incentive to reward whistleblowers.

To be covered under Section 922 of Dodd-Frank, whistleblowers must report a violation of securities laws under the SEC's jurisdiction or commodities laws under the CFTC's jurisdiction. Complaints about violations of general banking regulations are not covered (see, for example, *Boyle v. Evolve Bank & Trust*, 2017 WL 3075157, at \*5 (W.D. Tenn. July 19, 2017) (Dodd-Frank whistleblower protection provision is not a "general-purpose anti-retaliation provision"); *Zillges v. Kenney Bank & Trust*, 24 F. Supp. 3d 795, 801 (E.D. Wis. 2014)).

Unlike with SOX, which covers internal as well as external whistleblowing, an individual generally must report information to the SEC to meet the definition of a whistleblower under Section 922 of Dodd-Frank (*Digital Realty Trust, Inc. v. Somers*, 2018 WL 987345 (Feb. 21, 2018); but see Section 1057 Anti-Retaliation Protections for Financial Services Employees). Qualified whistleblowers who report both to the SEC and internally but suffer retaliation only **because of** their internal report are protected by Dodd-Frank (*Digital Realty*, 2018 WL 987345, at \*11).

### Section 1057 Anti-Retaliation Protections for Financial Services Employees

Section 1057 of Dodd-Frank prohibits "covered persons" or "service providers" from terminating or discriminating against any "covered employee" (as defined below) or authorized representative of covered employees because that employee or representative has done any of the following:

- Provided, caused to be provided, or is about to provide or cause to be provided information to the employer, the CFPB, or any other state, local, or federal governmental authority relating to any violation of or any act or omission that the employee reasonably believes to be a violation of any provision of Title X of Dodd-Frank (the Consumer Protection Act) or any other provision of law subject to the CFPB's jurisdiction.
- Testified or will testify in any proceeding resulting from the administration or enforcement of any provision of the Consumer Protection Act or any other provision of law subject to the CFPB's jurisdiction.
- Filed, instituted, or caused to be filed or instituted any proceeding under any federal consumer financial law.
- Objected to or refused to participate in any activity, policy, practice, or assigned task that the employee reasonably believed to be in violation of any law, rule, order, standard, or prohibition subject to the jurisdiction of or enforceable by the CFPB.

(12 U.S.C. § 5567(a).)

"Covered employee" means any individual performing tasks related to the offering or provision of a consumer financial product or service (12 U.S.C. § 5567(b)).

“Covered person” means any person who engages in offering or providing a consumer financial product or service and any affiliate of that person if the affiliate acts as a service provider to that person (12 U.S.C. § 5481(6)).

“Service provider” means any person who provides a material service to a covered person in connection with the offering or provision by that covered person of a consumer financial product or service (12 U.S.C. § 5481(26)).

By definition, these anti-retaliation and anti-discrimination provisions are broader than the anti-retaliation provisions in Section 922 of Dodd-Frank because they protect employees who report wrongdoing only internally to their employers and do not require the covered employee to report information to the SEC, the CFPB, or any other governmental or administrative agency (*Digital Realty*, 2018 WL 987345, at \*9).

For more about whistleblower protections under SOX and Dodd-Frank, see Practice Note, Whistleblower Protection Under Sarbanes-Oxley and the Dodd-Frank Act ([7-501-7799](#)).

### Recent SOX and Dodd-Frank Awards

Since the whistleblower program began in 2011, the SEC has received over 22,000 tips. Enforcement actions attributed to those tips have resulted in the SEC’s collection of over \$975 million dollars and award of more than \$260 million to dozens of individuals. (SEC: 2017 Annual Report Whistleblower Program, pp. 10, 16; SEC Release No. 2018-44 (March 19, 2018).) The SEC continued to make substantial awards through the end of 2017 (see, for example, SEC Release No. 82214 (Dec. 5, 2017) (more than \$4.1 million award) and SEC Release No. 82181, (Nov. 30, 2017) (more than \$16 million award to two claimants)). On March 19, 2018, the SEC announced its highest ever Dodd-Frank whistleblower award of more than \$83 million split among three whistleblowers (SEC Release No. 2018-44 (March 19, 2018)).

### FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT (FIRREA)

Whistleblowers in the banking industry are protected by two other statutes that work together:

- The Financial Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which defines the substantive violations.
- Financial Institutions Anti-Fraud Enforcement Act (FIAFEA), which provides the reward mechanism.

Under FIRREA, the Department of Justice (DOJ) has authority to seek civil monetary penalties against entities and individuals for violations of the mail and wire fraud statutes affecting a federally insured financial institution (12 U.S.C. § 1833a). In deciding whether to pursue monetary penalties against corporate entities and the extent of any such penalties, the DOJ generally considers a variety of factors, including:

- The harm caused by the violation.
- Remediation undertaken by the entity.
- The number and seniority of individuals involved in the misconduct.

Actions by the DOJ are subject to a 10-year statute of limitations. A two-year limitations period applies to civil actions for retaliation (12 U.S.C. § 1833a(h)).

A whistleblower who provides original information about violations of various banking laws may be entitled to an award of the lesser of:

- 25% of the final penalty, restitution, or forfeiture.
- \$100,000.

(12 U.S.C. § 1831k.)

Under FIAFEA, an employee with information about a FIRREA violation must file a declaration with the DOJ (12 U.S.C. § 4201). If the DOJ collects an award based on original information in the whistleblower’s declaration, the whistleblower can receive an award of up to \$1.6 million, depending on the amount of recovery (12 U.S.C. § 4205(d)(1)).

FIRREA also protects employees of insured depository institutions (depository banks) and banking regulators from retaliation after engaging in protected activity. Protected activity requires that the employee report externally to a federal banking agency or the DOJ. A two-year statute of limitations applies to civil retaliation actions. (12 U.S.C. § 1831j.)

### EMPLOYMENT TERMINATIONS AND DISPUTE RESOLUTION SEPARATION AND SETTLEMENT AGREEMENTS

Many employment disputes resolve before trial, typically by entering into a separation or settlement and release agreement with the employee (for sample agreements, see Standard Documents, Separation and Release of Claims Agreement ([0-503-8253](#)) and Settlement and Release of Claims Agreement: Single Plaintiff Employment Dispute ([3-521-1350](#))). Financial services employers must be aware of certain requirements when entering into these agreements.

#### Confidentiality Provisions in Settlement and Other Agreements

Rule 21F-17 of the Dodd-Frank regulations prohibits an employer from impeding an individual from communicating directly with SEC staff about a possible securities law violation, including enforcing or threatening to enforce a confidentiality agreement that prohibits whistleblowers from communicating with the SEC (17 C.F.R. § 240.21F-17(a)).

In 2014, the SEC announced that it would strategically analyze and bring enforcement actions regarding severance, confidentiality, and employment agreements that violate Rule 21F-17. In connection with this well publicized, targeted enforcement sweep, the SEC filed its first enforcement action in April 2015 against KBR, Inc. for using improperly restrictive language in confidentiality agreements that had the potential to stifle the whistleblowing process (SEC Release No. 2015-54). In that first publicized action, the SEC did not address a severance, employment, or general confidentiality agreement or policy, but rather, an agreement that required witnesses to maintain the confidentiality of an employer’s internal compliance investigation. In that agreement, the witnesses acknowledged that they could face discipline or be fired if they discussed the substance of the interview with outside parties without prior approval from the company’s legal department. The SEC found this confidentiality language unlawful and required the company to:

- Pay a civil monetary penalty of \$130,000.
- Revise its confidentiality agreements to include specific language provided by the SEC.

On August 10, 2016, the SEC announced that it settled another enforcement action, this time against BlueLinx Holdings, Inc., for violating Rule 21F-17 by using certain confidentiality language in its severance agreements. The agreements required outgoing employees to:

- Waive their rights to monetary recovery should they file a charge or complaint with the SEC or other federal agencies.
- Notify the company before making any authorized disclosure in a legal or regulatory proceeding.

(SEC Release No. 2016-157.)

The SEC has since continued its aggressive oversight of separation and confidentiality agreements, with substantial repercussions for some employers. For more on the SEC's enforcement efforts, see Box, SEC Challenges to Separation Agreements and Confidentiality Provisions.

Although the settlement orders are not binding precedent, they signal the SEC's position regarding confidentiality provisions in settlement and other employment-related agreements, something employers should consider when drafting those provisions. The SEC also has announced that as part of its examinations of registered investment advisers and registered broker-dealers, it is reviewing, among other things, employment and severance agreements for compliance with Rule 21F-17 (SEC Office of Compliance Inspections and Examinations, National Exam Program Risk Alert, Oct. 24, 2016).

FINRA similarly advises that confidentiality provisions in settlement agreements should expressly authorize employee communications with securities regulators such as the SEC and recommends the following language:

Any non-disclosure provision in this agreement does not prohibit or restrict you (or your attorney) from initiating communications directly with, or responding to any inquiry from, or providing testimony before, the SEC, FINRA, any other self-regulatory organization or any other state or federal regulatory authority regarding this settlement or its underlying facts or circumstances.

(Regulatory Notice 14-40.)

Given the SEC's enforcement priorities and FINRA guidelines, companies regulated by the SEC and FINRA-regulated firms should:

- Review confidentiality restrictions and other relevant provisions in their agreements and handbooks.
- Consider whether and what remedial steps to take proactively to cure any issues with the language in these key documents.

For sample language that can be used in separation agreements, see Standard Document, Separation and Release of Claims Agreement: Confidentiality: Disclosure and Use Restrictions ([0-503-8253](#)).

Even when a company has revised its agreements voluntarily to comply with Rule 21F-17(a), the SEC may still impose monetary penalties and the potentially burdensome requirement of contacting former employees who signed the problematic separation agreements and informing those former employees that, notwithstanding money paid in connection with their separation agreements, they remain free to report any company wrongdoing (real or perceived) to the SEC.

### Other Key Provisions

Separation agreements may also contain garden leave provisions that extend the term of employment and prevent the departing employee from working elsewhere during the garden leave period (see Garden Leave).

Another often-negotiated term is what language the employer will use in describing the reason for the employee's termination on Form U5. For more information on Form U5, see Form U5 Termination Notice.

### FINRA INDUSTRY ARBITRATION OF EMPLOYMENT DISPUTES

FINRA operates the largest securities dispute resolution forum in the US, providing an arbitral forum to handle employment and investment disputes between and among investors, brokerage firms, and individual brokers.

The rules governing FINRA, including FINRA arbitration, are contained in the FINRA Rules, which apply to:

- All brokers and dealers who are registered with FINRA (Members).
- Any individual (associated person) in the investment banking or securities business who is directly or indirectly controlling or controlled by a member firm.

(FINRA R. 13200(a).)

By submitting their Form U4 securities registration application at the commencement of employment, employees agree to arbitrate:

... any dispute, claim or controversy that may arise between [them and their] firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the SROs indicated in Section 4 (SRO REGISTRATION) as may be amended from time to time and that any arbitration award rendered against [them] may be entered as a judgment in any court of competent jurisdiction.

(Rev. Form U4, § 15A (05/2009).)

Member firms must provide registered employees with an arbitration disclosure when they are asked to sign a U4, specifically informing them that they are waiving their right to sue in court, including the right to a jury trial, for any covered claims (FINRA R. 2263). Courts generally have found that the Form U4 and the accompanying disclosure statement constitute an enforceable arbitration agreement (but see Legal Update, Registered Representatives of Broker Dealers Now Required to Arbitrate Disputes in 49 States (New Jersey Says Otherwise ([w-000-7258](#)))).

The FINRA Code of Arbitration Procedure for Industry Disputes (Industry Code) governs the arbitration of disputes solely involving two or more member firms or associated persons (for example, cases between brokerage firms or between brokers and brokerage firms) (FINRA R. 13000). Employment disputes that are subject to mandatory FINRA arbitration are governed by the Industry Code. In addition to the rules governing industry arbitrations generally, the Industry Code provides specific rules for arbitrations involving promissory note proceedings and statutory employment discrimination claims (see Practice Note, FINRA Industry Arbitration: A Step-by-Step Guide: Promissory Note Proceedings ([w-000-4413](#)) and Statutory Employment Discrimination Claims ([w-000-4413](#))).

A dispute must be arbitrated under the Industry Code if it arises out of the business activities of a member or an associated person and is between or among:

- Members.
- Members and associated persons.
- Associated persons.

(FINRA R. 13200(a).)

Certain employment claims are **not** arbitrable under FINRA rules, including:

- Class actions.
- Collective actions under:
  - the FLSA;
  - the Age Discrimination in Employment Act (ADEA); or
  - the Equal Pay Act (EPA).

(FINRA R. 13204.)

Parties to certain employment disputes are not required to pursue their claims in an industry arbitration but may agree to do so. For example:

- Where a dispute involves a claim of statutory employment discrimination, the parties may arbitrate it only if they all agree, either before or after the dispute arises (FINRA R. 13201(a); see Practice Note, *FINRA Industry Arbitration: A Step-by-Step Guide: Statutory Employment Discrimination Claims* ([w-000-4413](#))).
- Where a dispute involves a claim under a whistleblower statute that prohibits predispute arbitration agreements, such as SOX, the parties may arbitrate it only if all parties agree after the dispute arises (FINRA R. 13201(b); see also Practice Note, *Whistleblower Protections Under Sarbanes-Oxley and the Dodd-Frank Act: Arbitration of Whistleblower Claims* ([7-501-7799](#)) and *Compliance with Dodd-Frank Anti-Arbitration Provisions*).

The types of employment claims most commonly brought before FINRA include:

- Breach of contract (including claims related to the payment of bonuses, commissions, and other compensation).
- Breach of a promissory note.
- Libel or slander based on the reason for an employment termination reported on a Form U5.
- Wrongful termination.

(FINRA Dispute Resolution Statistics: Top 15 Controversy Types in Intra-Industry Arbitrations.)

For more information on FINRA arbitration procedures and scope, see:

- Practice Note, *FINRA Industry Arbitration: A Step-by-Step Guide* ([w-000-4413](#)).
- FINRA Industry Arbitration Flowchart ([w-000-6674](#)).
- FINRA Arbitration Toolkit ([w-000-7422](#)).

## PRIVATE ARBITRATION AGREEMENTS

Many employers include predispute arbitration agreements as stand-alone covenants or as part of an employment agreement.

Under these arbitration agreements, any disputes that arise between the parties are resolved through mandatory arbitration rather than in the courts.

## Limitations on Waiver of FINRA Forum

Many financial service employees are bound by mandatory arbitration procedures under FINRA (see FINRA Industry Arbitration of Employment Disputes). FINRA Rule 13200 requires the arbitration of certain claims and therefore does not allow member firms to require associated persons to waive their right to arbitration in a predispute agreement (FINRA R. 13200; see *Thomas James Assoc. v. Jameson*, 102 F.3d 60, 66-67 (2d Cir. 1996) (representatives cannot waive arbitration entirely)). However, the courts and FINRA have differed about whether predispute arbitration agreements that mandate dispute resolution in an arbitral forum other than FINRA are enforceable.

Some courts had held that, despite the FINRA rules, an associated person can waive the right to resolve disputes in a FINRA forum in a private agreement and the parties may contractually agree to arbitrate in a non-FINRA forum (see, for example, *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Oliver*, 681 F. App'x 64, 65-66 (2d Cir. 2017 (summary order) (settlement agreement displaced agreement to arbitrate under FINRA Rule 13200)). FINRA, however, disagrees and has issued a regulatory notice clarifying that any member firm that enters into an agreement to arbitrate disputes in a forum other than FINRA violates FINRA rules and may be subject to disciplinary action (FINRA Reg. Notice 16-25 (July 2016)).

Even the regulatory notice, however, allows member firms to enter into private agreements to arbitrate in a non-FINRA forum if it is a non-exclusive forum. In these cases, FINRA recommends that firms state in their agreements that:

“This agreement does not prohibit or restrict you from filing an arbitration claim in the FINRA arbitration forum as specified in FINRA rules.”

Employers also may opt to provide that employment disputes are governed by FINRA, but provide for an alternative arbitration forum, such as AAA, if FINRA declines to arbitrate the controversy.

## Class and Collective Action Waivers

The courts also have enforced class and collective action waivers against individuals covered by FINRA. Class and collective actions cannot be arbitrated under FINRA (FINRA R. 13204(a)(1), (b)(1)). The rules also generally bar the arbitration of claims that are embedded in a class or collective action unless the individual withdraws from or opts out of the pending action (FINRA R. 13204(a)(2), (b)(2)). Although the rules are silent about the waiver of class and collective actions, the US Court of Appeals for the Second Circuit has found that nothing in the rules prevent courts from enforcing a waiver of those claims (*Cohen v. UBS Fin. Servs., Inc.*, 799 F.3d 174, 178-80 (2d Cir. 2015)).

## Compliance with Dodd-Frank Anti-Arbitration Provisions

Financial services employers using private predispute arbitration provisions for claims that are not subject to FINRA arbitration also must ensure that those provisions comply with Dodd-Frank's anti-arbitration provisions. Dodd-Frank prohibits agreements requiring predispute arbitration of SOX claims and specifically states that

“[n]o predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section” (18 U.S.C. § 1514A(e)(2)). This broad language initially raised concerns with employers that arbitration agreements could be invalidated in their entirety if the agreements did not expressly carve out SOX claims.

The federal circuit courts of appeals generally have interpreted this prohibition narrowly. For example, in *Santoro v. Accenture Federal Services, LLC*, the plaintiff filed a complaint against Accenture alleging claims under several federal statutes but did not raise any whistleblower retaliation claims under Dodd-Frank or SOX. Accenture moved to compel arbitration under an arbitration clause in the plaintiff’s employment contract. The plaintiff argued that the entire arbitration agreement was invalid under Dodd-Frank because it did not carve out whistleblower retaliation claims and therefore could generally be interpreted as requiring arbitration of these claims. (748 F.3d 217 (4th Cir. 2104).)

The court held that Dodd-Frank’s statutory prohibitions against predispute arbitration agreements apply only to the extent that the agreements waive or limit judicial resolution of whistleblower retaliation claims. The court upheld the plaintiff’s arbitration agreement because Accenture was not seeking to compel him to arbitrate any whistleblower claims. More generally, the court found that when there are no whistleblower causes of action, Dodd-Frank does not invalidate an otherwise enforceable arbitration agreement. (748 F.3d at 223-24; Legal Update, Dodd-Frank Whistleblower Provisions Do Not Override FAA Arbitration Mandate for Non-Whistleblower Claims: Fourth Circuit ([0-567-7005](#)); see also *Holmes v. Air Liquide USA, LLC*, 498 F. App’x 405, 407 (5th Cir. 2012).)

The US Court of Appeals for the Third Circuit similarly held that Dodd-Frank’s predispute arbitration prohibition only applied to retaliation claims under SOX and not to retaliation claims under Section 922 of Dodd-Frank, which does not contain the same language prohibiting the predispute arbitration of SOX claims. (*Khazin v. TD Ameritrade Holding Corp.*, 773 F.3d 488 (3d Cir. 2014); see also *Murray v. UBS Sec., LLC*, 2014 WL 285093, at \*10-11 (S.D.N.Y. Jan. 27, 2014); Legal Update, Dodd-Frank Whistleblower Retaliation Claims Are Not Exempt from Predispute Arbitration Agreements: Third Circuit ([4-591-6706](#))).

Despite these favorable decisions, the issue remains unsettled. Financial service employers using individualized arbitration agreements (and not subject to FINRA arbitration) should consider which statutory claims are included in or excluded from the scope of an agreement. Courts are likely to employ a case-by-case analysis to determine to what extent, if any, mandatory arbitration agreements are enforceable regarding whistleblower retaliation claims under these statutes.

#### FORM U5 TERMINATION NOTICE

Form U5, the Uniform Termination Notice for Securities Industry Registration, is used by broker-dealers to terminate the registration of associated persons with FINRA and in other applicable jurisdictions and self-regulatory organizations (*Dawson v. N.Y. Life Ins. Co.*, 135 F.3d 1158, 1161 (7th Cir. 1998) (“Any dealer in securities who is a member of the NASD must file a Form U5 whenever a registered agent leaves the firm for any reason.”)). The member firm must file a

Form U5 within 30 days of the employee’s termination (FINRA Reg. Notice 10-39 (Sept. 2010)). The available designations on a departing employee’s Form U5 are:

- Discharged.
- Permitted to resign.
- Deceased.
- Voluntary.
- Other.

For all designations other than voluntary or deceased, the employer must provide an explanation of the reasons for the termination. (See Form U5 Instructions, § 3.) The forms follow brokers throughout their careers and can affect their professional mobility. As a result, the statements made on a Form U5 about the reasons for an employment termination are often negotiated and litigated and employees sometimes bring proceedings to expunge information on the Form U5 (see Box, Form U5 Expungement).

#### SEC CHALLENGES TO SEPARATION AGREEMENTS AND CONFIDENTIALITY PROVISIONS

The SEC recently has scrutinized separation agreements and confidentiality provisions and imposed substantial fines and penalties on those companies that use (or had used) agreements with provisions that restrict their employees’ or former employees’ rights to communicate with regulators or recover whistleblower bounty awards. While not an exhaustive list, the following case summaries illustrate the SEC’s enforcement efforts.

##### **BLUELIX HOLDINGS, INC. (SEC RELEASE NO. 2016-157, AUG. 16, 2016)**

Although several versions of its separation agreements contained a provision that permitted employees to disclose confidential information “required to be disclosed by law, court, or other legal process,” the agreements required employees to notify the company before making those disclosures.

In addition, the BlueLinx separation agreements contained a common carve-out in its waiver of claims:

Employee further acknowledges and agrees that nothing in this Agreement prevents Employee from filing a charge with...the Equal Employment Opportunity Commission, the National Labor Relations Board, the Occupational Safety and Health Administration, the Securities and Exchange Commission or any other administrative agency if applicable law requires that Employee be permitted to do so; however, Employee understands and agrees that Employee is waiving the right to any monetary recovery in connection with any such complaint or charge that Employee may file with an administrative agency.

The SEC concluded that these two provisions violated SEC Rule 21F-17 because:

- The notice provision forced employees “to choose between identifying themselves to the company as whistleblowers or potentially losing their severance pay and benefits.”

- The waiver of the monetary reward impermissibly “removed the critically important financial incentives that are intended to encourage persons to communicate directly with the Commission staff about possible securities law violations.”

The cease and desist order required BlueLinx to:

- Pay a \$265,000 penalty.
- Contact former employees to inform them that the separation agreements they signed do not prevent them from providing information to the SEC or accepting a whistleblower bounty award.
- Include the following revised language in its separation agreements going forward:

**Protected Rights.** Employee understands that nothing contained in this Agreement limits Employee’s ability to file a charge or complaint with the Equal Employment Opportunity Commission, the National Labor Relations Board, the Occupational Safety and Health Administration, the Securities and Exchange Commission or any other federal, state or local governmental agency or commission (“Government Agencies”). Employee further understands that this Agreement does not limit Employee’s ability to communicate with any Government Agencies or otherwise participate in any investigation or proceeding that may be conducted by any Government Agency, including providing documents or other information, without notice to the Company. This Agreement does not limit Employee’s right to receive an award for information provided to any Government Agencies.

#### **Health Net, Inc. (SEC Release Nos. 2016-164, Aug. 16, 2016)**

In August 2011, after SEC Rule 21F-17 became effective, Health Net modified its severance agreements to explicitly waive a departing employee’s “right to file an application for an award for original information submitted pursuant to Section 21F of the Securities Exchange Act of 1934.” In June 2013, Health Net again revised the severance agreement, deleting the language expressly prohibiting employees from applying for SEC whistleblower awards and adding a provision clarifying that “[n]othing herein shall be construed to impede the employee from communicating directly with, cooperating with or providing information to any government regulator.”

The severance agreement also included a provision similar to the one at issue in BlueLinx, stating that:

[N]othing in this Release precludes Employee from participating in any investigation or proceeding before any federal or state agency or governmental body . . . however, while Employee may file a charge, provide information, or participate in any investigation or proceeding, by signing this Release, Employee, to the maximum extent permitted by law . . . waives any right to any individual monetary recovery . . . in any proceeding brought based on any communication by Employee to any federal, state or local government agency or department.

The SEC conceded that there was no evidence that Health Net ever tried to enforce the offending provision or prevent communication with the SEC or that anyone had ever refrained from contacting the SEC because of this paragraph. In addition, Health Net had removed the offending paragraph on its own in October 2015. Nevertheless, the SEC concluded that the quoted provision “directly targeted the SEC’s whistleblower program by removing the critically important financial incentives that are intended to encourage persons to communicate directly with the [SEC] staff about possible securities law violations” and therefore violated Rule 21F-17 “by impeding individuals from communicating directly with the [SEC] staff about possible securities law violations.”

The cease and desist order required Health Net to:

- Pay a \$340,000 fine.
- Contact former employees to inform them that the separation agreements they signed between August 2011 and October 2015 do not prevent them from seeking or obtaining a whistleblower incentive award from the SEC. No new language was required, however, because the company had already removed the offending provision.

The SEC’s approach in the BlueLinx and Health Net matters has not been ratified by the courts. The agency’s position is limited to its interpretation of its own Rule 21F-17 and has no impact outside the SEC (for example, in the federal civil False Claims Act arena).

#### **ANHEUSER-BUSCH INBEV SA/NV (RELEASE NO. 2016-196, SEPT. 28, 2016)**

The company entered into a separation agreement in late 2012 with a specific employee after his termination and subsequent mediation of various alleged employment law claims. The separation agreement contained provisions that:

- Prohibited the employee from disclosing confidential or proprietary company information, with no carve-out for reporting to government agencies.
- Prohibited the employee from disclosing the substance of the separation agreement.
- Imposed \$250,000 in liquidated damages if the employee breached the confidentiality provisions.

After signing the agreement, the employee, who had been voluntarily communicating with SEC in connection with an ongoing investigation, ceased his communications with the SEC.

In September 2015, the company amended its separation agreements to state:

I understand and acknowledge that notwithstanding any other provision of this Agreement, I am not prohibited or in any way restricted from reporting possible violations of law to a governmental agency or entity, and I am not required to inform the Company if I make such reports.

The cease and desist order required only that the company contact certain former employees identified by the SEC to

inform them that they were not prohibited from providing information to the SEC. The company was not required to contact all employees who had signed separation agreements since the rule was implemented in August 2011, as had been ordered in other cases. The company also was not required to make additional changes to its separation agreements because it had voluntarily amended those agreements in 2015. In addition, unlike other cases, it appears the SEC imposed no separate monetary penalty against the company for violating Rule 21F-17(a).

**NEUSTAR, INC. (SEC RELEASE NOS. 2016-268, DEC. 19, 2016)**

The company's severance agreements included a non-disparagement clause with the following language:

Except as specifically authorized in writing by NeuStar or as may be required by law or legal process, I agree not to engage in any communication that disparages, denigrates, maligns or impugns NeuStar . . . including but not limited to communication with . . . regulators (including but not limited to the Securities and Exchange Commission . . .).

Any breach of this clause required the employee to forfeit all but \$100 of the severance paid under the agreement. The SEC found that at least one former employee was impeded by this clause from communicating with the agency (though the SEC has found violations of Rule 21F-17(a) even without evidence that anyone had actually been impeded).

After the SEC's investigation commenced, the company voluntarily removed the reference to "regulators" from the non-disparagement clause and included a more common provision that stated:

In addition, nothing herein prohibits me from communicating, without notice to or approval by NeuStar, with any federal government agency about a potential violation of a federal law or regulation.

To settle the matter, the company agreed to:

- Pay a civil penalty of \$180,000.
- Contact 246 former employees to inform them that the severance agreements they signed between August 12, 2011, and May 21, 2015, did not prevent them from communicating concerns about potential violations of law or regulation to the SEC. No remedial revisions to the company's template severance agreement were required because the company had voluntarily made revisions.

**BLACKROCK, INC. (SEC RELEASE NO. 2017-14, JAN. 17, 2017)**

The SEC claimed that more than 1,000 departing BlackRock employees signed separation agreements containing language stating that they "waive any right to recovery of incentives for reporting of misconduct" as a condition of receiving monetary separation payments from the firm. BlackRock added the waiver provision in October 2011, after the SEC adopted its whistleblower program rules. The firm continued using the waiver in separation agreements until March 2016, when it voluntarily revised those agreements.

To settle the matter, BlackRock agreed to:

- Pay a \$340,000 civil penalty.
- Undertake remedial actions, including mandatory yearly training to summarize employee rights under the SEC's whistleblower program.

**HOMESTREET, INC. (SEC RELEASE NO. 2017-24, JAN. 19, 2017)**

The company used certain severance agreements that included the following commonly used waiver language:

This release shall not prohibit Employee from filing a charge with the Equal Employment Opportunity Commission or discussing any matter relevant to Employee's employment with any government agency with jurisdiction over the Company but shall be considered a waiver of any damages or monetary recovery therefrom.

The SEC concluded, consistent with its previous findings, that employees might interpret the waiver as applying to the agency's monetary whistleblower incentive award program and, therefore, would unlawfully impede employees from communicating with the SEC or reporting potential violations of securities law.

Before the investigation, however, the company had voluntarily revised its standard severance agreement to substitute the following language, largely tracking language the SEC required in a prior order with another company:

Employee understands that nothing contained in this Agreement limits Employee's ability to file a charge or complaint with any federal, state or local government agency or commission ("Government Agencies"). Employee further understands that this Agreement does not limit Employee's ability to communicate with any Government Agencies or otherwise participate in any investigation or proceeding that may be commenced by any Government Agency including providing documents or other information without notice to the Company. This Agreement does not limit the Employee's right to receive an award for information provided to any Government Agencies.

Despite its proactive revisions, the company settled the matter and agreed to:

- Pay a \$500,000 civil penalty (which included a penalty to settle charges that it conducted improper hedge accounting).
- Contact certain former employees who had signed the agreement to provide a link to the order and inform them that severance agreements did not prevent them from reporting information to the SEC or seeking and obtaining a whistleblower award from the SEC.



## FORM U5 EXPUNGEMENT

The explanation provided by a firm about the reasons for termination on an employee's Form U5 are often the subject of much negotiation and litigation. Statements made on Form U5 are included in a registered person's CRD record and used by employers during the hiring process. Registered persons may seek to revise or expunge certain information in the CRD system. Disclosure categories that are ineligible for expungement from the CRD through arbitration include:

- Civil judicial actions.
- Criminal matters.
- Financial matters.
- Investigations.
- Regulatory actions.

(See FINRA Expungement Training (Oct. 2016), p. 20.)

Expungement is widely accepted as a remedy, not a private right of action (see, for example, *In re Clark*, 2012 WL 12261414, at \*2 (D. Ariz. Bkrtcy. Ct. Apr. 24, 2012)). A claim for expungement, therefore, must be part of a larger wrongful termination, defamation, or other claim against an employer or customer. For example, an employee may claim that the information contained in the CRD system is defamatory (see, for example, *Galameau v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 504 F.3d 189 (1st Cir. 2007)).

Depending on the circumstances, employees seeking expungement may file claims in FINRA arbitration or a court

of competent jurisdiction (though a proposed rule change may alter this process). FINRA arbitration eligibility rules require that claims be brought within six years of the occurrence or event giving rise to the claim (FINRA R. 12206, 13206). However, claims that are no longer eligible for FINRA arbitration may be pursued in court if the applicable state limitations period is longer and has not run (see FINRA R. 12206(b), 13206(b)).

The process and requirements to expunge information from the CRD system differ depending on whether the statements at issue arise out of a customer dispute and whether an arbitration proceeding was initiated in the first instance. Although a detailed discussion of the expungement process is beyond the scope of this Note, several FINRA rules specifically govern expungement, including:

- FINRA Rule 2080.
- FINRA Rule 2081.
- FINRA Rule 12805.
- FINRA Rule 13805.

However, these rules do not generally apply to intra-industry (employer-employee) disputes unless the information to be expunged involves customer dispute information (see FINRA R. 2080 FAQs). In addition, FINRA has issued a notice of proposed rulemaking regarding changes to the FINRA arbitration code regarding expungement procedures, among other things (see FINRA Reg. Notice 17-42 (Dec. 6, 2017)). The comment period for the proposed rule change closed February 5, 2018.

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