

# Securities Briefing Vol. 9, No. 1

June 24, 2011

## NEW SEC WHISTLEBLOWER PROGRAM RULES

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) in July 2010, Congress established a whistleblower program that directs the SEC to pay a substantial award to eligible individuals who voluntarily provide original information to the SEC about potential federal securities law violations leading to a successful enforcement action that results in monetary sanctions exceeding \$1 million. On May 25, 2011, the Securities and Exchange Commission (the SEC) published final rules (the Whistleblower Rules)<sup>1</sup> to implement the whistleblower provisions of the Dodd-Frank Act. The adopted Whistleblower Rules provide for a potential award to the whistleblower of 10 to 30 percent of the total monetary sanctions collected, depending on a number of factors. The Whistleblower Rules become effective 60 days after they are submitted to Congress or published in the Federal Register.

The following is a brief overview of the key aspects of the Whistleblower Rules, broken down into two sections: (1) whistleblower award eligibility and (2) key provisions.

### 1. WHISTLEBLOWER AWARD ELIGIBILITY REQUIREMENTS

The new Whistleblower Rules provide for whistleblowers to qualify for monetary awards under specific circumstances.

- **Natural Persons.** A whistleblower must be a natural person. This means an entity is not eligible. Whistleblowers may remain anonymous; however, to be considered for an award while remaining anonymous, the information must be submitted through an attorney.
- **Voluntary submission.** Information provided by a whistleblower must be voluntarily submitted to the SEC and not the result of being obligated to report the information as a result of a pre-existing legal duty, a contractual duty, or a duty that arises out of a judicial or administrative order. A whistleblower is deemed to have provided information voluntarily if the whistleblower has provided information: (1) before a request, inquiry, or demand that relates to the subject matter of the submission is directed to the whistleblower or anyone representing the whistleblower by the SEC, (2) in connection with an investigation, inspection, or examination by the Public Company Accounting Oversight Board or any self regulatory organization, or (3) in connection with an investigation by Congress, any other authority of the federal government, or a state Attorney General or securities regulatory authority.
- **Original Information.** The information provided to the SEC must be original information, based on the whistleblower's independent knowledge or independent analysis. To qualify as original, the information

cannot already be known by the SEC, nor can it be derived exclusively from an "allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media,"<sup>2</sup> unless the whistleblower is the source of the information. The information must also have been provided to the SEC after July 21, 2010. Independent knowledge means factual information possessed by the whistleblower that is not derived from publicly available sources. Independent analysis means the whistleblower's own analysis and can be based upon the whistleblower's evaluation of publicly available information, requiring the whistleblower bring to the public information some additional evaluation, assessment, or insight. If original information is first provided to the company, the whistleblower has 120 days to report the same information to the SEC and still be considered to have provided original information. However, the Whistleblower Rules do not require persons to submit their information through the company compliance program first before submitting such information to the SEC.

- **Successful enforcement.** The SEC will pay an award to a whistleblower when the whistleblower's information leads to the successful enforcement action in which the SEC obtains monetary sanctions totaling more than \$1 million. The Whistleblower Rules define "action" to mean a "single captioned judicial or administrative proceeding" brought by the SEC, with two exceptions: (1) an "action" will constitute two or more SEC proceedings "arising from the same nucleus of operative facts" and (2) for purposes of paying awards on a SEC action for which the SEC has already made an award, the SEC will treat as part of that same action any subsequent SEC proceeding that, "individually, results in a monetary sanction of \$1,000,000 or less, and that arises out of the same nucleus of operative facts."<sup>3</sup>
- **Excluded Persons.** Subject to certain exceptions, the following persons would generally not be entitled to receive whistleblower protection:
  - Attorneys who obtain information from legal representation
  - Independent public accountants who obtain information as part of their client engagement required by the securities laws
  - Officers, directors, trustees, or partners of an entity, employees with internal audit or compliance responsibilities and employees or associations of either firms that are retained to investigate possible securities laws violations are excluded from receiving an award
  - Other exclusions. Certain other individuals are excluded from receiving awards (i.e., employees of certain agencies, people who are criminally convicted in connection with the conduct, and certain other individuals.)
  - Exceptions. The Whistleblower Rules provide exceptions for an otherwise excluded whistleblower to be eligible for an award. These exceptions apply when: (1) the designated person has a reasonable basis to believe that disclosure of the information to the SEC is "necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors;" (2) the designated person has a reasonable basis to believe that the entity is engaging in conduct that will impede an investigation of the misconduct; and (3) at least 120 days have elapsed since the whistleblower provided information to his or her supervisor, the company's audit committee, chief legal officer, chief compliance officer, or their equivalents.<sup>4</sup>

## 2. KEY PROVISIONS OF THE WHISTLEBLOWER ACT

Key provisions of the new Whistleblower Rules include:

- The SEC is required to maintain the confidentiality of the whistleblower's identity, subject to certain exceptions. The Whistleblower Rules allow the SEC to share information received from whistleblowers with certain appropriate regulatory authorities. While the Rules allow a whistleblower to submit information to the SEC anonymously, in order to be eligible for the payment of an award, the whistleblower must disclose his identity and be represented by counsel.
- The individual is to be treated as a whistleblower as of the date he or she first reports the information to the company; however, the individual must report the same information to the SEC within 120 days. This 120 day "look-back period" requires a whistleblower to act within a certain period of time to ensure that his/her eligibility for an award under the program is not compromised.
- While the Whistleblower Rules do not require internal reporting, when determining the amount of an award, the SEC will consider the whistleblower's participation in the company's internal compliance procedures a "plus-factor."
- For anti-retaliation measures to apply, a whistleblower must have a reasonable belief that a violation of the securities laws has occurred, is ongoing or is about to occur, and the whistleblower provided this information in the required manner. The anti-retaliation protections apply whether or not the whistleblower satisfies the requirements, procedures, and conditions to qualify for an award.
- After receiving a whistleblower complaint, the SEC may choose, in some circumstances, to contact the company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back.

The Whistleblower Rules include financial incentives for a whistleblower to bring his or her complaint directly to the SEC while completely bypassing the company's internal compliance program. While the SEC has indicated it has built significant incentives into the new whistleblower award program to encourage whistleblowers to report internally in the right circumstances, the question remains whether the new provisions will effectively discourage internal reporting and risk undermining a company's internal compliance program. In response, a company should encourage its employees to first report complaints directly to the company. This can be achieved through a comprehensive review of the company's internal compliance program to ensure an effective program exists, training employees about the company's compliance program and anti-retaliation policy, considering internal financial incentives for first reporting to the company, and convincing employees that all communications will remain confidential and without retaliatory action.

### **Copy of SEC Final Rules Regarding Implementation of the Whistleblower Provisions**

A copy of the final SEC whistleblower rules is available on the SEC's Web site.

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1 See SEC Release No. 34-64545, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, available at: <http://www.sec.gov/rules/final/2011/34-64545.pdf>.

2 All quotes in this publication are from SEC Release No. 34-64545.

3 SEC Release No. 34-64545.

4 SEC Release No. 34-64545.

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