

The New SEC Whistleblower Rules: Improving A Successful Program Or Undermining It?

Introduction

The U.S. Securities and Exchange Commission's ("Commission" or "SEC") whistleblower program has, by all accounts, been a huge success. Added to the Securities Exchange Act of 1934 ("Exchange Act") as Section 21F by the Dodd-Frank Act in 2010, and implemented by rules adopted in May 2011, the program has received over 22,000 submissions. Information obtained from those tips has aided the agency in securing over \$2.5 billion in financial remedies, portions of which have been returned to investors.

The program has also benefitted 97 individuals who have collectively been awarded about \$523 million. See, e.g., SEC Press Release (Sept. 23, 2020). The most recent award, announced on September 28, 2020, was in the amount of \$1.8 million. Clearly there will be more.

The agency has also taken aggressive steps to protect whistleblowers and the program. A series of enforcement actions against those who would impede a whistleblower have been filed. See, e.g. *In the Matter of HomeStreet, Inc.* Adm. Proc. File No. 3-17802 (Jan. 19, 2017) (settled with cease and desist order based on Exchange Act Sections 21F, 13(b)(2)(A) and 13(b)(2)(B) and a penalty of \$500,000 paid by firm); but see *Digital Realty v. Sommers*, 138 S.Ct. 767 (2018) (cannot be a whistleblower under the statute unless first report to SEC, not internally).

On September 23, 2020, the Commission adopted amendments to the whistleblower program. Many feared the proposals might undermine the program. Those amendments, along with the initial proposals and select comments on the proposals, are analyzed below.

The Proposed Amendments

In 2018 the Commission announced proposed amendments to the whistleblower rules. While the stated purpose was to improve and strengthen the program many viewed the

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proposals through a skeptical lens. Those proposals are built on four key substantive areas: 1) permitting awards to be based on non-prosecution agreements (“NDAs”) and deferred prosecution agreements (“DPAs”); 2) modifications granting the agency certain discretion tied to the amount of small and very large awards; 3) modifying the “related actions” guidance; and 4) addressed *Digital Realty* (“Proposed Release” at 9-11). A number of other proposals clarify certain issues and codify internal agency procedures.

NPAs/DPAs: A key proposal sought to expand the type of actions that the Commission might consider when making awards. Specifically, the Proposed Release detailed provisions that would permit the Commission to make awards based on U.S. Department of Justice (“DOJ”) or state attorney generals matters resolved with either a deferred prosecution agreement (“DPA”) or a non-prosecution agreements (“NPA”) in criminal cases. This proposal also permits certain SEC actions that were outside the context of a judicial or administrative proceeding to be considered.

The existing whistleblower rules under Exchange Act Section 21F did not specifically authorize awards for DPA, NPAs or even the type of SEC matters cited. By amending the definition of the word “action” in Exchange Act Rule 21F-4(d) and the phrase “monetary sanctions” in Rule 21F-4(e) the program was expanded to include these matters.

Award amount: Proposals that related to the amount of awards were perhaps the most controversial and least understood based on an analysis of the comment letters. The proposals focused on the amounts awarded under Rule F-6. For small awards the proposals would give the Commission the discretion to adjust the amount upward to \$2 million (changed to \$5 million in the final release) but to no more than the statutory maximum of 30%, based on the particular facts and circumstances.

For certain large awards essentially the reverse process was proposed. Specifically, for matters that involved at least \$100 million of total collected monetary sanctions – the predicate for awards – the Commission would have the discretion to adjust the amount of the award downward to effect program goals.

Related actions: A third key point focused on Rule 21F-3 regarding related actions. Here a whistleblower who receives an award from the Commission may also be eligible for one based on monetary sanctions collected in a related action. The proposal called for an addition to Rule 21F-3(b) and the repeal of the original provision. Under the new provision a claimant would only be entitled to one award.

Digital Realty: The Proposed Rules also addressed The High Court’s ruling. There the Court held that Exchange Act Section 21F - (a)(6) required an individual report a securities law violation to the Commission to be eligible for employment protection. Proposed Rule 21F-2 “comports with the Court’s holding by, among other things, promulgating a uniform definition of ‘whistleblower’ that would apply to all aspects of Exchange Act Section 21F.”

Other provisions: The Proposing Release also included a series of other proposals

focused on increasing efficiency and correcting technical points. Those include: 1) Rule 21F-4(e)(clarify the term “monetary sanctions”); 2) Rule 21F - 9 (add flexibility to modify how Form TCR which is used to submit an award request is tendered); 3) Rule 21F - 8 (modify forms for program); Rule 21F-8 (clarify materials relied on in making an award); add paragraph (e) to Rule 21F-8 (bar individuals from submitting false applications).

Guidance: Finally, the Proposing Release contained a section which would offer guidance on the overall program. A key point involved the definition of the phrase “independent analysis.” It focused delimiting the use of public information in the context of furnishing factual material to support an award claim.

Overview of the Comment Letters

The Commission received approximately 150 comment letters. The positions advocated ranged from those who thought the program was a huge success and should not be changed to persons who clearly did not favor it. Many of the Comments centered on the provisions regarding the amount of the award and what a number of commentators saw as an effort to impose some type of cap on the amount. Others focused on questions keyed to the program documents discussed in a technical amendment and to the provisions dealing with related actions. A sampling of the comments is set forth below.

Better Markets: The letter notes that by “any measure, the statutorily mandated Whistleblower Program has been a wild success, yet the Commission is proposing changes that risk snatching defeat from the jaws of victory.”

SIFMA: The letter states that “SIFMA supports many of the Commission’s ideas set forth in the Proposing Release.”

Senators: A letter by six Senators -- Sherrod Brown, Jack Reed, Elisabeth Warren, Patrick Leahy, Chris Van Hollen, and Christopher Coons and one from Senator Chuck Grassley -- addressed the question of what all viewed as an effort to cap awards. As the letter from the six Senators states: “Regrettably, the Proposal could deter whistleblowers . . .” by creating confusion because “it suggests the SEC could cap awards.” A letter by the National Whistleblower Center and another from two Stanford Professors essentially echoed this position.

Center for Capital Markets Competitiveness: This letter states in part that the “bounty program . . . administered by the SEC has operated on a broad set of nebulous and subjective criteria. While a certain degree of confidentiality is required under Section 21F . . . the paucity of details in the orders granting (and denying) bounty awards provides little if any decision-useful information to regulated persons as to what conduct they should avoid.”

The Amendments Adopted

On September 23, 2020 the SEC adopted final amendments to its whistleblower rules (“Final Release”). Those adopted focused on expanding the scope of the awards, giving

the agency discretion to increase small awards, memorializing existing practice to eliminate situations where there are other award programs and addressing *Digital Realty*. The Final Release ends with a section on Guidance.

DPAs & NPAs: The Commission adopted the proposed amendments regarding DOJ DPAs and NPAs. The proposal regarding SEC non-judicial and administrative proceedings was also adopted. The new provisions thus expand the scope of the whistleblower provisions. The program will now extend to certain DOJ actions involving DPAs and NPAs. Under the amendments the program will also extend to Commission actions that are outside the context of a judicial or administrative proceeding. See Rule 21F-4(d). The Commission chose not to include state actions in the amendments, indicating a lack of insight into those matters. See Rules 21F – 4(d) and (e).

Amounts: The Commission also resolved the question about the amounts by focusing on smaller awards. Traditionally about 75% of the awards made under the program are \$5 million or less. The amendments added Exchange Act Rule 21F-6(c) which incorporates a presumption for awards of that size stating that the Commission will pay a meritorious claimant the statutory maximum amount if no negative criteria are present. This will permit the agency to maximize small awards.

In contrast, the Commission chose not to adopt proposed Rule 21F-6(d)(2) regarding large awards. That provision would have formalized a process under which the agency would conduct an enhanced review of certain large awards and possibly make downward adjustments. This ended the controversy that many commentators viewed as an effort to impose a “cap” on the amount of large awards.

Other cases: An amendment to Rule 21F-3(b) essentially codifies the Commission’s approach to determining whether an action is related for purposed of making an award. As the press release issued with the Final Release notes: “This amendment codifies the Commission’s approach to determining whether an action is a related action . . .” If there is a separate award scheme the other action would not be eligible for an award.

Digital Realty: To address the Court’s ruling regarding the definition of the term whistleblower, the Commission will modify Rule 21F-2 , creating a uniform definition of the term “whistleblower” -- the key issue in the Supreme Court’s decision. Accordingly, there will be a uniform definition for Section 21F. The Commission also clarified the extent of retaliation protection by amending Rule 21-2(H)(2) to protect certain lawful acts. The agency is also issuing interpretative guidance defining the concept.

Other provisions: The Commission approved a series of amendments to speed, clarify and enhance the process. See, e.g., Rule 21F-4(e)(clarify definition of “monetary sanctions”); Rule 21F(6)(amended to clarify agency discretion in applying award factors and fixing amount); Rule 21F-9 (amended to give agency more flexibility); Rule 21F-8 (discussing forms to be used); Rule 21F-12 (clarifying list of materials agency can consider); Rule 21F-13 (materials that can comprise administrative record).

Interpretative guidance: The Commission is also publishing interpretive guidance to

clarify the meaning of the phrase “Independence analysis” which is key to the award process. Under that process the person must provide “evaluation, assessment, or insight beyond what would be reasonably apparent to the Commission from publicly available information,” according to the Final Release. The guidance goes on to discuss other factors the agency will consider in making an assessment.

Adoption: The Commission approved and adopted the proposals detailed above by a 3-2 vote of the Commission. Commissioners Allison Herren Lee and Caroline A. Crenshaw dissented. Commissioner Herren expressed concern about the provisions granting discretion to the Commission regarding the amount of the awards. As she stated in her comments: “I find myself unable to support this rule because of the treatment given to the central issue of the Commission’s discretion to reduce awards . . . “ in certain cases.

Commissioner Crenshaw agreed with her fellow Commissioner. She also expressed concern with the guidance regarding the phrase independent analysis. In this regard the Commissioner noted that “I worry this guidance will inadvertently impact the perception of the type of information the Commission considers valuable.”

Each comment by the two dissenting Commissioners echoes statements made in the comment letters. Each was considered in the Final Release. Some have lingered from the beginning of the program.

Discussion

The SEC whistleblower program is by any measure a huge success. Since its inception nearly a decade ago there is no doubt that it has made significant contributions to the success of the SEC Enforcement Program.

The rule amendment process, which generated a significant amount of consternation, may well be a reflection of the program success. As Better Markets stated in its comment letter, the fear was that the agency would somehow “mess-up” a successful program.

Now, however, after wading through 150 comment letters, venting arguments about “caps” and “discretion” and the amount of awards, the final rules have been issued. The headline of a recent press release by the National Whistleblower Center may tell it all: “U.S. Securities and Exchange Commission’s Vote Reaffirms Broad Support for Whistleblower Program But Includes Worrisome Changes.” Senator Chuck Grassley posted a statement of approval on his website the day the amendments were approved. Nobody would dispute the success of the SEC whistleblower program or that it has been broadened and strengthened.