NWC | NATIONAL WHISTLEBLOWER CENTER

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September 17, 2018

Submitted via e-mail to rule-comments@sec.gov

Mr. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Comments of the National Whistleblower Center on the SEC's Proposed Rulemaking: Whistleblower Program Rules (File No. S7-16-18)

Request for Extension of the Comment Period

Dear Chairman Clayton:

The National Whistleblower Center ("NWC") hereby requests an enlargement of the comment period related to the various amendments proposed by the U.S. Securities and Exchange Commission ("SEC" or "Commission") to the current SEC whistleblower program. *See* Whistleblower Program Rule Amendments, Rel. No. 34-83557, File No. S7-16-18, RIN 3235 – AM11 (June 28, 2018); 83 Fed. Reg. 34,702 (July 20, 2018).[1] In addition, because the current deadline for filing comments is September 18, 2018, the NWC hereby files its first preliminary comments on the proposed rule.[2] These comments are being filed without prejudice to the NWC's filing its complete response after it obtains access to the documents requested in its FOIA, and has adequate time to draft its responses in light of these materials.

REQUEST FOR EXTENSION OF THE COMMENT PERIOD

Shortly after the whistleblower amendments were proposed, the NWC filed a Freedom of Information Act ("FOIA") request with the Commission. Materials responsive to this FOIA would include communications between the Commission and the Chamber of Commerce. The NWC filed this FOIA request to discern what special interests had lobbied for Proposed Rule (d)(2). After nearly two months, the Commission finally identified **15,877** emails that could be in response to NWC's request. These include **1,078** emails with the Commission that reference

[1] The proposed rules, along with comments by the Commissioners regarding the rules and other relevant information was linked in the blog by Ben Kostyack, "SEC Proposes Rules that will Undermine Whistleblower Rights," *The Whistleblower Blog* (July 9, 2018), at https://www.kkc.com/blog/sec-proposes-rules-that-will-undermine-whistleblower-rights.

[2] The NWC also hereby endorses the concerns raised by attorneys who work, *pro bono,* with the National Whistleblower Center. *See* Kohn, "The Problem with the SEC's Plan to Cap Whistleblower Awards," Law360 (July 10, 2018), at https://www.kkc.com/news/?id=651; Kohn, et al., to Clayton, "Rule Comment" (July 24, 2018), reprinted at https://www.kkc.com/assets/site_18/files/sec/secrulemakingletter-final.pdf.

both "whistleblower" and "Chamber of Commerce" between January 2, 2017 and June 29, 2018.

However, the Commission has yet to actually ***release*** the responsive materials. Furthermore, it is unlikely that the Commission will release all requested materials – if any – prior to the end of the comment period it has imposed, as Commission staff made clear that even materials prioritized by NWC (communications including "whistleblower" and "Chamber of Commerce") "will [be] provide[d in] rolling releases as they become available."

Yet, by granting NWC's expedited processing request, the Commission agreed that NWC had "identified an important Government activity that is current" and demonstrated a compelling "urgency to inform the public." The materials NWC requested are imperative to the public's understanding of the reasoning behind the Proposed Rule, the impact it will have on the whistleblower program, and the influence the Chamber of Commerce and other members of the regulated community had on this rulemaking.

The SEC is the first administrative agency to adopt policies modelled on those advocated for by the Chamber of Commerce, to the detriment of whistleblowers and the whistleblower program. In doing so, the Commission is incorporating a misleading position on award caps – a position rejected by Congress on numerous occasions because it would undermine the core objective of the whistleblower program by discouraging the most important whistleblowers from risking everything and stepping forward.

The Commission's amendments to the whistleblower program were made in secret, potentially relying on anti-whistleblower interests instead of the experts in the whistleblowing community. The public has a right to know who proposed these changes, who had input into the proposal, and what the motives behind these deleterious alterations were in order to understand how the rule – and the new program – would function in practice.

The public must have access to the relevant information with enough time to give competent, fully-informed feedback to the Commission on proposed rules that will completely undermine one of the most important aspects of the agency's enforcement and recovery capability.

Given the unmistakable complexity of the Proposed Rule, its potential to have a significant impact on both whistleblowers and the Commission's ability to detect securities laws violations, and the public's right to know which special interests had a role in shaping the rule, the Commission must extend the comment period by ***a minimum of 60 days***, to begin ***after*** the Commission has released ***all materials related to the proposed amendments***.

The NWC is also concerned that some of the proposals announced by the Commission reflect the policy positions of the U.S. Chamber of Commerce. The Chamber has staked out a radically anti-whistleblower position, and for years has sought to "cap" the amount of rewards available to whistleblowers.[3] Congress has repeatedly rejected these proposals. The SEC is

[3] *See* National Whistleblower Center, "Saving America's 'Most Important Tool to Uncover and Punish Fraud (July 30, 2014), reprinted at

the first executive agency to endorse "caps" in a proposed rule, and based on the public comments of the Commissioners, appears poised to be the first agency to ever adopt this discredited and highly destructive Chamber of Commerce proposal. Consequently, there is a compelling need for full and complete transparency as to why the Commission proposed this rule, and what lobbying efforts were behind the proposals.

INITIAL COMMENTS

Inasmuch as the current deadline for filing a response to the proposed rules is September 18, 2018 the NWC is compelled to file its initial comments on two of the Commission's proposals. We specifically call your attention to the new Proposed Rule, § 240.21F-6(d)(2) [hereinafter "Proposed Rule (d)(2)"] and the "proposed interpretive guidance regarding the meaning and application of 'independent analysis' as defined in Exchange Act Rule 21F-4(b)(3)" [hereinafter "Proposed Analyst Guidance"]. Both are highly destructive to the Commission's existing whistleblower program and contrary to Congressional intent and the statutory language governing the program, undermining the incentives intended for analysts and those blowing the whistle on the most insidious securities laws violations.

Proposed Rule (d)(2), contrary to Supreme Court precedent and Dodd-Frank's "core objective," disincentivizes whistleblowers who identify the largest violations of securities laws at potentially much greater personal risk. Similarly, by utilizing the operative word "could," the Proposed Analyst Guidance discourages whistleblowing. The Proposed Analyst Guidance essentially allows the Commission to reject any analyst merely because the information the analyst relied on was public, even if it was information the Commission would never have used to initiate an investigation of its own volition.

I. The Commission Must Apply the Holding of *Digital Realty* When Evaluating the Proposed Cap on Whistleblower Rewards Under Proposed Rule (d)(2)

As a threshold matter, the Commission must review all of its proposed rule changes in light of the recent guidance offered by the U.S. Supreme Court in *Digital Realty Trust v. Somers*. In that case, the Court held that the Commission violated the Congressional intent of the Dodd-Frank Act in enacting certain rules and administrative guidance regarding the Commission's whistleblower program.

The Court was perfectly clear as to the fundamental mission of the Dodd-Frank Act's whistleblower law:

> Dodd-Frank's purpose and design corroborate our comprehension of § 78u-6(h)'s reporting requirement. The "core objective" of Dodd-Frank's robust whistleblower program . . . is "to motivate people who know of securities law violations to *tell the SEC*," S. Rep. No. 111–176, at 38 (emphasis added). By enlisting whistleblowers to "assist the Government [in] identify[ing] and

https://www.whistleblowers.org/storage/documents/RebuttalDocs/final%20fca%20report.pdf. The report rebuts a proposal by the U.S. Chamber of Commerce to cap rewards under the False Claims Act.

> prosecut[ing] persons who have violated securities laws," Congress undertook to improve SEC enforcement and facilitate the Commission's "recover[y] [of] money for victims of financial fraud." *Id.,* at 110. To that end, § 78u-6 provides ***substantial*** monetary rewards to whistleblowers who furnish actionable information to the SEC. See § 78u-6(b).

Digital Realty Trust v. Somers, 138 S. Ct. 767, 777 (2018) (emphasis added).

Thus, every proposed rule offered by the Commission must be evaluated in light of these fundamental principles. Do the proposals "motivate people who know of securities law violations to tell the SEC" about these violations? If the proposed rules do not promote this "core objective" of the law, indeed if they are openly hostile to it, they should not be approved.

Proposed Rule (d)(2) establishes a cap on the amount of compensation offered to whistleblowers whose original information identifies the largest and most outrageous violations of securities laws. Only in such large fraud cases would whistleblowers suffer a radical reduction in the amount of compensation for which they are eligible. Proposed Rule (d)(2) reduces the compensation available to the most important whistleblowers to the ***lowest possible amount***, thereby discouraging the reporting of large frauds by well-placed insiders worldwide.

It is beyond question that establishing a rule that would limit the amount of awards available to whistleblowers who disclose large frauds that result in fines and sanctions in excess of $100 million against fraudsters would ***not*** help motivate whistleblowers to step forward.[4] These large fraudsters – many of whom act with the knowledge or consent of top ranking corporate officials, or themselves hold top corporate jobs – are often in a position to impact the career and reputation of employees. Reducing the amount of awards available to employees who courageously risk retaliation from these high-ranking or well-placed fraudsters violates the "core objective" of the SEC whistleblower law.

Simply stated, capping the amount of an award in the largest cases does not "motivate people who know of securities law violations to tell the SEC," it discourages them, impermissibly contradicting Supreme Court precedent and defying common sense.

II. The Commission's Proposed Analyst Guidance Undermines the Dodd-Frank Act's Statutory Definition of a "Whistleblower"

The Proposed Analyst Guidance completely undermines one of the most important features of the securities laws whistleblower program. Congress explicitly required the Commission to recognize independent analysts. Nevertheless, the Commission's "interpretive guidance" regarding the Analyst Rule is so broad as to completely undermine the statutory incentives

[4] *See* Dyck, et al., "Who Blows the Whistle on Corporate Fraud," *The Initiative on Global Markets Working Paper No 3,* University of Chicago Booth School of Business (Oct. 2008), reprinted at *https://www.whistleblowers.org/storage/documents/univofchicagowhoblowswhistle.pdf*. *Also see,* Index of Documents for *The New Whistleblower's Handbook,* Rule 30 ("Whistleblowing Works), linked at https://www.kkc.com/handbook/never-forget-whistleblowing-works.

provided to analysts, and effectively cut off from eligibility the overwhelming majority of analysts otherwise covered under the law.

The Dodd-Frank Act's definition of a "whistleblower" includes "analysts." Analysts, by definition, are not "insiders" who meet the stereotypical definition of a whistleblower. Instead, they are typically non-employees who base their disclosures on their "analysis" of publicly available information. Prior to the recession of 2008, many analysts relied upon publicly available information to identify the securities violations that triggered the market collapse, and frauds engaged in by notorious criminals such as Bernie Madoff. Congress recognized that these atypical whistleblowers had the potential to provide significant assistance to the Commission's enforcement staff (which unquestionably is not large enough to uncover every fraud) and protect investors.

Encouraging "analysts" to aid in Commission enforcement efforts was one of the major advances in whistleblower protection approved by Congress in the wake of the disastrous market collapse of 2008.

The new "Independent Analysis Standard" proposed by the Commission would, in effect, completely undermine Congress' requirement in the Dodd-Frank Act that analysts be treated as whistleblowers. This method is crafty, and smacks of the linguistic manipulations often employed by the Chamber of Commerce and other special interests to oppose every important whistleblower initiative.

In the Commission's proposed standard for "assessing" whether a whistleblower's submission provides sufficient "analysis" of "publicly available information," the "Commission would determine based on its own review of the relevant facts during the award adjudication process whether the violations ***could*** have been inferred from the facts available in public sources."

The trick is in the use of the word "could." Any publicly available information "could" have been relied upon by the Commission staff in discovering a violation. The problem arises when the publicly available information did ***not*** result in the Commission discovering the violation on its own. Whether or not the Commission staff "could" have theoretically discovered the violation is absolutely irrelevant. The fact is that an analyst only qualifies for a reward in cases in which the Commission did ***not*** discover the violation, and the analyst's submission triggered (or contributed to) the investigation.

The universe of publicly available information related to the misconduct of publicly traded companies is immense, and it is obvious that the Commission staff cannot not properly evaluate this information in the vast number of circumstances. For example, the Commission staff "could" have uncovered the massive frauds committed by Madoff, but unfortunately for those who lost millions, they did not. Whether the Commission "could" have relied on public information to prevent the collapse of numerous financial institutions or publicly traded companies such as Enron or Bear Stearns is simply not relevant. What is important to investors is not what the Commission "could" have done. It is what the Commission ***did*** do.

Employing the manipulative term "could" gives the Commission discretion – contrary to Congressional intent – to deny an award to an analyst that is responsible for uncovering a securities violation that leads to a successful Commission enforcement and recovery, even where the Commission failed to discover – and may not ever have discovered – the underlying offense that would have enabled it to initiate an investigation.

CONCLUSION

The Commission must extend the comment period for this rulemaking by a minimum of 60 days to begin after the Commission has released all materials related to the proposed amendments covered under the FOIA request filed by the NWC. If no enlargement is granted, the Commission should not approve the cap on rewards associated with the enforcement of large frauds as set forth in Proposed Rule (d)(2), and must reject the Proposed Analyst Guidance concerning the definition of independent analysis.

Sincerely,

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