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URGENT MATTER

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Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
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Re: **NINTH SUPPLEMENTAL COMMENT**
File Number S7-16-18

Update: **Post *Digital*, the Commission Retains Authority to Enforce Sarbanes-Oxley Act Protections for Internal Whistleblowers.**

Dear Chairman Clayton and Secretary Countryman:

We are writing to further comment on the U.S. Securities and Exchange Commission's ("SEC") or "Commission") proposed amendments to the whistleblower program.[1] We are filing this comment in order request that the Commission rely upon its regulatory and enforcement authority under the Sarbanes-Oxley Act ("SOX" or "the Act") to ensure that internal whistleblowers continue to be fully protected under the Commission's regulations.

In light of the U.S. Supreme Court's decision in *Digital Realty v. Somers*, 583 U.S. ___ (2018), the Commission has proposed a rule to eliminate the coverage of internal whistleblowers under its regulations. *See* Proposed Rule 21F-2(d)(4). The explanatory notes accompanying the proposed change show deference to this decision, stating that:

[1] *See* Whistleblower Program Rules, 83 Fed. Reg. 34,702 (2018), Rel. No. 34-83557; File No. S7-16-18.

> [t]he Supreme Court recently held in *Digital Realty Trust, Inc. v. Somers* . . . that a whistleblower under Section 21F of the Exchange Act must report a possible securities law violation to the Commission in order to qualify for employment retaliation protection under Section 21F(h)(1) . . . Accordingly, we believe that it is appropriate to amend Rule 21F-2 to conform to the Supreme Court's construction of Section 21F.

83 Fed. Reg. at 34,704.

If approved without modification, the proposed rule 21F-2(d)(4) would negatively impact the integrity of internal compliance programs for which Congress, the Commission, whistleblower advocacy organizations, and the vast majority of publicly traded corporations strongly endorse.

The Supreme Court's decision in *Digital* only impacted the ability of the Commission to protect internal compliance programs under the Dodd-Frank Act. But the case was extremely limited in scope, and only evaluated the specific statutory language in the DFA. It did not evaluate other statutes that gave jurisdiction and authority to the SEC which do not contain the limitations the the Court focused on in *Digital*. As explained below, SOX provided the Commission with explicit regulatory authority to enforce the anti-retaliation provisions set forth in SOX, which include full coverage of internal disclosures to compliance programs, Audit Committees, and other key officials necessary to ensure that internal controls are function properly. The *Digital* decision did not impact and should not abrogate the Commission's ability to protect the integrity of internal compliance programs pursuant to other regulatory authorities, including SOX.

Regulatory Authority

The Sarbanes-Oxley Act has four provisions that protect whistleblowers, three of which broadly cover internal whistleblowers and ensure that retaliatory conduct will not undermine internal controls, auditing requirements, and compliance requirements that are integral to the Commission's regulatory scheme. Under SOX, the SEC has the regulatory authority to ensure that such internal disclosures are fully protected under the SEC whistleblower regulations approved in 2011. P.L. 107-204, § 3, *codified at* 15 U.S.C. § 7202.

The Commission, in its *amicus* brief before the U.S. Supreme Court in *Digital*, identified four provisions of SOX that cover whistleblowing and/or would justify fully protecting internal whistleblowing. The Commission argued that the DFA provided sufficient statutory authority to empower the SEC to promulgate regulations protecting the SOX disclosures referenced above:

> The "[w]histleblower protection" provisions of Sarbanes-Oxley . . . protect disclosures to any federal "regulatory or law enforcement agency," "any Member of Congress or any committee of Congress," or "a person with supervisory authority over the employee." 18 U.S.C. 1514A(a)(1). A Sarbanes-Oxley provision . . . 15 U.S.C. 78j-1(m), expressly protects internal disclosures about auditing matters. Other provisions of Sarbanes-Oxley and the Exchange Act *require* certain auditors and attorneys to disclose certain information internally. 15 U.S.C. 78j-1(b) and 7245. . . And another provision . . . 18 U.S.C. 1513(e) . . . protects reports to law

> enforcement officers about federal offenses, necessarily requires reporting to an entity other than the Commission.

Brief of the United States as Amicus Curie, *Digital Reality v. Somers*, 583 U.S. ___ (2018).[2]

Although the Court ruled that the *Dodd-Frank Act* did not contain authority to protect internal whistleblowers from retaliation, the *Sarbanes-Oxley Act* does directly provide the authority to do so. SOX requires the SEC to treat violations of the Act analogously to violations of the Securities Exchange Act of 1934 ("SEA"), and the Dodd-Frank Act ("DFA") grants the SEC authority to enforce SOX's anti-retaliation provisions. *Digital* did not interpret the Commission's authority to protect internal whistleblowers pursuant to the authority granted to the Commission under SOX, as the Act directly provides statutory authority for the SEC to enforce and promulgate regulations under the Act.

On the face of Section 3 of SOX, it is indisputable that the Commission can amend the current whistleblower rules regarding retaliation and ensure that internal whistleblowing remains fully protected.[3] Specifically, Section 3(a) confers explicit rulemaking authority to the SEC necessary to enforce any provision of SOX, including its anti-retaliation provisions, charging the SEC with "promulgat[ing] such rules and regulations such rules and regulations, as may be necessary or appropriate … *in furtherance of this Act*." 15 U.S.C. § 7202(a) (emphasis added). Further, Section 3(b) provides that a violation of any provision of SOX, or any rule or regulation issued thereunder, constitutes "for all purposes … a violation of the Securities Exchange Act," and incurs the same penalties. 15 U.S.C. § 7202(b)(1). This gives the SEC authority to enforce *all* provisions under SOX.

Section 806 of SOX provides protection against retaliation when a whistleblower discloses information that the whistleblower reasonably believes constitutes a violation of the securities laws to "a person with supervisory authority over the [whistleblower] (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)." P.L. 107-204, § 806, *codified at* 18 U.S.C. § 1514A(a)(1)(C); *see also* LETTER FROM THE SENATE JUDICIARY COMMITTEE (Nov. 9, 2004). This section ensures that internal whistleblower reports to compliance, audit committees, or directors are included as violations enforceable under SOX.

Under the DFA, an individual is considered a whistleblower for the purposes of determining SEC jurisdiction over retaliation protection if that individual "provides … information in a manner described in Section 21F(h)(1)(A)." 17 C.F.R. § 240.21F-2(b)(ii). That section of the SEA in turn provides that an individual is protected as a whistleblower if the individual "mak[es] disclosures that are required or protected under [SOX]." 15 U.S.C. § 78u-6(h)(1)(A). This includes Section 806's anti-retaliation protections for internal reporting.

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[2] Available at https://www.kkc.com/wp-content/uploads/2020/01/SEC-Amicus-in-Digital.pdf.

[3] Significantly, the two principle authors of the whistleblower protection provision of the Sarbanes-Oxley Act, Senator Charles Grassley and Patrick Leahy expressed their opinion that the SOX law authorized the SEC to implement rules and regulations protecting whistleblower in accordance with the SOX law. *See* Letter from Senators Grassley and Leahy to SEC Chairman William Donaldson (Nov. 9, 2004), available online at: https://www.kkc.com/wp-content/uploads/2020/01/donaldsonletter11.9.04.pdf.

The SEC therefore has complete regulatory authority over retaliation against a whistleblower that reports potential securities violations internally. SOX not only grants the SEC the authority to promulgate rules such as 21F-2(b)(ii) protecting whistleblowers from retaliation but also requires that the SEC treat violations of SOX's own anti-retaliation provisions as it treats any other violation of the SEA. This gives the SEC the ability to enforce anti-retaliation measures directly under Section 806 of SOX as well as under its own DFA rules, which protect disclosures made under the same section. The SEC can thus enforce violations of Section 806's anti-retaliation provisions regardless of whether a whistleblower that reported internally also reported to the SEC.

Thus, the Commission should amend its current whistleblower rules to reference its regulatory and enforcement authority under the Sarbanes-Oxley Act, and continue to fully support internal whistleblowers and the integrity of internal compliance and auditing functions by explicitly predicating its anti-retaliation regulations on the authority set forth in the SOX.

Public Policy Strongly Supports Amending the Commission's Whistleblower Retaliation to Continue to Support Internal Whistleblowers

The importance of maintaining the Commission's current regulations protecting internal reporting was forcefully argued by the SEC in the *amicus* brief filed by the United States before the Supreme Court in *Digital*. In addition, the vast majority of publicly traded companies and their related trade associations have confirmed the importance of ensuring that the SEC's whistleblower rules continue to protect internal reporting programs. Nothing undermines such programs more than retaliation, and the chilling effect caused by such retaliation.

In statements filed before the U.S. Supreme Court by the United States in *Digital*, the Commission fully explained the importance of maintaining protection for internal whistleblowers:

> Reading that provision to protect only whistleblowers who report to the Commission would defeat Congress's purpose, weaken internal corporate-compliance programs, and potentially flood the Commission with allegations that have not been vetted by the corporate insiders best situated to address them in the first instance.
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> ***
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> In adopting its rules, the Commission explained that encouraging reporting through *internal* compliance procedures, such as those required or protected by the laws cross-referenced in [the Sarbanes-Oxley Act] advances the purposes of Section 78u-6. Specifically, the Commission explained that internal reporting enables the private sector to screen out meritless claims, and thereby improves the quality of whistleblower tips later brought to the Commission; that internal reporting gives businesses the opportunity to self-correct without the need for intrusive Commission investigations; and that internal reporting thereby promotes efficient use of both corporate and government resources.

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> That approach [protecting internal whistleblowers] is especially appropriate given the purpose of Section 78u-6 and the practical desirability of encouraging internal whistleblowing as a way to promote corporate compliance.
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> [Protecting internal whistleblowers] would "support, not undermine, the effective functioning of company compliance and related systems." 76 Fed. Reg. at 34,323. During its rulemaking, the Commission received numerous comments from businesses and related associations that urged the agency to promulgate rules encouraging or requiring internal reporting. *E.g.*, *id.* at 34,302 n.21, 34,326 n.230. The Commission agreed that internal reporting systems "are essential sources of information for companies about misconduct," and therefore "play an important role in facilitating compliance with the securities laws." *Id.* at 34,323, 34,325. Among other benefits, "[s]creening allegations through internal compliance programs may limit [meritless] claims, provide the entity an opportunity to re- solve the violation and report the result to the Commission, and allow the Commission to use its resources more efficiently." *Id.* at 34,359 n.450. "[W]histleblower reporting through internal compliance procedures can [thereby] complement or otherwise appreciably enhance * * * enforcement efforts," without substituting for them. 76 Fed. Reg. at 34,359 n.450. All this facilitates efficient use of private-sector and government resources, and effectuates Section 78u- 6's design to prevent fraud and other securities-law violations. Reading the anti-retaliation provisions to protect only those who report to the Commission, by contrast, would "defeat the purpose of the legislation."

This analysis remains true, notwithstanding the Supreme Court's holding that the DFA (*but not SOX*) did not contain sufficient statutory justification for protecting internal whistleblowers.[4] The

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[4] The Commission also explained the importance of fully protecting internal whistleblowers in the commentary published at the time it issued its initial whistleblower rules: "[C]ompliance with the Federal securities laws is promoted when companies have effective programs for identifying, correcting, and self-reporting unlawful conduct by company officers or employees. The objective of this provision is to support, not undermine, the effective functioning of company compliance and related systems by allowing employees to take their concerns about possible violations to appropriate company officials first while still preserving their rights under the Commission's whistleblower program. This objective is also important because internal compliance and reporting systems are essential sources of information for companies about misconduct that may not be securities-related (*e.g.*, employment discrimination or harassment complaints), as well as for securities- related complaints. We believe that the balance struck in the final rule will promote the continued development and maintenance of robust compliance programs. As we noted in our proposing release, we are not seeking to undermine effective company processes for receiving reports on possible violations including those that may be outside of our enforcement interest, but are nonetheless important for companies to address." 76 Fed. Reg. 34,323 (June 13, 2011).

policy arguments set forth above go to the heart of the legislative intent behind the creation of the SEC whistleblower program, and the programmatic interests of incentivizing reporting while at the same time supporting a robust internal compliance culture. The Commission has an opportunity in the current rulemaking process to vindicate these policy imperatives by amending its current rules to explicitly reference the authorities it possesses under the Sarbanes-Oxley Act as a source of authority to continue protecting internal whistleblowers, and ensure that all of the whistleblower provisions of SOX are covered under the Commission's rules.

Maintaining protection for internal whistleblowers is also necessary based on the fact that the majority of whistleblowers who eventually disclosure information to the Commission through the TCR process made their initial disclosures internally. In its *amicus* brief filed before the U.S. Supreme Court in *Digital,* the Commission explained that many of these internal whistleblowers are subjected to retaliation:

> Of the whistleblowers who received awards from the Commission in 2016, about 80% reported internally before reporting to the Commission. SEC, *2016 Annual Report to Congress on the Dodd-Frank Whistleblower Program* 18. There are numerous reasons why employees tend to report internally first, including loyalty to the organization, hope that supervisors will rectify or explain the perceived misconduct without the need for government intervention, or (as with auditors and attorneys) a legal obligation to raise a matter in-house. *See* Janet P. Near & Marcia P. Miceli, *After the Wrongdoing: What Managers Should Know About Whistleblowing*, 59 Bus. Horizons 105, 105, 113 (2016). Studies also show that retaliation for internal reporting, when it occurs, generally follows quickly.

Further in 2019, the SEC reported that 69% of Whistleblower Award Program recipients were insiders and of those 85% raised their concerns internally, or "understood that their supervisor or relevant compliance personnel knew of the violations before reporting their information of wrongdoing to the Commission."[5] It is well established that internal whistleblowers are often subjected to retaliation, and this retaliation has a devastating impact on the integrity of internal controls. The need to fully protect internal whistleblowers is highlighted by studies conducted by the Institute of Internal Auditors, a trade association with more than 180,000 members in 170 countries. Their study demonstrated the following:

- 55 percent of Chief Auditing Executives were directed to omit important findings from their audit reports;
- 49 percent were directed "not to perform audit work in high-risk areas.

Auditors were "directed" to "suppress or significantly modify" "valid internal audit findings, and 38% of those requests came directly from the company's Chief Executive Officer, 24% from a company's Chief Financial Officer and 18% from persons with responsibility for compliance or

[5] SEC, *2019 Annual Report to Congress*, Whistleblower Office, 18. Available at https://www.sec.gov/files/sec-2019-annual%20report-whistleblower%20program.pdf.

legal matters. Moreover, numerous auditors reported that they were subjected to retaliation based on their audit findings.[6]

Conclusion

At the request of numerous publicly traded companies and trade associations the SEC, in its final whistleblower rules published in 2011 approved numerous provisions encouraging employees to use internal reporting programs to raise concerns. These incentives went so far as to permit whistleblowers to obtain larger rewards if they first contacted an internal compliance program. Furthermore, restrictions were placed on employees who work in compliance or auditing functions in order to ensure that programs designed to enhance internal controls could properly function. A fundamental part of these regulations concerned protecting those who reported internally from retaliation. It is absolutely essential that the Commission take advantage of the current rulemaking proceeding to ensure that internal whistleblowers remain fully protected, despite the ruling in *Digital*. Ensuring continued protection for internal whistleblowers can be fully accomplished under the existing regulatory and statutory provisions of the Sarbanes-Oxley Act.

Proposed Rule 21F-2(d)(4) should not be approved. Instead, the rules should be amended pursuant to the Commission's authorities under Section 3 of the Sarbanes-Oxley Act to continue to protect internal whistleblowers.

Attached is a draft proposal for amending Rule 21F-2. The proposed changes to the current rule are emphasized in bold.

Thank you for your careful attention to these matters. We would welcome the opportunity to more fully explain this proposal.

Respectfully submitted,

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encl: Attachment to KKC Comment Dated Jan. 8, 2020 – Proposal for Rule § 240.21F-2

[6] *See* Institute of Internal Auditors, *Politics of Internal Auditing* (2015), https://na.theiia.org/news/Documents/Politics-of-Internal-Audit-news-release.pdf.

cc: Commissioner Robert J. Jackson Jr., via e-mail
Commissioner Allison Herren, Lee, via e-mail
Commissioner Hester M. Peirce, via e-mail
Commissioner Elad L. Roisman, via e-mail
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ATTACHMENT TO KKC COMMENT DATED JANUARY 8, 2020

PROPOSAL REGARDING § 240.21F-2

(a) *Definition of a whistleblower.* (1) You are a whistleblower if, alone or jointly with others, you provide the Commission with information pursuant to the procedures set forth in §240.21F-9(a) of this chapter, and the information relates to a possible violation of the Federal securities laws (including any rules or regulations thereunder) that has occurred, is ongoing, or is about to occur. A whistleblower must be an individual. A company or another entity is not eligible to be a whistleblower.

(2) To be eligible for an award, you must submit original information to the Commission in accordance with the procedures and conditions described in §§240.21F-4, 240.21F-8, and 240.21F-9 of this chapter.

(b) *Prohibition against retaliation.*(1) For purposes of the anti-retaliation protections afforded by Section 21F(h)(1) of the Exchange Act (15 U.S.C. 78u-6(h)(1), **or the Sarbanes-Oxley Act, 15 U.S.C. §§ 78j-1(m) and 78j-1(b), and 18 U.S.C. §§ 1513(e) and 1514A**, you are a whistleblower if:

(i) You possess a reasonable belief that the information you are providing relates to a possible securities law violation (or, where applicable, to a possible violation of the provisions set forth in 18 U.S.C. 1514A(a)) that has occurred, is ongoing, or is about to occur, and;

(ii) You provide that information in a manner described in Section 21F(h)(1)(A) of the Exchange Act (15 U.S.C. 78u-6(h)(1)(A) **or the Sarbanes-Oxley Act, 15 U.S.C. §§ 78j-1(m) and 78j-1(b), and 18 U.S.C. §§ 1513(e) and 1514A**.

(iii) The anti-retaliation protections apply whether or not you satisfy the requirements, procedures and conditions to qualify for an award.

(2) Section 21F(h)(1) of the Exchange Act (15 U.S.C. 78u-6(h)(1)) and **the Sarbanes-Oxley Act, 15 U.S.C. §§ 78j-1(m) and 78j-1(b), and 18 U.S.C. §§ 1513(e) and 1514A**, including any rules promulgated thereunder, shall be enforceable in an action or proceeding brought by the Commission.

(3) The Commission shall take enforcement action for retaliation in violation of the Sarbanes-Oxley Act, 15 U.S.C. §§ 78j-1(m) and 78j-1(b), and 18 U.S.C. §§ 1513(e) and 1514A pursuant to its authority in Section 3 of the Sarbanes-Oxley Act, 15 U.S.C. 7202(a) and (b).