

NWC | NATIONAL WHISTLEBLOWER CENTER

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September 18, 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: Proposed Rule File Number S7-16-18, Whistleblower Program Rules

Dear Chairman Clayton,

The following comment is submitted on behalf of the [National Whistleblower Center \(“NWC”\)](#) pursuant to File Number S7-16-18. This comment provides additional information related to the concerns identified in the comment submitted on behalf of the NWC on September 17, 2018¹. The proposal by the U.S. Securities and Exchange Commission (“SEC”) for changes to the Whistleblower Reward Program, specifically to Section 21F of the Securities Exchange Act of 1934, would be damaging to the effectiveness of the SEC’s whistleblower program and would not serve the best interests of the public. This proposed change is inconsistent with the intention of Congress, as well as basic rules underpinning the effectiveness of whistleblower laws.

Congress explicitly required the SEC to consider the deterrent effect of paying awards when setting the amount payments. [15 U.S.C. § 78u-6\(c\)\(1\)\(B\)\(i\)\(III\)](#). As set forth below, and consistent with the prior comments of the National Whistleblower Center and other persons, a cap on awards would undermine the deterrent effect of paying awards.

Putting a cap on rewards has no known effect ensuring that the SEC would become a “responsible steward of the public trust”², as noted by [Chairman Clayton](#); instead, it will only deter whistleblowers from coming forward. Moreover, the existence of high rewards ensures good governance in a myriad of ways. Two functions deserve more careful explanation:

¹ <https://www.whistleblowers.org/storage/docs/sec-nwc-9-17-18-final.pdf>.

² Clayton, Jay, Chairman. "Statement at Open Meeting on Amendments to the Commission’s Whistleblower Program Rules." SEC.Gov. June 28, 2018. <https://www.sec.gov/news/public-statement/statement-open-meeting-amendments-commissions-whistleblower-program-rules-ftn1>.

- High rewards increase the likelihood that more whistleblowers will come forward to the SEC with their information; and
- Whistleblower rewards encourage companies to create robust internal compliance programs. Bolstering compliance programs aligns with the mission of the SEC as they prevent fraud from occurring in the first place.

In drafting this submission, NWC has reviewed hundreds of blogs, webpages, and news articles concerning the role/promise large rewards play in effectuating the “core objective” of the Dodd-Frank Act’s whistleblower provision.³ Significantly, many corporate law firms that represent regulated industries have noted the positive impact that large rewards (whether actual or simply anticipated) can have on motivating employees to step forward. Statements by these law firms acknowledge that big rewards promote compliance and transparency within any workplace.

High Rewards Encourage More Disclosures:

Like any rational actor, humans weigh trade-offs before making decisions. Should a whistleblower find the trade-off not worth their while, the SEC will rarely ever uncover another fraud case. Marc J. Fagel, an associate at [Gibson Dunn LLC](#), stated,

“It seems evident that the promise of a huge payoff will lure increasing numbers of self-proclaimed whistleblowers, not to mention their counsel, into the awaiting arms of the SEC. Even if many (or even most) of these claims lack merit (as suggested by some of the more colorful illustrations in the SEC’s claim denials), companies confronted with whistleblower allegations have no choice but to treat them seriously. Failing to do so — or worse, taking steps viewed as discouraging whistleblowers from coming forward — can result in stand-alone enforcement proceedings by the SEC, or tougher sanctions if an underlying securities violation is found and charged by the agency.”⁴

Statement released after award of \$17 million given by the SEC on June 9, 2016 (emphasis added).

Should the SEC adopt the changes to the cap, this “promise of a huge payoff” is no longer a certainty, discouraging many potential whistleblowers.

³ “The ‘core objective’” of Dodd-Frank’s robust whistleblower program . . . is ‘to motivate people who know of securities law violations to *tell the SEC*’ . . . To that end, §78u-6 provides **substantial** monetary rewards to whistleblowers who furnish actionable information to the SEC.” *Digital Realty Trust*, 138 S.Ct. 767 (2018) (emphasis added).

⁴ Fagel, Marc J. "SEC’s Whistleblower Program Is Gaining Steam." [Gibsondunn.com](https://www.gibsondunn.com). August 1, 2016. <https://www.gibsondunn.com/wp-content/uploads/documents/publications/Fagel-SECs-Whistleblower-Program-is-Gaining-Steam-DJ-8-1-16.pdf>.

Not only will the SEC lose out on potential whistleblowers in the U.S., the changes will also discourage those living abroad. Under the Foreign Corrupt Practices Act (“FCPA”), the SEC is authorized to accept tips from those outside of U.S. borders. This transnational mandate is of the utmost importance. The FCPA creates a more transparent international arena and facilitates fair trading practices. This program is very robust; in fact, from 2011 through 2017, the SEC received 2,655 tips from 113 countries, outside the U.S. Eduardo Singerman and Paul Hugel of BDO USA LLP and Clayman & Rosenberg LLP, respectively, [state](#) a similar opinion:

“The SEC whistleblower program encourages individuals, both U.S. citizens and residents and foreign nationals worldwide, to report to the commission violations of federal securities laws and the Foreign Corrupt Practices Act. **The program’s success is based on the possibility of significant monetary awards**, its anti-retaliation protection, and the confidentiality of the whistleblower’s identity.”⁵

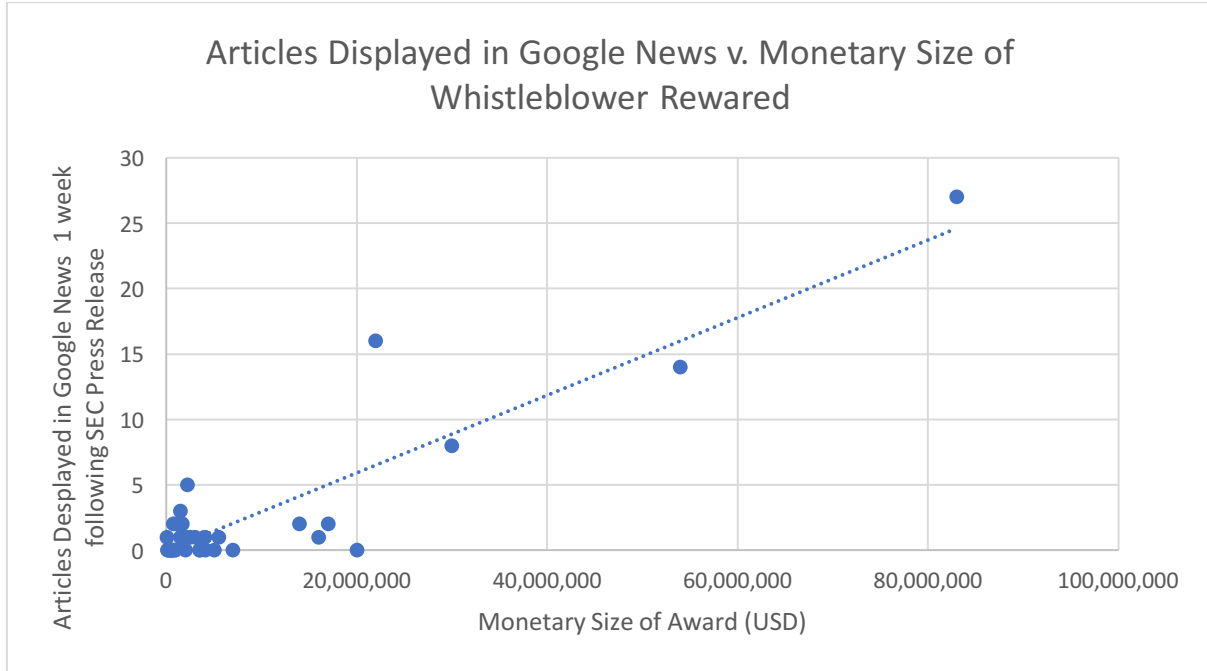
This statement released after the announcement of the report of the SEC’s fiscal year in monetary rewards of almost \$50 million to 12 whistleblowers (emphasis added).

Only if an individual with the relevant information is able to see that the U.S. government is willing to reward those who expose fraud and corruption, in consideration of the risk endured by them as well as the substantial financial windfall that the U.S. Treasury obtains as a result of that information, will such an individual be willing to come forward and report such corruption to the SEC. Those with such information, particularly those living abroad, often learn about whistleblower rewards through media channels. Media publicity not only educates the public (and potential whistleblowers) as to the existence of the program, but also has a strong deterrent effect on potential wrongdoers.

The graph below uses data analyzed by the National Whistleblower Center and demonstrates that large rewards receive significantly more media attention than small rewards. This includes all whistleblower reward press releases listed on the SEC website as of September 17, 2018. This graph utilizes articles displayed in Google News one-week post-press release, charted against the amount of the reward. In other words, the NWC reviewed each press release issued by the Commission regarding every award issued. Thereafter, the NWC did an identical Google News search to find articles covering the award using the search terms “SEC” and “whistleblower.” By clicking the blue dots on the chart, you can see the underlying statistics. We will make the excel spreadsheet available upon request.

As demonstrated in the chart, larger rewards generate significantly greater publicity which both incentivizes perspective whistleblowers and deters criminal activity/securities fraud.

⁵ Singerman, Eduardo, and Paul Hugel. "Voices The Dodd-Frank Whistleblower Program Keeps Whistleblowers Busy in 2017." Accountingtoday.com. January 9, 2018. <https://www.accountingtoday.com/opinion/the-dodd-frank-whistleblower-program-keeps-whistleblowers-busy-in-2017>.



As the chart above demonstrates, the amount of reporting on whistleblower awards broadly increases with larger awards. Should the SEC continue to provide these large rewards, the detection of fraud will continue through whistleblower tips. As noted by law firm Bryan Cave Leighton Paisner LLP, generous rewards [encourage employees to blow the whistle](#):

“This award shows that it is not only your company’s employees who may take internal issues to the SEC. Instead, outside contractors and even government employees may go to the SEC. **This award suggests that the SEC will continue to publicize large monetary awards to encourage whistleblowers to provide evidence of larger-scale issues.**”⁶

Statement released in response to \$2.5 million-dollar rewards given by the SEC on July 25, 2017 (emphasis added).

High Rewards Encourage Robust Compliance Programs:

Not only will capping awards at 10% disrupt the quantity of awards received, it will discourage companies from maintaining adequate internal compliance programs. Experts from many fields of law agree that strong whistleblower rights and protections encourage companies to beef up

⁶ Srere, Mark A., Elaine D. Kock, Jennifer K. Mammen, and Jennifer L. Berhorst. "\$2.5 Million SEC Whistleblower Award Goes to Government Employee." Bryancave.com. July 27, 2017. <https://www.bryancave.com/en/thought-leadership/2-5-million-sec-whistleblower-award-goes-to-government-employee.html>.

compliance programs and adhere to standards set out by the SEC. Should the proposed cap go into effect, many companies will be less incentivized to promote a transparent and fraud free workplace. Jason Kaufman and John Fullerton III of Epstein Becker Green, LLC [recently wrote](#),

“These recent awards are a good reminder that employers must be more diligent and cautious than ever when it comes to securities compliance and investigating internal complaints by would-be whistleblowers, as *the awards available to tipsters under the “bounty” program are a tremendous incentive to report to the SEC.*”⁷

Statement released was in response to \$49 million reward from the SEC on March 19, 2018 (emphasis added).

Both lawyers maintain that awards are the primary incentive for reporting to the SEC **and** that reporting to the SEC is the primary incentive for companies to be diligent in their securities compliance.

A [client memorandum](#) from law firm Davis Polk & Wardwell LLP, it was warned that with the rulemaking,

“reporting incentives for larger cases may be disincentivized,” and that,

“in considering whistleblowers’ rights and when drafting separation agreements, employment agreements, compensation plans, policies and other company documents, companies should continue to keep in mind that protecting and encouraging whistleblowers has been a priority for the enforcement division of the SEC as well as the SEC’s Office of the Whistleblower.”⁸

Statement made in response to the proposed rule amendment from the SEC on June 28, 2018

Law firms have agreed with this sentiment for many years now. A [memorandum](#) from Dechert LLP notes that,

“The continued increase in whistleblower reports to the SEC, and resulting awards to individuals who provide information leading to significant enforcement actions, suggest that companies must take credible steps to respond to internal reports of

⁷ Kaufman, Jason, and John F. Fullerton, III. "SEC Issues Largest Dodd-Frank Whistleblower “Bounty” Awards Ever." [Financialservicesemploymentlaw.com](https://www.financialservicesemploymentlaw.com). March 21, 2018. <https://www.financialservicesemploymentlaw.com/2018/03/21/sec-issues-largest-dodd-frank-whistleblower-bounty-awards-ever/>.

⁸ "SEC’s Proposed Amendments to Its Whistleblower Program May Increase Reporting of Potential Securities-Law Violations to the SEC." [Davispolk.com](https://www.davispolk.com). July 6, 2018. https://www.davispolk.com/files/2018-07-06_secs_proposed_amendments_to_its_whistleblower_program_may_increase_reporting_of_potential_securities-law_violations_to_the_sec.pdf.

potential violations of the securities laws. If not, there is a significant risk that individuals – even if they are located outside of the United States and/or have compliance or internal audit responsibilities – who feel that their concerns are going unaddressed may turn to the SEC in the hopes of reaping potentially significant awards, necessarily at their employers’ eventual expense.”⁹

“These developments demonstrate the need for companies to aggressively take steps to address compliance concerns raised internally by their own employees, or else run the risk that employees may choose to report concerns to the SEC in the hope of obtaining potentially significant monetary rewards and protection from retaliation by their employers.”¹⁰

Statement released after the SEC released their annual report to Congress on the Dodd-Frank Whistleblower Program in 2014.

These law firms acknowledge the importance that large rewards have on the way companies will comply with their employees and take the steps necessary to fix and settle internal reports that go on in the workplace. Not only do U.S. employees get protected by the government, but also foreign workers have the ability to blow the whistle to the U.S. government and receive a generous reward from the SEC as well. Foreign employees cannot benefit from the Dodd-Frank/Sarbanes-Oxley Acts anti-retaliation provisions, so their only motive for ever blowing the whistle is the prospect of a generous financial reward. Implementing this cap will also decrease the amount of fraud detected in foreign countries.

Other notable law firms have released material noting the importance of companies enhancing their compliance programs due to the threat of whistleblowers being incentivized by rewards. According to [Willkie Farr & Gallagher LLP](#),

“It is therefore important for companies not only to have compliance policies that include robust procedures for responding to internal reports of misconduct but also to be committed to following those procedures through timely and appropriate action. To do otherwise is to risk opening the door to the whistleblower program to the company’s own compliance officers.”¹¹

⁹ Zucker, Jeremy, Darshak Dholakia, and Elisa Wiygul. "Overview of Compliance Concerns Raised by Recent U.S. SEC Whistleblower Developments." Info.dechert.com. December 9, 2014. <https://info.dechert.com/10/4069/landing-pages/overview-of-compliance-concerns-raised-by-recent-u.s.-sec-whistleblower-developments.asp>.

¹⁰"Overview of Compliance Concerns Raised by Recent US SEC Whistleblower Developments." Dechert.com. December 17, 2014. <https://www.dechert.com/knowledge/onpoint/2014/12/overview-of-compliance-concerns-raised-by-recent-us-sec-whistleb.html>.

¹¹Weinstein, Martin, Robert Meyer, and Jeffrey Clark. "Company Compliance Officer Wins a Dodd-Frank Whistleblower Award." Willkie.com. April 27, 2015. https://www.willkie.com/~media/Files/Publications/2015/04/Company_Compliance_Officer_Wins_a_Dodd_Frank_Whistleblower_Award.pdf.

Statement released after reward of more than \$1 million from the SEC on April 22, 2015

Internal compliance programs within the workplace give the employers enough time to investigate the reported misconduct and take the measures necessary to keep a transparent workplace. According to [Paul, Weiss, Rifkind, Wharton & Garrison LLP](#),

“The recent whistleblower awards serve as a powerful reminder of the importance of corporate compliance programs. It remains extremely beneficial for companies to maintain internal reporting channels for employees who would like to report potential misconduct, to develop procedures designed to prevent and detect misconduct, and to investigate any potential misconduct promptly.”¹²

Statement released after CFTC awarded multiple whistleblowers a total of more than \$45 million on August 2, 2018.

Companies must take the internal reporting seriously. If they do not, the generous rewards from the SEC will encourage employees to give tips to the government and blow the whistle. According to [Weil, Gotshal & Manges LLP](#),

“In the meantime, companies should remain vigilant in encouraging internal reporting and diligently investigating all potential wrongdoing... This award – and the quite considerable lengths to which the SEC went to protect the identity of the whistleblower – will embolden more whistleblowers to report securities violations”¹³

Released after SEC’s announcement of its first whistleblower reward on August 21, 2012.

Statements by these law firms concur that large monetary rewards reinforce compliance programs within companies and decrease federal violations. According to [Arent Fox LLP](#),

“To regulated entities, this week’s unprecedented whistleblower awards reinforce the need for robust compliance programs that decrease the likelihood of federal

¹² "CFTC Issues Largest Ever Whistleblower Award and First Award to a Foreign Whistleblower." Paulweiss.com. July 30, 2018.
<https://www.paulweiss.com/practices/litigation/financial-institutions/publications/cftc-issues-largest-ever-whistleblower-award-and-first-award-to-a-foreign-whistleblower?id=26829>.

¹³ Bartholomew, Christian, and Sarah Nilson. "SEC Issues First Whistleblower Award." Weil.com. August 2012.
https://www.weil.com/~media/files/pdfs/securities_litigation_enforcement_weil_alert_august_2012.pdf.

securities-law violations, as well as internal controls that facilitate reporting and remediation of potential compliance lapses within the company.”¹⁴

Statement released in response to award from the SEC of over \$83 million on March 19, 2018.

The Commission’s Justification for the Rate Cap is Not Supported in Law or in Fact:

In the rulemaking proposal the Commission postulated two justifications for the cap. First, to preserve the Investor Protection Fund or “IPF.” Second, to generate revenue to be used for other programs that serve the public interest. Both are not supportable.

As for protecting the amount of money in the IPF, Congress anticipated that the Commission may try to reduce awards based on the amount of monies in the IPF. Thus, the DFA’s statute clearly prohibits the Commission from taking into consideration the balance of the IPF when making reward decisions. Significantly, while prohibiting the Commission from considering the balance in the IPA, Congress **required** the Commission to consider the deterrence effect of an award when weighing how large of an award to pay. The statute states:

In determining the amount of an award made under subsection (b), the Commission—

(i) shall take into consideration—

- (I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action;
- (II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action;
- (III) **the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers** who provide information that lead to the successful enforcement of such laws; and
- (IV) such additional relevant factors as the Commission may establish by rule or regulation; and

(ii) **shall not take into consideration the balance of the Fund.**

[15 U.S.C. § 78u-6\(c\)\(1\)\(B\)](#) (emphasis added)

In direct conflict with this statutory prohibition, the Commission explicitly stated that one of the goals of the cap on rewards was to protect the amount of monies in the IPF. In its discussion on the cap, the Commission stated:

¹⁴ Fiorentino, Lynn R., Peter V. B. Unger, and Michael F. Dearington. "Whistle While They Work: SEC Announces Largest-Ever Dodd-Frank Whistleblower Awards." Arentfox.com. March 23, 2018. <https://www.arentfox.com/perspectives/alerts/whistle-while-they-work-sec-announces-largest-ever-dodd-frank-whistleblower>.

“These awards could substantially diminish the IPF, requiring the Commission to direct more funds to replenish the IPF rather than making that money available to the United States Treasury, where they could be used for other important public purposes.”

In violation of Congressional intent, the proposed rules provide the Commission with the authority to do precisely what Congress has prohibited:

“Finally, in any order that adjusts any of the dollar amounts [of the rewards] . . . the Commission shall consider . . . the potential impact any adjustment might have on the IPF.”

The Dodd-Frank Act’s whistleblower program is **not** simply a revenue-producing statute. The core purpose of the law is to encourage the reporting of securities violations, to protect investors and to utilize the deterrent impact of “substantial rewards” to stop corporate crimes before they even occur. A collateral benefit is to encourage firms to institute strong and independent compliance programs. The cap proposed by the Commission undermines all of these goals.

The fact that an effective whistleblower program can be revenue producing is of no consequence, and it is highly improper for the Commission to weigh its desire to spend the proceeds collected by the government due to whistleblower disclosures on other “important public purposes” when considering whether or not to reduce whistleblower rewards. “The ‘core objective’ of Dodd-Frank’s robust whistleblower program . . . is ‘to motivate people who know of securities law violations to *tell the SEC*,” *Digital Realty Trust*, 138 S.Ct. 767 (2018) (emphasis in the original), not to generate revenue for other programs the Commission believes are “important.”

Conclusion:

The National Whistleblower Center strongly concurs with the authors of *fcpablog.com*, which provides substantial legal commentary on relevant legal developments. [As noted](#),

We encourage the SEC to reconsider this amendment. Whistleblowers are critical to the SEC’s mission of protecting investors and market integrity. They risk their careers, livelihoods, and reputation when they come forward. A robust whistleblower reward program encourages individuals to report wrongdoing to the SEC despite the serious risks and personal losses they face.¹⁵

Statement released after SEC’s proposed its amendment to their whistleblower program on June 28, 2018.

Generous rewards given (or promised) to whistleblowers from the SEC provide strong motivation for whistleblowers to come forward and expose securities violations, often at great personal risk.

¹⁵ Tillipman, Jessica, and Paige Brownlow. "Tillipman and Brownlow: Is the SEC about to Weaken the Whistleblower Program?" *Fcpablog.com*. August 15, 2018. <http://www.fcpablog.com/blog/2018/8/15/tillipman-and-brownlow-is-the-sec-about-to-weaken-the-whistl.html>.

Reducing the amount and putting a cap on the rewards will discourage them from putting everything they have on the line if they do not get the reward they deserve. Without whistleblowers coming forward and giving tips to the government, fraud and corruption will thrive.

Large whistleblower rewards give employers a reason to create a transparent work environment and be encouraging of employee internal disclosures.

The quotes cited above by corporate law firms highlight the importance of large monetary rewards given (or promised) by the SEC. These firms are in the business of defending publicly traded corporations, and their comments on the impact of large rewards (whether given or promised) on incentivizing employees to report, and incentivizing companies to enhance their compliance programs, should be carefully considered. This is especially true as these comments were made before the cap was proposed by the SEC.

The rate cap proposal will be detrimental to the goals of the whistleblower program, ethical corporate governance, and the protection of investors. The rule should not be approved.

Thank you in advance for your careful to this letter and other comments submitted on behalf of the NWC. We would like to meet one-on-one with each Commissioner and to meet directly with the Commission staff responsible for reviewing the public comments and finalizing the rule. You can reach me at contact@whistleblowers.org.

Sincerely,

/s/ Stephen M. Kohn¹⁶
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¹⁶ This comment is filed on behalf of the [National Whistleblower Center](#). It does not necessarily reflect the opinion of clients individually represented by Mr. Kohn in his capacity as an attorney-at-law or as a partner in the law firm of [Kohn, Kohn and Colapinto](#). The NWC would like to thank its public interest interns Cesar Marquez and Anna Wysen for their invaluable assistance in analyzing the media documentation and their contributions to the comment.