U.S. Securities and Exchange Commission

Speech by SEC Commissioner: Statement at Open Meeting to Adopt Final Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

by

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U.S. Securities and Exchange Commission

Washington, D.C.
May 25, 2011

Thank you, Chairman Schapiro.

Section 21F of the Securities Exchange Act, which was added by the Dodd-Frank Act, provides for a new SEC whistleblower program. Under the program, the SEC is to pay a bounty to an eligible whistleblower who voluntarily provides the SEC with original information concerning a securities law violation that leads to a successful enforcement action. The bounty can be considerable: between 10 and 30 percent of the monetary sanctions awarded in the enforcement action to which the tips leads.

Dodd-Frank affords the Commission a great opportunity — namely, the chance to fashion a well-calibrated whistleblower program that elicits high-quality tips that warrant the agency's active pursuit; that does not incentivize individuals to submit frivolous, spurious, or unduly speculative tips that distract the Commission from more productive investigations; and that does not thwart internal compliance programs that companies have set up.

Unfortunately, the Commission missed its opportunity. While I appreciate the SEC staff's professionalism in wrestling with countless difficult questions throughout this rulemaking, I do not think that the final rule strikes the right balances among the tradeoffs involved in crafting the whistleblower program. In addition, I am concerned that the final rule constructs a process for tipping the Commission that whistleblowers will find overly burdensome and perplexing. Accordingly, I am not able to support the recommendation before us and respectfully dissent.

Although there are other shortcomings with the rulemaking, the balance of my remarks highlights some of my principal concerns.

As those who have tracked this rulemaking know, singular attention has centered on the extent to which the whistleblower program, depending on how it is structured, could unduly erode the value of internal compliance programs in rooting out and preventing wrongdoing. Ensuring the integrity of corporate compliance programs is especially important because companies with well-functioning compliance programs may be able to detect and remedy misconduct more swiftly than the SEC can. This is so even when the SEC has the benefit of a solid tip, given the Commission's many other responsibilities. Indeed, the federal government, through the Sarbanes-Oxley Act and otherwise, has encouraged companies to implement compliance programs to ensure that wrongdoing is uncovered and that misconduct is stopped, sanctioned, and remedied as soon as possible.

I appreciate the considerations that have been expressed in arguing against requiring a whistleblower who is an employee to report internally at the company to be eligible for a bounty. But the Commission could have improved the final rule appreciably, even if it stopped short of mandating internal reporting as a general matter. Three examples are illustrative.

First, a whistleblower is eligible to receive a bounty, even if the whistleblower submits the tip to the SEC after having been contacted pursuant to an internal investigation. Put differently, the final rule permits a whistleblower to knowingly bypass a company's good-faith attempts to identify and investigate alleged violations. A middle-ground exists between allowing a whistleblower to circumvent an ongoing internal investigation, as the final rule does, and prohibiting the whistleblower from collecting a bounty altogether once an internal investigation is underway. Specifically, in the limited instance of when the company has already contacted the whistleblower in an effort to ferret out and address alleged wrongdoing, the

Commission should have underpinned the integrity of internal compliance programs by requiring a whistleblower, in order to receive a bounty, to have internally reported the same information as the whistleblower provides to the SEC, perhaps with a carveout for extraordinary circumstances.

Second, the final rule provides that a whistleblower's bounty "may increase" if the whistleblower participated in the company's internal compliance system. Instead, the final rule could have said "will increase" to incentivize an employee to make use of the company's internal procedures, so long as those procedures are deemed to be effective. Likewise, the bounty "may decrease," according to the final rule, if the whistleblower interfered with the company's internal compliance procedures, such as by making a fraudulent statement that hinders the company's efforts to detect and investigate the alleged securities law violation. It would have been an improvement had the Commission committed, at the outset, to reducing the bounty when the whistleblower takes steps that undermine the efficacy of internal compliance. In other words, "may decrease" should be "will decrease."

Third, under the final rule, various compliance and internal audit personnel, including others with similar responsibilities, are eligible to receive a whistleblower bounty if there is a "reasonable basis to believe that disclosure of the information to the Commission is necessary to prevent the [company] from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors" or there is a "reasonable basis to believe that the [company] is engaging in conduct that will impede an investigation of the misconduct." I am concerned that, in practice, these exceptions will swallow the general rule that compliance and internal audit personnel are not eligible to receive bounties; for it may not be difficult for an individual to assert the reasonable belief required to fall within one or both of these exceptions, even if the belief is not well-founded in fact. To the extent compliance and internal audit personnel use this flexibility to sidestep even effective internal compliance programs, companies will be frustrated in their efforts to spot and halt wrongdoing and to expeditiously implement new safeguards against unlawful conduct. A compromise could have been to require compliance and internal audit personnel, in addition to falling within one of these exceptions, also to have reported internally to be eligible to receive a whistleblower bounty, perhaps with a carveout for extraordinary circumstances.

In sum, I do not think that the final rule adequately preserves the important role that corporate compliance programs serve in ensuring that the law is complied with and that other misbehavior is deterred.

I am also concerned that the SEC will be inundated with allegations, not all of which will be fruitful for us to pursue. Without question, because of tips we will receive, the agency will be able to uncover otherwise undetected misconduct. But at least some of the tips that come in will not be of the highest quality because, for example, the complained-of conduct is not a securities law violation, even if the behavior is untoward. Further, some allegations may prove to be spurious or, even if submitted in good faith, far too speculative and ultimately unfounded. However, even such tips command SEC staff attention because it is difficult to distinguish strong leads from weaker ones without careful follow up. Separating the wheat from the chaff when faced with thousands upon thousands of complaints is and will be very challenging.

The Commission is best able to protect investors and to promote the integrity of our securities markets when our enforcement resources are allocated efficiently and we can give proper attention to our well-considered priorities. When allocating our valuable resources, we always have to be mindful of the opportunity cost of the agency's time and effort. Accordingly, it is key that the whistleblower program increase the chance that the tips we receive from whistleblowers are limited to the kinds of high-quality leads that are most worthy of the SEC's active pursuit. I do not think that the final rule succeeds in this regard, but instead runs an undue risk of encouraging lower-quality submissions that risk diverting SEC resources from priorities that, if pursued more aggressively, would better protect investors.

In fact, the adopting release recognizes that the Commission's whistleblower program is considerably more permissive than the False Claims Act in terms of what kind of tip may give rise to a bounty, which is to underscore, to my mind, that the final rule does not do enough to efficiently filter out lower-quality submissions. As the release explains, the "barriers to participation as a False Claims Act whistleblower are appreciably higher than in our program: for example, to be eligible for an award under the False Claims Act, a *qui tam* relator must file a federal court complaint alleging fraud with specificity as required by Rule 9(b) of the Federal Rules of Civil Procedure, whereas under [the SEC's] program, a

whistleblower only needs to complete a Form TCR, sworn under penalty of perjury." Further, the final rule defines a "whistleblower" as one who provides information to the SEC that "relates to a possible violation of the federal securities laws . . . that has occurred, is ongoing, or is about to occur." A whistleblower's merely having to allege that a violation is "possible" to enjoy the prospect of an outsize bounty risks spurring an excessive flow of lower-quality tips to the Commission. Such as by requiring a "reasonable likelihood" of a violation, the final rule could have better ensured that the tips the Commission receives are meritorious, which would have empowered the agency in more effectively dedicating our resources to the highest-priority enforcement matters.

Finally, for those who would provide the Commission with meaningful, credible tips, I am troubled that the process for tipping the SEC and obtaining a bounty will too frequently prove to be overly confusing and intimidating for whistleblowers. Numerous commenters criticized the Commission's proposal as unduly complicated. I worry that the challenge of navigating through the program may chill individuals from providing the Commission with what would be valuable tips. A more user friendly process for submitting a tip and collecting a bounty could have guarded against the risk that the bureaucracy of the whistleblower program will itself cause the SEC to lose out on valuable leads.

The question is not whether or not a whistleblower program is worthwhile. Without doubt, the federal securities laws should be vigorously enforced, and high-quality tips can help the SEC fulfill our law enforcement responsibilities. Rather, the question, as I see it, is whether or not the rule before us has struck the appropriate balances given the range of considerations that go into fashioning a program for whistleblowers.

As my remarks indicate, I believe that we could and should have calibrated the final rule differently, shifting the tradeoffs in favor of ensuring the integrity of internal compliance programs as a complement to government enforcement; reducing the risk that lower-quality submissions will distract the Commission from pursuing more productive investigations and higher enforcement priorities; and ensuring that whistleblowers are not forced to confront overly burdensome and discouraging procedural hurdles when tipping the SEC. Had the Commission tuned the whistleblower program to achieve these ends more effectively, we would have better served investors and our markets as a whole.

I want to conclude by again thanking the staff for your dedicated efforts throughout this rulemaking.

http://www.sec.gov/news/speech/2011/spch052511tap-item2.htm
