

SEC Enacts Even More Rigorous Whistleblower Program After Public Comment

BY THE SECURITIES LITIGATION PRACTICE

On May 25, 2011, the SEC held a public hearing on final rules implementing the SEC whistleblower program under the Dodd-Frank Act. The program is designed to incentivize individuals to bring high quality tips to the SEC to assist investigations of possible securities law violations. The Commission received 240 comments and 1300 form letters on the Proposed Rules.¹ The final rules, adopted on Wednesday and scheduled to go into effect in 60 days, address “hot topics” such as internal compliance reporting; whistleblower status for attorneys, directors, compliance professionals, and auditors; retaliation protections; awards for culpable whistleblowers; and simplifying the process for making complaints.

Internal Compliance Reporting. The final regulations will **NOT** mandate internal reporting of violations **before** reporting to the SEC’s Whistleblower Office. While acknowledging that the issue of internal compliance reporting generated the most vigorous comments and concerns, the SEC declined to mandate internal reporting, with Commissioner Mary Shapiro stating that “the whistleblower knows best” how to proceed.

Rather, the Commission amended the rules in an attempt to incentivize, but not mandate, that whistleblowers report internally in three ways. First, the final rules lengthen the time period that a whistleblower can wait to report to the SEC after an internal report and still get credit for the tip, extending the 90 day period to 120 days. Paul Hastings, on behalf of clients, proposed a 180 day period, because the 90 day period initially proposed by the SEC is too short to allow for a meaningful review before disclosure. Second, when the Commission considers the amount of a whistleblower award, it will weigh the extent to which the whistleblower assisted or interfered with the company’s internal investigation. Third, the Commission will give whistleblower status to an individual who only reports internally to the company if the company then reports the possible violation to the SEC, crediting the individual with information established by the company’s investigation. Dissenting Commissioner Casey stated that these amendments underestimate the negative impact of the whistleblower program on internal compliance programs, and that they offer a “pound of cure over an ounce of prevention,” points enunciated by companies and counsel, including Paul Hastings, during the comment period.

Complaints by Attorneys, Compliance Professionals, Officers, Directors, and Audit Staff. The final rule broadens the pool of eligible whistleblowers and makes it easier for attorneys, compliance professionals, directors, officers and audit staff to qualify as whistleblowers and for information in their tip to be used in an SEC investigation. The final rule narrows the exclusions that apply to attorneys,

auditors, or compliance officers and includes more exceptions to these restrictions. These revisions make whistleblower status more available to these individuals. The final rules still protect privileged communications, information obtained by public auditors in the course of the engagement, and information provided to officers and directors as part of their compliance responsibilities. The rules also permit broader use of information provided in tips by expanding the definition of “original information or independent analysis.”

Culpable Whistleblowers Protected. The rules for culpable whistleblowers are not revised. Under the rules, culpable whistleblowers generally are eligible, but the amount of their award is reduced to the extent that their own conduct contributed to the fraud.

Retaliation Protections Bolstered. The Final Rules enhance protections of whistleblowers, even if their tip relates only to “possible” violations and whether or not there is a successful SEC enforcement action. To be protected from retaliation, the whistleblower must have a “reasonable belief” that a securities violation may have, is, or will occur. This amendment imports an objective standard into the rule.

Trends in Tips Already Received in Whistleblower Office. SEC staff testified that the Whistleblower Office is fully staffed and that the quality of tips received has improved since passage of Dodd-Frank. SEC staff testified that the number of tips has increased, although they have not flooded the Office, and that the tips are accompanied by more extensive documentation and corroboration. The SEC began receiving tips as soon as the Dodd-Frank Act passed.

Simpler Forms. The final rules will simplify the tip process through a single online form. A new Whistleblower internet page now is operational on the SEC’s website – www.sec.gov. The page is part of an on-line tip system that will enable the SEC to monitor tip activity more effectively across the agency, according to staff testimony.

The Commission voted 3-2 to accept the final rules, with Commissioners Paredes and Casey dissenting. The final rules are available at: <http://www.sec.gov/rules/final/2011/34-64545.pdf>.

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¹ The comment letter submitted by Paul Hastings in December 2010 is available at:
<http://www.sec.gov/comments/s7-33-10/s73310-137.pdf>.