

# SEC's Proposed Amendments to Its Whistleblower Program May Increase Reporting of Potential Securities-Law Violations to the SEC

July 6, 2018

On June 28, 2018, the Securities and Exchange Commission (“SEC”) voted to propose amendments to the rules governing its whistleblower program. These changes include expanding the types of resolutions covered by the program, giving the SEC discretion in modifying awards, eliminating potential double recovery, adjusting the claims review process, and barring individuals who submit false information or make repeated frivolous claims.<sup>1</sup> The proposed amendments would also expressly adopt the reporting requirements set forth in *Digital Realty Trust, Inc. v. Somers*, a recent Supreme Court decision which held that Dodd-Frank whistleblower protections apply only when a securities-law violation is reported to the SEC.<sup>2</sup> If adopted, these rules may increase reporting of potential securities-law violations to the SEC, though more data is needed to better understand the potential ramifications.

## History of the SEC Whistleblower Rules and Recent Developments

In July 2010, Congress passed the Dodd-Frank Act, which provided specific incentives and protections for “whistleblowers.” In May 2011, the SEC adopted rules to enact the whistleblower program. These rules set forth the definitions and conditions required to qualify as a whistleblower, the process for reporting, and the rewards available for whistleblowers.<sup>3</sup>

Earlier this year, the Supreme Court interpreted the reporting requirements needed to benefit from Dodd-Frank’s whistleblower protections. As discussed in a [previous alert](#), in *Digital Realty Trust, Inc. v. Somers*, the Supreme Court rejected the SEC’s interpretation that Dodd-Frank’s whistleblower protections could apply when an employee had reported potential violations internally but had not reported such violations to the SEC. The Court found that this interpretation was inconsistent with the plain language of the statute and that an employee is required to report possible securities-law violations to the SEC in order to benefit from anti-retaliation protections.

## Proposed Rule Amendments

At its June 28, 2018 open meeting, the Commissioners proposed amendments to the whistleblower rules with a 3-2 vote.<sup>4</sup> In introducing the proposed changes, Chairman Clayton stated that the purpose of the amendments was to “make the [whistleblower] program more effective” and “enhance the Commission’s

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<sup>1</sup> The SEC also clarified the meaning of certain policies and procedures, such as the forms through which individuals can submit information to the SEC.

<sup>2</sup> 138 S. Ct. 767 (2018).

<sup>3</sup> See 17 C.F.R. §§ 240.21F-1–17.

<sup>4</sup> Despite the split vote, all of the Commissioners noted the importance of the whistleblower program and highlighted the program’s success.

ability to more appropriately and expeditiously reward those who voluntarily provide critical information that leads to successful enforcement actions.”<sup>5</sup> The proposed amendments explicitly adopt the reporting requirement set out in *Digital Realty*, requiring that whistleblowers report in writing to the SEC.<sup>6</sup> In addition, the proposed amendments cover the following topics:

- *Expanding the definition of “action” to cover additional criminal resolutions and SEC settlement agreements.* The current rules are silent as to whether the SEC can reward whistleblowers who provide information that results in a Deferred Prosecution Agreement (“DPA”) or Non-Prosecution Agreement (“NPA”) with the U.S. Department of Justice or a state attorney general in a criminal case. The proposed rules clarify that these actions, as well as settlement agreements with the SEC outside of the context of judicial or administrative proceedings, are covered under the whistleblower program.
- *Giving discretion to adjust upward potential awards that could result in a payout of less than \$2 million.* Noting the historical prevalence of awards under \$2 million, the SEC proposed rules to give it discretion to modify upward awards that otherwise would result in a payout of less than \$2 million. The SEC could adjust an award up to \$2 million, subject to the statutory maximum of 30% of the total monetary sanctions. In choosing to exercise this option, the SEC would consider whether an upward adjustment would better reward the whistleblower and incentivize potential future whistleblowers.
- *Giving discretion to adjust downward potential awards that could result in sanctions of more than \$100 million.* The SEC would also have the discretion to modify downward potential awards that could result in total monetary sanctions of over \$100 million so that the amount does not exceed “what is reasonably necessary to reward the whistleblower and to incentivize similarly situated whistleblowers.”<sup>7</sup> However, the award amount would still be subject to a statutory minimum of 10% of the total monetary sanctions and under the proposed rules could not be adjusted below \$30 million.
- *Adjusting the definition of “related action” to eliminate potential double recovery.* Under the current rules, the SEC can pay awards based on amounts collected in “related actions.” The proposed rules clarify that an action will be deemed a “related action” only when the SEC’s whistleblower program has “the more direct or relevant connection to the action.”<sup>8</sup> The purpose of this provision is to eliminate potential double recovery under different whistleblower programs for the same information.
- *Barring certain individuals from seeking an award based on past behavior.* The SEC could bar individuals from submitting whistleblower award applications where they had previously submitted false information or where they have submitted three frivolous award applications.

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<sup>5</sup> SEC Chairman Jay Clayton, Statement at Open Meeting on Amendments to the Commission’s Whistleblower Program Rules (June 28, 2018), available at <https://www.sec.gov/news/public-statement/statement-open-meeting-amendments-commissions-whistleblower-program-rules>.

<sup>6</sup> Proposed Rule 17 C.F.R. § 240.21F-2, available at Amendments to the Commission’s Whistleblower Program at 164 (2018), <https://www.sec.gov/rules/proposed/2018/34-83557.pdf>.

<sup>7</sup> Proposed Rule 17 C.F.R. § 240.21F-6(d)(2), available at Amendments to the Commission’s Whistleblower Program at 171 (2018), <https://www.sec.gov/rules/proposed/2018/34-83557.pdf>.

<sup>8</sup> Proposed Rule 17 C.F.R. § 240.21F-3, available at Amendments to the Commission’s Whistleblower Program at 166–67 (2018), <https://www.sec.gov/rules/proposed/2018/34-83557.pdf>.

- *Creating a summary disposition procedure.* For likely denials of award applications—such as untimely applications or applications that do not comply with procedural requirements—the proposed rules would create a summary disposition procedure.

While not connected to a specific proposed rule, the SEC also requested public comment on whether to establish a discretionary award mechanism for whistleblowers in SEC enforcement actions that result in monetary sanctions of less than \$1 million.<sup>9</sup>

In addition to the proposed rule amendments, the SEC also proposed interpretative guidance on the meaning of “independent analysis” that is required in a whistleblower’s submission to the SEC. The SEC’s proposed guidance clarifies that “independent analysis” means “evaluation, assessment, or insight beyond what would be reasonably apparent to the Commission from publicly available information.”<sup>10</sup>

Commissioners Jackson and Stein voted against the proposed amendments. Commissioner Jackson voiced concern with discretionary adjustments to awards, noting that it injected uncertainty and politics into determinations of awards, and welcomed comments that could provide data to help understand the effect of these changes on whistleblowers’ incentives.<sup>11</sup> Commissioner Stein was similarly troubled by the discretionary adjustment provision, questioning both its effect on the program’s incentives and whether downward modification of awards is consistent with the SEC’s statutory authority.<sup>12</sup>

### Practical Considerations

The proposed amendments are open for public comment for 60 days after publication in the Federal Register.<sup>13</sup> Following the formal comment period, the SEC will consider the comments—possibly amending the rules as a result—before issuing final rules.

Should the current proposed rules become final, the result may be an increase in reports of potential wrongdoing directly to the SEC. Whistleblowers who may not have reported violations because they were likely to result in smaller monetary sanctions may now have an incentive to report. And, with the proposed rule changes to conform with *Digital Realty*, these reports are now more likely to be made directly to the SEC.

On the other hand, reporting incentives for larger cases may be disincentivized, since large awards could be modified downward. Commissioner Stein’s skepticism about the SEC’s statutory authority to modify award amounts downward may also foreshadow future legal challenges should the proposed rule become final.<sup>14</sup>

As discussed in a [previous alert](#), in considering whistleblowers’ rights and when drafting separation agreements, employment agreements, compensation plans, policies and other company documents,

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<sup>9</sup> Amendments to the Commission’s Whistleblower Program at 110–11 (2018), <https://www.sec.gov/rules/proposed/2018/34-83557.pdf>.

<sup>10</sup> Amendments to the Commission’s Whistleblower Program at 97 (2018), <https://www.sec.gov/rules/proposed/2018/34-83557.pdf>.

<sup>11</sup> SEC Commissioner Robert J. Jackson, Jr., Statement on Proposed Rules Regarding SEC Whistleblower Program (June 28, 2018), *available at* <https://www.sec.gov/news/public-statement/jackson-statement-whistleblowers-062818>.

<sup>12</sup> SEC Commissioner Kara M. Stein, Statement on Proposed Amendments to the Commission’s Whistleblower Program Rules (June 28, 2018), *available at* <https://www.sec.gov/news/public-statement/statement-stein-whistleblower-062818>. Commissioner Stein also objected to the guidance on the “independent analysis” provision, expressing doubt that the guidance helped clarify its meaning.

<sup>13</sup> As of July 6, 2018, the notice had not yet been published in the Federal Register.

<sup>14</sup> SEC Commissioner Kara M. Stein, Statement on Proposed Amendments to the Commission’s Whistleblower Program Rules (June 28, 2018), *available at* <https://www.sec.gov/news/public-statement/statement-stein-whistleblower-062818>.

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. Rule 21F-17, which was promulgated under the Dodd-Frank Act as a means to prohibit employers from interfering with an employee's right to report potential securities laws violations to the SEC, reads: "No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications." Since 2015, the SEC has brought a number of enforcement actions against companies for their use of what the SEC considered to be restrictive clauses in severance agreements and other documents that, according to the SEC, impeded whistleblowers under Rule 21F-17 of the Securities Exchange Act.

In addition to SEC enforcement, the plaintiffs' bar has been active in reviewing public filings to see if companies are in compliance with the Rule. We do not expect that such activities will be deterred by the proposed amendments.

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