

SEC Whistleblower Amendments May Increase Reporting in Smaller Cases

October 16, 2020

A divided Securities and Exchange Commission voted to amend its whistleblower rules to: (1) increase the amounts of smaller awards; (2) assert SEC discretion in determining award amounts; (3) cover Deferred Prosecution Agreements (DPA) and Non-Prosecution Agreements (NPA) with the Department of Justice; and (4) streamline the SEC's process for evaluating applications. The changes may incentivize whistleblowers to report smaller cases, while increasing uncertainty about award amounts in cases that typically draw large penalties, including those involving the FCPA, accounting fraud and issuer disclosure failures.

By a 3-2 vote, the SEC voted to amend its whistleblower rules on September 23, 2020. As discussed in our [previous alert](#), the SEC initially proposed amendments more than two years ago. Some comments that the proposal was anti-whistleblower delayed final adoption until now. Although the SEC changed some of the initial proposals, the two Democrat commissioners still voted against the amendments.

The Amended Rules

The amendments made the following changes:

- *Increase smaller awards.* The majority of SEC whistleblower awards are less than \$5 million. The amendments establish a presumption that the Commission will pay a meritorious claimant the statutory maximum (30% of monetary sanctions) if certain criteria are met and the individual is qualified to receive an award of \$5 million or less.
- *Assert SEC's discretion.* In 2018, the SEC proposed to formalize its authority to reduce awards in excess of \$30 million. In response to criticism, the amendments now assert that the SEC already has this authority, including discretion to determine award amounts in percentage terms, dollar terms, or some combination, and to reduce an award based on its amount. The Commission stated that this discretion is not an assessment of whether awards are too small or large.¹
- *Cover DOJ DPAs and NPAs.* Previously, the rules were silent as to whether the SEC may award whistleblowers who provide information that results in a DPA or NPA with the Department of Justice. The amendments clarify that the rules cover these actions, as well as settlement agreements with the SEC outside of the context of judicial or administrative proceedings.

¹ Whistleblower Program Rules at 47–49 (2020), <https://www.sec.gov/rules/final/2020/34-89963.pdf>; see also 17 C.F.R. § 240.21F-6, available at Whistleblower Program Rules at 173 (2020), <https://www.sec.gov/rules/final/2020/34-89963.pdf>.

- *Require reports to the SEC, and in writing.* As discussed in a [previous alert](#), in *Digital Realty Trust, Inc. v. Somers*,² the Supreme Court rejected the SEC's view at the time that anti-retaliation protections apply when an employee reports internally but not to the SEC. The amendments formally adopt the *Digital Realty* requirement that whistleblowers seeking anti-retaliation protection must report to the SEC. The amended rules also require that the report be in writing.³
- *Bar frivolous complainants.* The SEC may bar individuals from submitting applications if they have previously submitted false information or have submitted three frivolous applications. This change is intended to streamline internal processes for the SEC.
- *Clarify "independent analysis."* Whistleblowers may submit claims based on their own analysis of data or other information. The SEC issued guidance that "independent analysis" may include evaluation of publicly available information if: (1) the analysis derives from multiple sources, including sources that "are not readily identified and accessed by a member of the public without specialized knowledge, unusual effort, or substantial cost"; and (2) such "sources collectively raise a strong inference of a potential securities law violation that is not reasonably inferable by the Commission from any of the sources individually."⁴

Democrat Commissioners Caroline A. Crenshaw and Allison Herren Lee voted against the amendments. Both objected to the assertion that the SEC has discretion to reduce a large award. Commissioner Lee noted that this "clarifying" language did not reflect the Commission's understanding at the time it proposed these rules in 2018,⁵ and she expressed concerns regarding the Commission's ability to "exercise this newly-claimed discretion to adjust awards up or down, on any case, large or small" without requirements for transparency. Both Commissioners also opposed the new definition of "independent analysis" and the requirement to submit information in writing.

Impact of the Amended Rules

The amendments could result in an increase in whistleblower reports in smaller cases, such as those involving potential compliance violations or violation of the broker-dealer, investment adviser, or other SEC rules, because of the new presumption of maximum awards (30% of sanctions) when the award is less than \$5 million. The amendments also could increase the frequency of whistleblower bypassing internal avenues and instead going directly to the SEC because the rules now integrate the *Digital Realty Trust, Inc. v. Somers* holding.

For larger awards, the assertion of discretion could lead to SEC efforts to reduce extremely large awards, such as those typically given in connection with whistleblower reporting of FCPA, accounting fraud, and issuer disclosure failures. Since the SEC began issuing awards in 2012, the largest awards were two awards of \$50 million each, \$39 million, \$37 million and \$33 million. Commissioner Lee's skepticism regarding this discretion may foreshadow future legal challenges.

² 138 S. Ct. 767 (2018).

³ 17 C.F.R. § 240.21F-2(a)(1), available at Whistleblower Program Rules at 167 (2020), <https://www.sec.gov/rules/final/2020/34-89963.pdf>.

⁴ Whistleblower Program Rules at 121–22 (2020), <https://www.sec.gov/rules/final/2020/34-89963.pdf>.

⁵ SEC Commissioner Allison Herren Lee, June Bug vs. Hurricane: Whistleblowers Fight Tremendous Odds and Deserve Better at n.8 (Sept. 23, 2020), available at <https://www.sec.gov/news/public-statement/statement-stein-whistleblower-062818>.

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Since its first award in 2012, the SEC has awarded more than \$527 million to 100 individuals, including \$133 million this fiscal year, and we expect that whistleblower tips will continue to be an important part of the SEC's enforcement program. Companies should continue to be mindful when dealing with potential whistleblowers, and avoid even the appearance of retaliation or efforts to prevent a whistleblower from reporting to the SEC.

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