

FINANCIAL INSTITUTIONS ALERT

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

SEC Seeks Comments on Proposed Whistleblower Rules Under Dodd-Frank

November 11, 2010

As we discussed in greater detail in a [prior alert](#), the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”) provides significant incentives and protections to whistleblowers that provide original information to the Securities and Exchange Commission (“SEC”) regarding violations of the securities laws. Specifically, whistleblowers are entitled to a bounty of between 10 percent and 30 percent of a sanction in excess of \$1 million against the violator, and are also protected from retaliatory conduct by their employers.¹ On November 3, 2010, the SEC released its proposed rules implementing the whistleblower provisions in the Act. During his comments on the proposed rules, Commissioner Troy A. Paredes summarized the challenges and competing interests that the SEC faced in drafting the proposed rules:

Establishing the infrastructure to implement the Dodd-Frank whistleblower program is a big challenge. How do we encourage high-quality tips without incentivizing an avalanche of lower-quality submissions that distract the Commission from more productive investigations? How do we efficiently filter out unfounded allegations that seem credible at first glance? How can we best ensure that the information whistleblowers provide us is meaningful, fulsome, and truthful without creating so many procedural hurdles that people do not tip the SEC because it takes too much work or because the forms a person has to complete to submit a tip are too intimidating or confusing? Should a whistleblower who has participated in the alleged securities law violation be eligible for a bounty? Should a person who passes a privileged communication along to the Commission be excluded from receiving an award? How should the Commission ensure that the government's whistleblower program does not undermine the internal compliance programs that companies have set up, particularly post-Sarbanes-Oxley — recognizing that although many corporate compliance programs are very well-designed, some are not?

Within the confines of Dodd-Frank's statutory language, the recommendation before us — which I support — seeks to strike appropriate balances in wrestling with these and other difficult tradeoffs.²

¹ Dodd-Frank Act, 111th Cong. § 922 (2010).

² Troy A. Paredes, Commissioner, U.S. Securities and Exchange Commission, Speech by SEC Commissioner: Statement at Open Meeting to Propose Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 (Nov. 3, 2010), [available here](#).

The SEC's 181-page release³ describes and seeks public comment on the following key features and provisions of the proposed rules:

- Whistleblowers cannot obtain awards if they are involved in the misconduct.
- Whistleblowers must provide information voluntarily to obtain awards. An individual who provides information to the SEC pursuant to a formal or informal request or pursuant to a legal duty is not acting voluntarily.
- Whistleblowers may only obtain awards if they provide "original information" derived from their "independent knowledge" or "independent analysis," terms which are defined under the proposed rules. Additionally, the following categories of individuals, and people that obtain information from those on the list, will not be deemed to possess information on which a reward may be based:
 - Attorneys that reveal client confidences to the SEC;
 - Accountants that reveal information obtained during an engagement required by the securities laws;
 - Employees performing legal, compliance, audit or similar functions that reveal information obtained in those capacities, unless the entity does not disclose the information to the SEC in a reasonable time or proceeds in bad faith; and
 - Persons that reveal information obtained in a manner that violates criminal laws.
- A whistleblower's submission is deemed effective on the date of an internal report or report to another governmental or regulatory agency as long as the whistleblower provides the information to the SEC within 90 days. However, the whistleblower is not required to make an internal report prior to providing information to the SEC.
- Whistleblowers may only obtain awards if they provide information that "[leads] to a successful enforcement," a standard that is applied more stringently if the information is provided after a staff investigation has commenced.
- In determining whether the \$1 million sanction threshold for the award has been met, the SEC will not aggregate multiple proceedings based on the same information. The SEC will also not count awards against the whistleblower or culpable entities whose conduct the whistleblower directed.
- The SEC will apply four criteria to determine the amount of an award and may also consider items on an additional non-exclusive and non-comprehensive list. Significantly, the list allows the SEC to consider whether the whistleblower followed internal reporting mechanisms before reporting the information to the SEC.
- While it is the SEC's policy to treat all information obtained during investigations as non-public and confidential, the proposed rules note that the SEC may be required to disclose the whistleblower's identity in certain circumstances, such as in a criminal proceeding.
- Whistleblowers will be required to provide information in a specific form and manner, but the SEC may waive the requirement in extraordinary circumstances.
- The SEC may require whistleblowers to provide testimony or other evidence on their eligibility for an award.

³ Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act Release No. 34-63237 (Nov. 3, 2010), [available here](#).

- Whistleblowers that provide information after the Act's enactment, but before the rules' effective date, are eligible for an award. The SEC further states that it "has already received numerous tips from potential whistleblowers after the date of enactment of Dodd-Frank."
- No amnesty is given to persons who provide information to the SEC, but where the whistleblower may be subject to prosecution, his cooperation may be credited.
- The SEC may communicate directly with whistleblowers without the consent of the attorneys for the entity involved (*i.e.*, the whistleblower's employer).

Notably, the proposed rules do not implement the anti-retaliation protections contemplated by the Act. In its general request for comments, the SEC writes, "[i]n addition, the Commission is seeking comment on whether it should promulgate rules regarding the interpretation or implementation of the anti-retaliation provisions"

Considering the tensions between promoting robust internal reporting mechanisms and encouraging whistleblowers to come forward so that the SEC may protect investors, financial institutions and broker-dealers may want to consider submitting comments on the SEC's proposed whistleblower rules. Additionally, financial institutions and broker-dealers may want to consider commenting on the SEC's decision to omit the anti-retaliation provisions from its proposed rules. We will be happy discuss the specifics of the SEC's proposed rules with you in greater detail and, if desired, work with you to develop comments by its December 17, 2010 deadline.

If you have any questions regarding the information in this alert, or with respect to other provisions of this legislation, please contact any of the attorneys listed below in our business or litigation Financial Institutions Groups or in our Broker-Dealer and Financial Products Group.

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