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SEC Adopts Amendments to Whistleblower Rules that Will Strengthen Some Aspects of the Program But Also Reduce Large Awards and Limit Protection Against Retaliation

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By a vote of 3-2, today the SEC adopted amendments to the rules governing the SEC Whistleblower Program. Now about a decade old, the program has proven to be successful in generating high-quality information regarding securities laws violations that have enabled the SEC to halt fraud schemes and protect investors. Since issuing its first award in 2012, the SEC Office of the Whistleblower has issued approximately $523 million in awards to whistleblowers. The SEC actions associated with those orders have resulted in orders totaling more than $2.5 billion. During the public meeting today adopting the new rules, all the Commissioners and other SEC officials that spoke noted the important contributions of whistleblowers to the SEC's Enforcement Program, recognized the challenges whistleblowers face in coming forward, and affirmed a commitment to maintaining a strong SEC whistleblower program. The amendments will become effective 30 days after publication in the Federal Register.

While we are pleased that the SEC took the time to adopt reforms that promote efficiency and expedite the processing of whistleblower tips and whistleblower award applications, we are troubled by the SEC's assertion of vague discretion to take into account the amount of an award in determining award percentage. The Dodd-Frank Act sets forth specific criteria that the SEC should employ in determining an award percentage between 10 percent to 30 percent of collected proceeds in a covered enforcement action. Positive award criteria justifying a higher award include the significance of the tip, the extent of the assistance that the whistleblower provided to the SEC, the law-enforcement interest in deterring the specific violation, and the extent to which the SEC reported the violation to their employer's internal compliance and reporting system. Negative factors that could lower an award include culpability for the violation, unreasonable delay in reporting, and interfering with a company's internal compliance system.

Nowhere in the statute did Congress suggest that the SEC should consider the amount of an award when it determines the appropriate award percentage. Although we are glad that the SEC withdrew the soft cap on whistleblower awards that it proposed in June 2018, the amended rules adopt a vague and subjective approach to lowering awards without offering any transparency as to how the SEC would apply that discretion. This uncertainty could dissuade whistleblowers from coming forward.

Presumption of the Maximum Award Percentage for Awards of $5 Million or Less

Under the SEC Whistleblower Program, the SEC is required to issue awards to eligible whistleblowers who provide original information that leads to enforcement actions with total monetary sanctions in excess of $1 million. In exchange for the valuable information, a whistleblower may receive an award of between 10 percent and 30 percent of the total monetary sanctions collected in the enforcement action.

As amended today, Rule 21F-6(c) now provides that for awards of $5 million or less, the SEC will pay the statutory maximum award – 30 percent of the total monetary sanctions collected in the enforcement action – where none of the negative award factors are present. This amendment is a win for most whistleblowers. According to the SEC, approximately 75 percent of SEC whistleblower awards have been $5 million or less. As such, most future meritorious SEC whistleblowers can expect to receive a boost in their award percentage under the amendments, assuming that none of the negative award factors are present.

SEC Asserts Discretion to Reduce Large Awards

A controversial proposal in the SEC's June 28, 2018 proposed amendments would have given the SEC discretion to reduce an award in a covered action that yielded collected monetary sanctions of at least $100 million if the SEC finds that the potential award exceeds what is "reasonably necessary to reward the whistleblower and to incentivize other similarly situated whistleblowers." The SEC would not, however, have the discretion to award less than 10 percent of the collected sanctions (the minimum award percentage set forth in the statute). Commentators asserted that this proposed rule would effectively result in larger awards being capped or set at the statutory minimum.

In the face of significant opposition to this proposed soft-cap, the SEC did not adopt this proposal, but instead asserted that it has the discretion to take into account the award amount in determining award percentage. In a press release announcing the amended rules, the SEC notes that it can determine award amounts "in its discretion . . . in percentage terms, dollar terms or some combination." Fortunately, the SEC noted that "based on the historical application of the award factors, if none of the negative criteria…are present [for an award above $5 million], the award amount would be expected to be in the top third of the award range." It is unclear from the rulemaking how the SEC will exercise its discretion to lower large awards.

In a September 17, 2020 letter to SEC Chair Clayton, several Democratic Senators expressed strong opposition to any proposed cap on whistleblower awards:

Moreover, you must ensure that the final rule does not afford the Commission or SEC staff undue discretion to reduce the dollar value of an award that would create uncertainty or discourage future whistleblowers. Specifically, cloaking the ability to reduce or limit the dollar amount of an award as an "adjustment" to "achieve the goals and interests" of the whistleblower program is disingenuous and would impair the integrity and proven success of the program. Such an "adjustment" is contrary to Congressional intent, public policy and the goal of investor protection.

Today Commissioners Crenshaw and Lee took a firm stance against the SEC considering the dollar amount when determining award percentage. The vote today might not be the last word on this issue. A whistleblower may challenge the reduction of an award in a large covered action by bringing a challenge under the APA, and Congress could amend the statute to clarify that the SEC should not take into account the size of an award in determining the appropriate award percentage

Increased Efficiency in Claims Review Process

After the SEC brings a successful enforcement action in excess of $1 million, the Commission posts the action on its Notices of Covered Action page. Once posted, whistleblowers have 90 calendar days to apply for an award. Thereafter, the SEC assesses the applications (known as the "claims review process") to determine: (1) whether a whistleblower is eligible for an award; and (2) the amount of the award.

In recent years, the SEC has struggled to efficiently review whistleblowers' applications for awards. In most cases, the claims review process has taken more than 2 years. The amended rules include several provisions that should increase efficiency in the claims review process.

First, new subparagraph (e) to Exchange Act Rule 21F-8 codifies the SEC's practice of barring applicants who submit materially false, fictitious, or fraudulent statements in their whistleblower submission, in their other dealings with the SEC, or in related actions, and provides an important new tool for the SEC in processing frivolous award applications. Prior to this amendment, the SEC was forced to assess frivolous applications for awards, which was a drain on the SEC's resources and delayed the timely assessment of potentially meritorious whistleblowers' applications.

Next, new Rule 21F-18 affords the SEC with a summary disposition procedure for certain types of common denials, such as untimely award applications, applications that involve a tip that was not provided to the SEC in the form and manner that the rules require, and applications where the claimant's information was never provided to or used by staff responsible for the investigation. Like the above-mentioned amendment, this will allow the SEC to bypass obvious denials and utilize its limited resources to timely assess potentially meritorious whistleblowers' applications.

Finally, the SEC's new presumption of the statutory maximum award amount for certain awards of $5 million or less will significantly speed up the claims review process. As mentioned, approximately 75 percent of the awards given out in the whistleblower program have been $5 million or less. As such, this presumption will allow the SEC to quickly make determinations in a majority of cases by only assessing the negative factors, which will in turn free up SEC resources to timely assess larger cases.

Limiting "independent analysis" whistleblower awards

Prior to the adoption of the whistleblower rule amendments, a whistleblower could qualify for an award by providing "independent analysis," defined in Rule 21F-4(b)(2) as an "examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public." But under an amendment to that rule, a whistleblower's submission will qualify as independent analysis only if it provides insight or assessment that goes beyond what would be reasonably apparent to the Commission from publicly-available information.

In assessing whether a whistleblower has met this requirement, the Commission will make determinations based on whether it could have inferred the information provided from the facts available in public sources. Where a tip contains publicly-available information, the submission must "bridge the gap" between public information and possible securities violations.

Rather than clarifying the meaning of "independent analysis," this new standard gives the SEC broad discretion to reject independent analysis whistleblower claims by concluding that, in hindsight, the SEC could have detected the violation. This vague and subjective standard will likely dissuade whistleblowers from submitting independent analysis to the SEC, thereby reducing opportunities for the SEC to detect fraud schemes.

In a recent order awarding approximately [$2.5 million to whistleblowers for highly probative independent analysis]() of a public company's filings that led to several successful enforcement actions, Jane Norberg, Chief of the Office of the Whistleblower, stated: "Detailed analysis by outsiders of companies can have a significant impact on the enforcement of the federal securities laws." And in a [press release announcing an independent analysis award](), Andrew Ceresney, then-Director of the SEC's Enforcement Division, notes that "[t]he voluntary submission of high-quality analysis by industry experts can be every bit as valuable as first-hand knowledge of wrongdoing by company insiders." Moreover, a primary impetus for the SEC Whistleblower Program was the SEC's failure to act on an independent analysis provided by Harry Markoplos about Bernard Madoff's [Ponzi scheme](). Markopolos detected Madoff's fraud nearly nine years before it became public and provided the SEC with detailed analysis, and repeatedly implored the SEC to act on his findings. The amended "independent analysis" is contrary to Congressional intent.

Narrowing the scope of "related actions" that qualify for an SEC whistleblower award

Under Rule 21F-3, the SEC would pay an award to a whistleblower who voluntarily provides original information that leads to a successful "related action" if the action is based on the same original information that the whistleblower provided to the SEC and led the SEC to recover monetary sanctions totaling more than $1 million. A "related action" is defined as a judicial or administrative action brought by:

1. the Attorney General of the United States;
2. an appropriate regulatory authority;
3. a self-regulatory organization; or
4. a state attorney general in a criminal case.

But under the amended Rule 21F-3(b)(3), a law enforcement action will not qualify as a related action if the SEC determines that a law enforcement agency has a separate whistleblower reward program that more appropriately applies to the enforcement action. And the Commission will not provide an award to a whistleblower for a potential related action if another government entity has already granted them an award under another reward program. Finally, if another government entity denied the whistleblower an award under another program, the whistleblower will not be permitted to readjudicate any issues before the Commission that were resolved against the whistleblower when another agency denied an award.

In addition, the amended rule clarifies that a whistleblower may not adjudicate their claims in two separate forums and potentially obtain two separate awards based on the same report and information. This change to the scope of related actions that qualify for an SEC whistleblower award could reduce the incentive for a whistleblower to come forward where an award under another reward program would be insufficient to justify the risk entailed in blowing the whistle. For example, the Financial Institutions Reform, Recovery and Enforcement Act whistleblower reward provision, which incentivizes whistleblowers to report to the DOJ fraud committed by U.S. financial institutions, caps awards at $1.6 million

Flexibility in applying the requirement to file Form TCR

Although the SEC whistleblower rules have required the submission of Form TCR to qualify for an award (which whistleblowers can file anonymously if represented by counsel), the SEC has exercised discretion in waiving that requirement in certain matters. Previously, SEC rules lacked a formal mechanism permitting an individual to qualify for an award where they provided original information to the SEC that led to a successful enforcement action but failed to file a Form TCR. As amended, Rule 21F-9 permits the SEC to waive compliance with the Form TCR/signed declaration requirement when it determines:

1. The administrative record “unambiguously” demonstrates the individual would otherwise qualify for an award; and
2. The individual shows they complied with the requirements within 30 days of communicating with Commission staff.

In addition, the amended Rule 21F-9 permits an individual who fails to satisfy these requirements to qualify for a waiver if they can show they complied with Rule 21F-9(a) and (b) within 30 days of first becoming aware of the requirements (or 30 days from the date the whistleblower retains an attorney to represent him or her in connection with their SEC whistleblower claim, whichever occurs first).

Requiring written whistleblower submissions

In response to the Supreme Court’s holding in *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767 (2018), where the Court held the Dodd-Frank Act’s definition of whistleblower requires a report to the SEC as a requirement for retaliation protection, the SEC amended Exchange Act Rule 21F-2(a) to provide a uniform definition of whistleblower status. This definition applies for all purposes under Section 21F – award eligibility, confidentially, and retaliation protection.

Under Rule 21F-2(a) as amended, the Commission will only grant whistleblower status to:

1. An individual;
2. Who provides the Commission with information “in writing;” and
3. “The information relates to a possible violation of the federal securities laws (including any law, rule, or regulation subject to the jurisdiction of the Commission) that has occurred, is ongoing, or is about to occur.”

In adopting this definition, the SEC stated that it determined that the “in writing” requirement does not place an onerous burden on whistleblowers, as some commenters had suggested. The Commission cited flexibility in meeting the “in writing” requirement – that submission online, by email, facsimile, or U.S. Mail would qualify. Further, the Commission explained that this requirement would help it preserve administrative efficiency and reliability while addressing external reports from across the country and around the globe.

Limiting the scope of Dodd-Frank whistleblower protection

Prior to the adoption of amended rules, the SEC broadly construed the whistleblower protection provision of the Dodd-Frank, which authorizes the SEC to take enforcement action to combat retaliation and permits whistleblowers to sue in federal court to recover damages for retaliation. Indeed, the SEC filed *amicus curiae* briefs arguing that the Dodd-Frank whistleblower protection provision protects internal disclosures. And the SEC took enforcement actions to punish retaliation and bar companies from impeding whistleblowing to the SEC. But today, the SEC adopted amendments that limit Dodd-Frank whistleblower protection.

Under amended Rule 21F-2, the SEC will protect whistleblowers only if they report a potential violation of the federal securities laws in writing. As we argued in comments drafted in conjunction with GAP, NELA, and Public Citizen, this interpretation is contrary to the plain meaning of the Dodd-Frank Act. Indeed, the second form of protected conduct set forth in the whistleblower protection provision of Dodd-Frank –"initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission" – expressly contemplates protection for oral disclosures. The writing requirement is also a significant departure from a well-developed body of precedent construing similar whistleblower protection laws. For example, courts have uniformly held that the whistleblower protection provision of the Sarbanes-Oxley Act, 18 U.S.C. § 1514A, protects persons providing information, orally or in writing, about potential securities violations.

Moreover, excluding oral disclosures from the ambit of Dodd-Frank whistleblower protection is inconsistent with the remedial purpose of the statute (provide robust protection to whistleblowers) and the SEC's interest in encouraging whistleblowers to come forward. If a whistleblower cooperates with an SEC investigation by providing important information during an interview with SEC staff without providing a written disclosure, the SEC would apparently look the other way if the whistleblower suffers retaliation due to their cooperation with an SEC investigation. That is an odd position for a civil law enforcement agency that has a strong interest in ensuring that employees of registrants and other entities subject to SEC jurisdiction can testify without fear of reprisal.

Rule 21F-2(d)(1)(iii)(B) further limits the scope of Dodd-Frank whistleblower protection by clarifying that protection will attach to a lawful act performed by a whistleblower (e.g., reporting a potential violation of federal securities law to the whistleblower's employer) only if the act "relate[s] to the subject matter of" the whistleblower's report to the Commission. That limitation on whistleblower protection is not compelled by the text of the statute. Indeed, none of the parties or *amici curiae* in *Digital Realty* proposed reading this limitation into the statute. As Justice Ginsburg noted in the majority opinion, "Moreover, nothing in Subsection (a)'s definition of 'whistleblower,' or in petitioner's interpretation of the statute, requires a temporal or topical connection between the violation reported to the Commission and the internal disclosure for which the employee suffers retaliation." 138 S. Ct. at 780-81 (citing Brief for the United States as Amicus Curiae, available at https://www.justice.gov/sites/default/files/briefs/2017/10/23/16-1276_digital_realty.pdf. The Court also noted that Petitioner Digital Realty acknowledged that Congress "could reasonably have made the policy judgment that individuals who report securities-law violations to the SEC should receive broad protection over time against retaliation for a variety of disclosures." *Id.* (citing Reply Brief for the Petitioners 11).

Fortunately, the amended Rule 21F-2 provides some helpful clarifications for whistleblowers about the scope of whistleblower protection:

- The SEC would protect whistleblower disclosures to an employer even if done before reporting to the SEC when the retaliation takes place after a person qualifies as a "whistleblower" by providing information directly "to the Commission" consistent with Section 21F(a)(6).

- The SEC declined to limit retaliation protection strictly to persons who satisfy the procedures and conditions for award eligibility, *e.g.*, the whistleblower would be protected even if their submission to the SEC did not qualify as “original information.”
- Citing the *Burlington Northern* standard, the SEC is defining retaliation to encompass what “a reasonable employee [would find] materially adverse,” which means “it well might have dissuade[d] a reasonable worker” from engaging in any lawful act encompassed by Section 21F(h)(1)(A).

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