Are Proposed Changes to the SEC Whistleblower Program a Step Backwards?

By Matthew LaGarde
October 24, 2018

This summer, the SEC voted 3-2 to propose amendments to the rules governing its whistleblower program (the "Proposed Amendments"). At nearly 200 pages long, the Proposed Amendments contain a number of substantive proposed changes to the Program. As the two dissenting Commissioners and others have noted, the Proposed Amendments represent a step back for the Program. However, there are elements of the Proposed Amendments that should encourage whistleblowers.

Capping SEC Whistleblower Awards at $30M

The Proposed Amendments would permit the SEC to limit awards that would otherwise result in a whistleblower receiving over $30 million, if the Commission determines that such an "exceedingly large potential payout" was not "reasonably necessary to fulfill the purposes of the program." *See* Proposed Amendments at 43–56. Importantly, any adjustment would still require that the award fall between 10% and 30% of the proceeds collected. *Id.* Also importantly, this would impact a very small percentage of whistleblower awards; to date, the SEC has issued awards to 59 whistleblowers, while issuing just three awards over $30 million. But it may give pause to whistleblowers to know that the SEC may cap their potential payouts for no other reason than the Commission has determined they are too large, particularly in light of the substantial risks and considerable efforts they expend to provide information to the SEC.

On the other hand, the SEC also included an amendment that would provide "a mechanism for the Commission to adjust upwards any awards that would potentially be below $2 million to a single whistleblower." *Id.* at 40–43. The SEC noted that "where the proposed rule is triggered, there would be a presumption in favor of some award enhancement[.]" *Id.*[1]

Clarifying the Scope of "Related Actions"

Elsewhere, the SEC clarified the scope of "related actions" for which it may reward whistleblowers. Related actions refer to actions brought by other regulatory agencies but which are based on the same original information the whistleblower provided to the SEC. Under the Proposed Amendments, related actions would include ones resulting in deferred prosecution agreements ("DPAs") and non-prosecution agreements ("NPAs") entered into by the Department of Justice or state attorneys general for which the government required an entity to pay monetary sanctions. *Id.* at 16–22. The SEC added that "[t]he same result would follow for a settlement agreement entered into by the Commission outside of the context of a judicial or administrative proceeding to address violations of the securities laws." *Id.*

However, the SEC also made clear under the Proposed Amendments that if the action forming the basis for the award is subject to a separate monetary award program, the SEC will deem it a "related action" only if it finds that the SEC whistleblower program has the "more direct or relevant connection to the action." *Id.* at 29–39. Under the Proposed Amendments, the SEC would also decline to pay an

award, even if it does determine that there is a "related action," if another entity has already issued the whistleblower an award. *Id.* Finally, the Proposed Amendments will disallow a whistleblower whose award application was denied by another award program from "readjudicat[ing] any issues . . . that the authority responsible for administering the other whistleblower award program resolved against [the whistleblower] as part of the award denial." *Id.* The SEC noted that while the Commission has yet to pay an award on a matter where a second whistleblower program also potentially applied, there are a number of other whistleblower award programs, including those administered by the Department of Justice and the Internal Revenue Service, where such "double-dipping" could arise.

Guidance on "Unreasonably Delayed" Reporting Issues

Another Proposed Amendment would provide the Commission with guidance regarding what it means for a whistleblower to have "unreasonably delayed" reporting issues to the Commission. *Id.* at 56–57. The SEC stated that "any delay in reporting to the Commission beyond 180 days is presumptively unreasonable" and added that short delays "may also readily qualify as unreasonable depending on the particular facts and circumstances at issue." *Id.* In justifying the proposed change, the SEC cited two Supreme Court decisions limiting the period within which the Commission must bring an enforcement action. *Id.* The SEC noted that "delay on the part of a whistleblower can have a debilitating impact on the Commission's ability to make a full recovery of ill-gotten gains and to obtain civil penalties." *Id.*

Defining Protections Against Whistleblower Retaliation

A couple of the Proposed Amendments relate to retaliation claims brought under the Dodd-Frank Act. The first is largely housekeeping: the SEC clarified that, in light of the Supreme Court's decision in *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767 (2018), the term "whistleblower" shall be defined throughout the Dodd-Frank Act, including for the purposes of the statute's anti-retaliation provision, as:

(i) an individual (ii) who provides the Commission with information "in writing" and only if (iii) "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."

Id. at 60–66. This revision reflects the Supreme Court's holding in *Digital Realty* that the protections against retaliation set forth in the Dodd-Frank Act do not protect those who only report violations of securities laws internally; instead, the Court held that individuals must file a whistleblower tip with the Commission in order to garner protections under the statute.

The Proposed Amendments also provide clarity regarding what actions on an employee's part constitute protected activity under the Dodd-Frank Act. The statute's anti-retaliation provision provides protection for internal whistleblowing for individuals who otherwise qualify as a "whistleblower," i.e., who have provided information to the Commission in the manner prescribed by the Commission. Under the Proposed Amendments, the SEC clarifies that such whistleblowers may garner protections under the Act even if they made the internal report that led to their retaliation prior to providing information to the Commission, so long as their report to the SEC occurred prior to the retaliatory act. *Id.* at 67–72. In other words, an individual is protected under Dodd-Frank if she reports an issue internally, then submits a written whistleblower tip on a related subject to the SEC – thereby becoming a "whistleblower" for the purposes of the Dodd-Frank Act – and then experiences retaliation.

The Proposed Amendments contain a number of other, less impactful changes, including:

- Clarifying the types of “monetary sanctions” that can form the basis of a whistleblower award, *id.* at 23–28;
- Adding flexibility in the form of whistleblower tips, *id.* at 74–76;
- Granting the Commission the ability to take measures to combat abusive or frivolous tipsters, *id.* at 76–80;
- Providing clarity regarding the method of submitting online tips, *id.* at 80–82;
- Limiting the manner in which a whistleblower may make supplemental submissions regarding a tip and/or award application, *id.* at 82–87
- Clarifying the items needed to be included in the record on appeal of an award determination, *id.* at 88–90;
- Establishing a summary disposition process for award applications to provide a more timely resolution of relatively straightforward denials, which “could free up staff resources to concentrate on the meritorious claims,” *id.* at 90–95; and
- Proposing an interpretive guidance regarding the meaning and application of “independent analysis” that gives rise to a whistleblower award, *id.* at 97–98.

The SEC Whistleblower Program continues to thrive. The SEC issued its most recent whistleblower award on September 24, 2018 and has now awarded approximately $326 million to 59 whistleblowers. If enacted, these Amendments will not cripple the Program. But overall, they represent a step backward. The SEC should not be in the business of limiting whistleblower incentives for reasons other than those expressly set forth in the statute. We encourage the Commission to reconsider that portion of the Proposed Amendments.

---

[1] The SEC also requested comments regarding whether the Commission could “at a future point” propose a rule that would enable it to, at its discretion, issue awards to whistleblowers who provide information that either did not result in an order for sufficiently large monetary sanctions or was publicly available. *Id.* at 110. The SEC also queried whether it could issue additional payments to otherwise meritorious whistleblowers in instances where the ordered monetary sanctions cannot be collected or the amount collected would result in a *de minimis* payment. *Id.* at 110–11. It is important to note, however, that the SEC merely requested comments regarding this additional discretion, and the change is not part of the Proposed Amendments.

This blog was subsequently published in Law360.