

MEMO# 24804

December 20, 2010

ICI Files Comment Letter On SEC Proposed Whistleblower Rules

[24804]

December 20, 2010

TO: COMPLIANCE MEMBERS No. 35-10
INTERNAL AUDIT ADVISORY COMMITTEE No. 12-10
RISK MANAGEMENT ADVISORY COMMITTEE No. 7-10
SEC RULES MEMBERS No. 139-10
SMALL FUNDS MEMBERS No. 84-10 RE: ICI FILES COMMENT LETTER ON SEC PROPOSED WHISTLEBLOWER RULES

Last week, the Institute filed a comment letter with the Securities and Exchange Commission on its proposed rules to implement Section 922 of the Dodd-Frank Act. Section 922 required the Commission to implement a process to provide a monetary reward to “whistleblowers” (i.e., a person or persons “who provide information relating to a violation of the securities laws to the Commission”) who meet certain specified conditions. [\[1\]](#) The Institute’s letter, which is substantively similar to the draft we circulated to members, is attached and briefly described below.

The Institute’s letter focuses on three main concerns with the proposal: its adverse impact on internal compliance programs; the Commission’s attempt to require registrants to report all violations of the securities laws to the Commission; and deficiencies in the criteria for rewarding whistleblowers.

The Proposal’s Adverse Impact on Internal Compliance Programs

While the Commission’s Release repeatedly acknowledges and discusses the importance of internal compliance programs, and claims that the rule was designed to avoid employees “front running” such programs by first reporting violations of law to the SEC rather than to their employer, there is nothing in the rule’s provisions that even mentions internal compliance programs. The letter discusses the disconnect between the language of the

Release and the language of the rule and recommends that the rule be conformed to the Release's discussion. In particular, we recommend that, if an employer has a whistleblower program that is compliant with Section 31 of the Sarbanes-Oxley Act, including the provisions enabling employees to report anonymously, an employee must, as a condition of reporting to the SEC, first report a violation to its employer.

The Proposal's Attempt to Impose New Reporting Obligations on Registrants

While the Release notes that the rules will not impose any new reporting requirements on registrants, the only way for an employer to avoid an employee obtaining whistleblower status under the proposed rules is if the employer self-reports a violation that the whistleblower has reported to the Commission. This provision would extend to all violations of law, since whistleblower status may be obtained on the basis of any violation that results in the Commission assessing a fine of more than \$1 million. The letter notes that this provision: (1) implicitly imposes a reporting requirement on registrants – contrary to statements in the Release; (2) will likely result in the SEC being inundated with information regarding minor violations and not the high quality information they are seeking; and (3) may disserve investors by requiring the Commission to expend time and energy reviewing all the information it receives to the exclusion of being able to focus on material information. To avoid these results, we recommend that the Commission revise the rule to eliminate the requirement that all violations be reported to the Commission.

Deficiencies in the Program's Criteria for Rewarding Whistleblowers

The letter discusses various deficiencies in the criteria proposed for rewarding whistleblower. To address these deficiencies, the letter recommends that the Commission add to the list of criteria, a duty for the whistleblower to have acted reasonably and in good faith when providing this information. This condition would enable the Commission to take into consideration factors such as: the whistleblower's motives in providing the information to the SEC; the level of cooperation provided by the whistleblower to the employer to correct the violation; and whether the whistleblower timely reported the violation to the employer or the SEC. In addition, we recommend that the criteria be revised to include the materiality of the information (to discourage the reporting of minor or insignificant violations) and a criteria prohibiting profiteering. With respect to this later issue, the letter discusses current attempts by the private bar to recruit whistleblowers with the "promises of riches to come." The letter recommends that the Commission address these concerns by: (1) prohibiting whistleblowers from being rewarded in a variety of forums based on the same violation the whistleblower reported to the Commission; and (2) prohibiting whistleblowers from collecting an award under the rules if they are or become a plaintiff in civil litigation relating to the violation the whistleblower reported to the SEC. The letter also recommends that the Commission have the flexibility to deny an award to an eligible whistleblower if the totality of the criteria so warrant such action.

Additional Concerns

The letter addresses concerns with the proposed definition of "original information." It recommends that this definition be narrowed to exclude (1) information relating to a

violation or potential violation that has been corrected by the registrant and (2) stale information – i.e., information beyond an applicable statute of limitations.

The Institute's letter also recommends that the Commission clarify the prohibition in Section 21F(h)(1) of the Securities Exchange Act, which prohibits an employer from retaliating against a whistleblower. In particular, the letter recommends that the Commission clarify that, so long as the employer's action is not retaliatory, but rather, based on independent grounds, Section 21F(h)(1) does not apply. The Commission should also clarify that having whistleblower status does not require an employer to retain an employee notwithstanding poor performance or attitude or violation of company policy.

The letter also recommends that the Commission clarify the rules' application to foreign entities and to information provided to multiple regulators, and that state and foreign regulators not be eligible for whistleblower status under the rules.

Tamara K. Salmon
Senior Associate Counsel

[Attachment \(in .pdf format\)](#)

endnotes

[\[1\]](#) See Institute Memorandum No. 24687 (Nov. 4, 2010), which summarized the Commission's release, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, SEC Release No. 34-63237 (Nov. 3, 2010). The Release is available at: <http://www.sec.gov/rules/proposed/2010/34-63237.pdf>.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.