KATZ, MARSHALL & BANKS, LLP

SEC Adopts Final Rules Amending Its Whistleblower Program

By Alia Al-Khatib
September 24, 2020

On September 23, 2020, the U.S. Securities and Exchange Commission (SEC) voted 3-2 to pass the final rules amending its whistleblower program. The five following changes will have the most impact on SEC whistleblowers who report potential violations of securities law:

1. Creation of a presumption in favor of awarding the maximum statutory award to whistleblowers who face a maximum potential award of $5 million or less;
2. Providing for the SEC's broad discretion in evaluating and applying award criteria, including explicitly the SEC's consideration of dollar amounts of awards;
3. Expanding the definition of successful enforcement actions to include deferred prosecution and non-prosecution agreements, as well as any settlement agreements that the SEC enters into outside of a formal proceeding;
4. Limiting recovery from the program where a whistleblower may be able to recover from another program; and
5. Revising the definition of whistleblower in light of *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767 (2018).

The details of these changes and their potential impact on whistleblowers are discussed in more detail below. In passing the rules, the SEC emphasized its intention "to provide greater transparency, efficiency and clarity to whistleblowers." Final Rules at 2. In implementing the final rules, some of which require greater clarity, the SEC should keep in mind these goals.

Background on the SEC Whistleblower Program

First established in 2010 under the Dodd-Frank Act, the SEC whistleblower program allows the Commission to award individuals who have provided the SEC original information about fraud and securities violations between 10% and 30% of the monetary sanctions recovered from a successful SEC enforcement action. The program has been very successful thus far. Since its inception, the SEC has obtained more than $2.5 billion in monetary sanctions as a result of whistleblower tips and has awarded approximately $521 million to 96 whistleblowers. In July 2018, the SEC voted 3-2 to propose amendments to the whistleblower program. Over two years later, the SEC passed the final rules, which largely adopt the proposed amendments with some important modifications. The new rules will take

effect 30 days after publication in the Federal Register.

Changes to Whistleblower Award Payouts

The regulations implementing the SEC whistleblower program set criteria for determining the appropriate amount of an award under Rule 21F-6.[1] These include factors that may increase the whistleblower's award, such as the significance of the information provided by the whistleblower, the whistleblower's level of assistance to the SEC and his or her participation in internal compliance systems,[2] and the extent to which the whistleblower's information advanced law enforcement goals of the Commission. The regulations also allow the SEC to decrease an award based on various factors, such as the whistleblower's level of culpability regarding the securities violations, whether the whistleblower unreasonably delayed reporting, and whether the whistleblower interfered in internal compliance systems.

In the final rules, the SEC voted not to pass one of the more controversial proposed amendments, which would have allowed the SEC to cap a total payout for any whistleblower award at $30 million based solely on the size of the award. *Id.* at 61-62. The proposal received numerous comments in opposition that argued that the rule would discourage whistleblowers from coming forward and that it would arbitrarily penalize whistleblowers. *See id.* at 60-61 (summarizing comments in opposition to the proposed amendment). Instead of adopting a bright line rule as initially proposed, the SEC instead modified language of Rule 21F-6. *Id.* at 48. The modified provision explicitly folds in consideration of the potential dollar amount of an award into the SEC's analysis of award criteria. *Id.* at 48-49. The SEC framed this provision as a clarification of its broad discretion; however, whistleblowers and their advocates are left with little clarity. While not explicitly adopting the rule as proposed, the SEC instead has adopted a more expansive rule that would allow for discretionary downward adjustments of any award amount.

One significant positive change for whistleblowers was the SEC's adoption of a presumption in favor of awarding the maximum statutory award of 30% of recovered proceeds to whistleblowers who are eligible to receive a maximum award of $5 million or less. The final rule benefits more whistleblowers than the proposed amendment, which would have allowed such a presumption for cases involving maximum awards of $2 million or less. The majority of whistleblowers, 75% according to the SEC's data, will benefit from this new rule. Once the SEC determines that no negative factors exist, such as engaging in culpable conduct with regards to an internal compliance program or securities law, the presumption applies, and the whistleblower should receive the maximum award of 30%. *Id.* at 52-53. The new rule helps to streamline the awards process. It also represents a positive step towards encouraging more whistleblowers, especially those who may

be concerned about jeopardizing their careers for relatively low potential awards, to come forward.

Final Rule Expanding "Successful Enforcement"

Another rule beneficial to whistleblowers is the expansion of the meaning of "successful enforcement." Because whistleblowers cannot control the law enforcement mechanism chosen by the Department of Justice (DOJ) or the SEC, this new rule allows whistleblowers to collect awards should the DOJ or SEC choose to pursue specific types of enforcement actions; however, the final rule is narrower than the one initially proposed. Under the new final rule, "successful enforcement" includes deferred prosecution and non-prosecution agreements entered into by the DOJ in a criminal case and settlement agreements entered into by the SEC in actions outside of a judicial or administrative proceeding that involve violations of securities laws. *Id.* at 13-14, 17. Such actions would be deemed "administrative actions," and any money recovered would be considered a "monetary sanction," which would allow the whistleblower to recover a percentage of that monetary sanction. *Id.* The final rule eliminated the extension of "successful enforcement" to include deferred prosecution and non-prosecution agreements entered into by state attorneys general. *Id.* at 17. One commenter argued persuasively to the SEC that securities violations under state law may differ considerably from those under federal law and warned of inconsistency in determining whistleblowers' eligibility across states. *Id.* at 20-21. While not as expansive as initially proposed, the rule nonetheless benefits whistleblowers who provide information that results in these specific forms of law enforcement action.

New Definition of "Related Action" and Its Limitations on Recovery

The final rule amends the definition of "related action," which effectively limits recovery under the SEC program where the whistleblower is eligible to recover under a different whistleblower program in addition to the SEC's. Prior to this rule, where another enforcement agency in addition to the SEC brings an action based on the information the whistleblower provided—a "related action" under the whistleblower program rules—the individual can also receive from the SEC whistleblower award fund a percentage of the other agency's recovery. The new rule does not provide a bright line; rather, the SEC will evaluate the facts and circumstances of the action to determine whether the SEC whistleblower program has the "more direct or relevant connection to the action." *Id.* at 43-44. The SEC was not persuaded by commenters who opposed the proposed amendment, including some who argued that the rule would undermine the program's goal of encouraging whistleblowers to come forward. *Id.* at 41-43.

Changes to Definition of "Whistleblower Status" and Anti-Retaliation Provisions

The SEC adopted the new definition of "whistleblower" as proposed. The new definition, articulated in the Supreme Court case, *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767 (2018), confers "whistleblower status" to "(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 law (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 65-66.

Under the new rule, anti-retaliation protections under the Dodd-Frank Act are available only if the individual first qualifies for "whistleblower status" by having reported the information to the SEC. This was the holding of *Digital Realty*. In its definition, the SEC goes farther than the Supreme Court, specifying that the information be presented to the Commission "in writing." The SEC justified the "in writing" requirement by noting it imposes "a minimal burden to individuals who want to report potential securities violations" and provides greater "efficiency and reliability" to the Commission in processing both internal and external reports of possible violations. *Id.* at 75-76. The SEC assured commenters who expressed concerns that this new definition would generate uncertainty for whistleblowers by noting that the "in writing" requirement "will be applied in a flexible manner to accommodate whistleblowers who make a good-faith effort to comply with our rules in seeking retaliation protection." *Id.* at 79-80. Individuals who report securities violations only within their companies have no protection under Dodd-Frank. If an individual reports internally and then reports to the Commission in writing, then that individual is protected only for retaliation experienced after, but not before, the SEC report. *Id.* at 78.

Change to Reporting Requirements

The final rule concerning reporting requirements for award eligibility was modified in order to address commenters' concerns that, in practice, an individual's initial communication with the SEC does not typically meet those requirements. *Id.* at 94-97. The final rule requires that whistleblowers submit either a tip through the SEC's online portal or a specific form, a Form TCR, by mail or fax to the SEC; however, recognizing that many individuals initially contact SEC officials informally prior to submitting a form, the SEC clarified that "an individual need not in the first instance provide original information to the Commission" through filing a specific form, though that individual must comply with the form reporting requirements within 30 days of first providing information to the SEC. *Id.* at 97. Consequently, an individual's first contact with the SEC need not meet the form requirements, as long as the individual follows those requirements within 30 days. This modification

relieves some fears generated by the initial proposal that whistleblowers would have been penalized for filing with the incorrect agency or making a procedural error in the initial report, or by contacting SEC enforcement staff before the Office of the Whistleblower.

While the final rules will not substantially hinder the progress of the program, some of the rules create additional hurdles for whistleblowers and leave some lingering questions about implementation in practice. The SEC should implement the rules consistently with the agency's intentions in the rules' passage, specifically to improve transparency, efficiency and clarity for whistleblowers. The SEC must keep the program's ultimate goals in mind—to award whistleblowers who present meritorious claims because they provided information that led to enforcement actions, and to encourage future whistleblowers to come forward.

---

[1] *See* 17 C.F.R. § 240.21F-6.

[2] Notably, the final rules maintain that a whistleblower's participation in internal compliance systems is one factor that the SEC considers in awarding an upward adjustment. *Id.* at 81.