



SEC votes 3-2 to amend whistleblower rules

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On September 23, 2020, after two years of debate and a flood of negative comments, the US Securities and Exchange Commission (SEC) voted 3-2 along party lines to approve amendments to the rules governing monetary awards made to whistleblowers. The amendments are intended to strengthen the whistleblower program by providing greater transparency, efficiency and clarity. They are also intended to enhance the SEC's ability to make awards that incentivize whistleblowers to come forward with tips. The adopting release includes guidance interpreting retaliation as well as guidance explaining what is meant by "independent analysis," one of the prerequisites to whistleblower award eligibility. On the same day that the SEC adopted the amendments, the SEC's Office of the Whistleblower (OWB) issued guidance for whistleblower determinations consistent with the new rules. We summarize key aspects of the amendments and related guidance and provide key takeaways below.

Background

As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the SEC enacted a whistleblower program in 2011 to incentivize individuals to provide tips and assist the SEC in combating violations of the securities laws. Under Section 21F-3 of the Securities Exchange Act of 1934 (Exchange Act), the SEC must pay awards to whistleblowers who voluntarily provide the SEC with original information about a violation of the federal securities laws that leads to a successful enforcement action by the SEC in which it obtains monetary

sanctions totaling more than \$1 million in a covered judicial or administrative action or related action. An award can range from 10-30 percent of the SEC's collected proceeds, with the final amount determined at the SEC's discretion. The whistleblower program has been regarded as a success to date. Since it began, the SEC has obtained more than \$2.5 billion in financial remedies from enforcement actions originating from whistleblower information and has awarded \$562 million to 106 individuals.

The amendments

Uniform "whistleblower" definition and written submission requirement

In *Digital Realty Trust, Inc. v. Somers*, the Supreme Court held that the Dodd-Frank Act's definition of "whistleblower" requires a report to the SEC as a requirement for retaliation protection (see our alert on the decision). In response, the SEC has now modified Rule 21F-2 to establish a uniform definition of "whistleblower" that applies to all aspects of the rule, including the award program, the heightened confidentiality requirements, and the employment anti-retaliation protections.

Under the amended rules, the SEC will only grant whistleblower status to an individual who provides information to the SEC "in writing," and the information must relate to a possible violation of the federal securities laws. The SEC said this would preserve administrative efficiency and reliability and would not burden whistleblowers since submissions can be made online, by email, fax, or US mail. Only an individual who meets the amended definition of a whistleblower is entitled to protection from retaliation under the rule. In addition, under the amended rules, a whistleblower who engages in a lawful act before reporting to the SEC but who is retaliated against after reporting to the SEC is protected, provided the lawful act relates to the matter of the whistleblower's report to the SEC.

Definitions

Through the amendments, the SEC clarified the meaning of certain key statutory terms.

Action

The amendments add a provision to existing Rule 21F-4(d) that clarifies the SEC's ability to grant whistleblower awards for deferred prosecution or non-prosecution agreements entered into by the Department of Justice in a criminal case, as well as similar settlement agreements entered into the SEC outside of the context of a judicial or administrative proceeding to address violations of the securities laws. The SEC determined that such alternative vehicles for resolving investigations into violations of laws are encompassed within the definition of "administrative action" so that the SEC has authority under the Dodd-Frank Act to authorize whistleblower awards for such matters. This amendment ensures that whistleblowers are not disadvantaged by the form of an action that the SEC or Department of Justice chooses to pursue.

Monetary sanctions

The SEC amended the definition of monetary sanctions under the rule to clarify that the monetary sanctions award that might trigger a whistleblower award must be ordered in the nature of relief for the violations charged. The SEC used receiver activity to explain the difference: if a court approves a receiver's plan for distribution of assets to investors without entering a disgorgement order, the amounts distributed to investors are viewed as "monetary sanctions" for the purposes of the whistleblower award program. In contrast, if the court authorizes the receiver to use funds to pay taxes or creditors, those amounts are not "monetary sanctions" for the purposes of the whistleblower award program.

Related action

Rule 21F-3 allows the SEC to 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 to the recovery of monetary sanctions. The SEC clarified that in order to receive a whistleblower award for a related action, there must be an award of monetary sanctions.

In addition, to qualify as a related action, a whistleblower must have submitted information directly to the governmental entity that brought the action, or the SEC must have provided the whistleblower's information to that entity.

The amendments also establish limitations on multiple recoveries in situations where another governmental entity's whistleblower program has a more direct or relevant connection to the action, or the whistleblower has already received an award by the governmental entity responsible for administering the other whistleblower report program. A whistleblower is also barred from re-adjudicating issues previously resolved by another governmental entity that denied the whistleblower an award. Similarly, the amendments clarify that a whistleblower may not adjudicate his or her claims in two separate forums and obtain two separate awards based on the same report and information. This amended rule could disincentivize whistleblowers from providing tips where an award under another reward program would not justify the risk involved in coming forward. Finally, the SEC repealed its prior similar rule that related only to CFTC proceedings.

Discretion for award amounts

Exchange Act Rule 21F-6 was amended to clarify the SEC's discretion in applying the award factors and setting the award amount, including the discretion to apply the award factors in percentage terms, dollar terms, or some combination thereof. The SEC reiterated that it has broad discretion to set the amount of an award but recognized in the amendments that it may only exercise that discretion based on the application of the enumerated award factors set forth in the rule. Exchange Act Rule 21F-12 was amended to clarify the list of materials that the SEC may rely upon in making an award determination.

This amendment to Rule 21F-6 garnered the most opposition. Although the adopting release stated that the SEC "has the authority to consider the dollar amount when applying the award criteria," Commissioners Lee and Crenshaw questioned that this discretion previously existed. They, along with lawyers representing whistleblowers and several Democratic senators, expressed concern regarding how the SEC will exercise this discretion and highlighted a lack of transparency or accountability related to the exercise of discretion. They asserted that the amendments bring more uncertainty to the process because of the vague and subjective approach. Such factors could dissuade whistleblowers from coming forward.

Presumption for award amounts

The amendments allow the SEC to streamline the award process. For awards of \$5 million and less, which historically have represented 75 percent of all whistleblower awards, there is a presumption that whistleblowers will receive the maximum statutory award amount where none of the negative award criteria specified in Rule 21F-6(b) are present, subject to certain limitations. See Exchange Act Rule 21F-6(c). This presumption may be overcome by only two exclusions: (1) the whistleblower's assistance as assessed by the SEC under Rule 21F-6(a) was limited; or (2) the SEC determines that providing the statutory maximum would be inconsistent with the public interest, investor protection, or the objectives of the whistleblower program.

Previously, the SEC faced complaints that it was slow to issue awards. This amendment should help the SEC process whistleblower claims faster and issue awards more efficiently. Even more, most meritorious whistleblowers can now expect a boost in their award percentage under the amendments if there are no negative award factors.

For awards estimated to be greater than \$5 million, the SEC will continue to analyze the award factors identified in Rule 21F-6. If there are no negative factors, the award amount would be expected to be in the top third of the award range. The SEC decided not to adopt proposed Exchange Act Rule 21F-6(d)(2), which would have provided a formalized process to review certain awards.

Award application issues

There are two additional amendments intended to increase the SEC's efficiency in processing whistleblower award applications. 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. Additionally, the rule permits the SEC to permanently bar any

applicant from seeking an award after the SEC determines that the applicant has abused the process by submitting three frivolous award applications to prevent repeat submitters from abusing the award application process.

Second, new Exchange Act 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. This new rule is designed to facilitate a timelier resolution for these relatively straightforward denials and free up staff resources to focus on processing potentially meritorious award claims.

Tip, complaint or referral (TCR) form requirements

Exchange Act Rule 21F-9 was amended to provide the SEC with additional flexibility to modify how individuals may submit the Form TCR. The SEC, however, also added a new provision that requires that a whistleblower file the Form TCR within 30 days of the date the whistleblower first provides the SEC with original information that forms the basis for claiming an award. If the whistleblower fails to meet the 30-day deadline, then he or she is deemed ineligible for an award in connection with that information (even if the whistleblower later resubmits that information in a Form TCR). The SEC may waive compliance with the TCR filing deadline requirements if: (1) the administrative record "unambiguously" demonstrates the individual would otherwise qualify for an award; and (2) the whistleblower complies with the requirements within 30 days of first providing the information or of first obtaining actual or constructive notice of the TCR filing requirements. The SEC asserted that this new provision was codifying existing practice, but critics claimed that the provision will disqualify a large number of whistleblowers who report their concerns to the wrong SEC office and are unaware of the TCR filing requirement, or who have informal contacts with the staff before deciding to file.

Interpretive guidance

In adopting the amendments, the SEC provided interpretive guidance in two areas: retaliation and "independent analysis."

Retaliation

Relying on Supreme Court precedent, the SEC clarified that it interprets the prohibition against retaliation as prohibiting "any retaliatory activity by an employer against a whistleblower that 'a reasonable employee [would find] materially adverse,' which means 'it might well have dissuade[d] a reasonable worker' from engaging in any lawful act encompassed by Section 21F(h)(1)(A)." The SEC indicated that this is a "broad standard" and declined to provide a list of prohibited forms of retaliation since such a list might "inadvertently omit certain retaliatory activities" that might otherwise meet the standard.

Independent analysis

The SEC's published interpretive guidance clarifies the meaning of "independent analysis" as that term is defined in Exchange Act Rule 21F-4 and utilized in award applications. To qualify as independent analysis, a whistleblower's submission must provide evaluation, assessment, or insight beyond what would be reasonably apparent to the SEC from publicly available information. The SEC considers whether the whistleblower's conclusion of possible securities violations derives from multiple sources; whether the sources are not readily identified and accessed by a member of the public without specialized knowledge, unusual effort, or substantial cost; and whether the sources collectively raise a strong inference of a potential securities law violation that is not readily inferable by the SEC from any of the sources individually.

Critics argue that this standard is vague and subjective, and that it grants the SEC broad discretion to reject independent analysis whistleblower claims by concluding in hindsight that the SEC could have detected the violation. They fear that this will discourage whistleblowers from submitting independent analysis and chill a source of information of potential federal securities law violations.

Office of the Whistleblower guidance

OWB guidance provides an overview of the program and outlines its process for determining awards. The guidance reiterates the new Rule 21F-6 standards for awards of \$5 million or less and outlines OWB's approach for assessing the negative factors that could reduce an award.

Notably, while the SEC declined to adopt a specific time-based presumption of unreasonable delay as interpretive guidance, noting only that it continues to believe that a 180-day delay may be consistent with unreasonable delay, OWB's guidance provides further perspective on how it evaluates unreasonable delay, including:

- Whether violations identified by the whistleblower were continuing during the delay
- Whether investors were harmed during the period of the delay
- Whether the whistleblower might profit from the delay by ultimately obtaining a larger award because the delay allowed the misconduct to continue, resulting in larger monetary sanctions
- Whether the whistleblower was engaged for a reasonable period of time with reporting internally during any delay
- Whether the delay is attributable to illness or other family or personal circumstances
- Whether the delay was the result of the whistleblower's effort to investigate, and
- Whether the delay was caused by the need to retain an attorney or remain anonymous

OWB also noted that it uses a similar facts-and-circumstances approach when evaluating whether to reduce an award in situations where the whistleblower may have engaged in culpable behavior.

Key takeaways

Employers should take particular note of two aspects of the amendments:

1. The SEC will apply a broad standard in assessing whether an employer retaliated against an employee. In making that assessment, the SEC will evaluate potential retaliation from the standpoint of a reasonable employee, and
2. Even if the employee has taken action before reporting to the SEC, retaliation protections under Dodd-Frank apply if the retaliation occurs after the employee has reported to the SEC

The main impact on whistleblowers from the Amendments results from:

1. The requirement that a whistleblower submit a Form TCR no later than 30 days after first providing information to the SEC in order to qualify for an award
2. The new presumption that for awards of \$5 million or less, the SEC will presumptively pay the 30 percent statutory maximum where no negative award factors are present
3. A more streamlined award process that may enable whistleblowers to receive more money sooner and thereby encourage more whistleblowers to come forward, and
4. The SEC's broad view of its discretion to set award amounts, which, if critics are correct, could result in smaller awards in large cases

The amendments, which become effective 30 days after publication in the Federal Register, may not be the last word on any of these issues. Whistleblowers may challenge an award reduction under the Administrative Procedure Act. The next Congress or a reconstituted SEC could reverse course or make other changes. The practical effects of these amendments on the SEC's ability to obtain tips, protect and award whistleblowers, and combat wrongdoing remains to be seen.

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