

# The SEC's New Whistleblower Rules: Three Things Companies Can Do To Respond | BY JORDAN ETH AND CRYSTAL MCKELLAR

In July 2010, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ('Dodd-Frank'), Congress created powerful new financial incentives for whistleblowers who report violations of the federal securities laws to the Securities and Exchange Commission (SEC). If the whistleblower's report leads to a successful enforcement action and the SEC receives more than \$1m in fines, the SEC is required to pay the whistleblower a bounty of between 10 and 30 percent of the total amount the government recovers. The whistleblower's information must be 'original', so a whistleblower will receive no bounty if the SEC has already learned the facts from another source (such as a company that self-reports).

The SEC unveiled the final rules for the whistleblower program on 25 May 2011, and these rules take effect on 12 August 2011. Over considerable objection from the business community, the new rules do not require employees to report suspected securities violations internally before blowing the whistle to the SEC. Companies are justifiably concerned that the rules may undermine companies' internal compliance and reporting programs by encouraging employees to bypass these procedures and run directly to the SEC for a payday.

While there is little doubt the whistleblower rules will increase the number of SEC investigations, critics question whether they will be effective in helping the SEC root out fraud. After all, the most notorious financial fraud of the recent financial crisis, Bernard Madoff's Ponzi scheme, was reported to the SEC by a whistleblower, and the SEC did not act on the information. Determining which tips merit further investigation may be even more challenging if, as many commentators anticipate, the SEC experiences a significant increase in volume after the rules come into effect.

In this changed environment, what should companies do? Below are a few suggestions.

## Update and communicate internal compliance and ethics programs

Notwithstanding the incentives the new rules may create to bypass internal reporting, it is more important than ever for companies to maintain robust internal compliance measures. First, companies should periodically review and update their programs to account for changes in the law and in the company's business model. For example, if a company has recently expanded its business into a new international market such as China or Latin America, its internal compliance and training programs will need to be updated to account

for the compliance risks that come with doing business in these jurisdictions.

Second, companies should cultivate a culture of compliance by clearly communicating its compliance policies to employees, and by encouraging and rewarding ethical behaviour. Engaging employees and others who are in the best position to detect wrongdoing is an essential component of an effective compliance program.

Companies should emphasise that internally-raised concerns will be taken seriously and that employees will not face retaliation. Experience shows that employees who blow the whistle often do so when they believe issues they raised internally were not adequately addressed by their employers, or because they were not able to raise their concerns due to fear of retaliation.

## Focus on the quality of compliance personnel

It is critical that companies carefully choose which compliance personnel to put on the receiving end of internal reports of suspected wrongdoing. These employees have greater responsibility, are under greater pressure, and are subject to newfound temptations under the new rules. They must quickly assess the quality of the tip and the tipper, exercise judgment in determining which tips to elevate to the next level, and have sufficient authority to make sure their recommended actions are implemented. As the 'keepers' of potentially extremely lucrative company secrets, they must also be trustworthy.

Although compliance personnel are generally not eligible to be whistleblowers, there are exceptions in the rules that permit them to blow the whistle on their own companies and collect rich bounties. The exceptions include: (i) if disclosure is necessary to prevent conduct that is 'likely to cause substantial injury' to the company or shareholders; (ii) if the company is impeding an investigation into a suspected violation; or (iii) more than 120 days have passed since the internal report was made.

## Position yourself to respond quickly

When a company receives a credible report, it must have procedures and personnel in place to respond promptly and thoroughly. When taking action (or deciding not to take action) companies should consider the fact that their actions may be reviewed by the SEC with the benefit of hindsight. A fast and efficient process will boost a company's credibility and possibly translate into more lenient treatment if the SEC eventually becomes involved. Involving outside counsel ►►



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early can also help boost credibility. Prompt investigation and remediation can prevent a small problem from growing into a larger, more costly one.

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