



## SEC Takes Steps Towards Implementing Whistleblower Reward Program

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On July 21, 2010, President Obama signed the Wall Street Reform and Consumer Protection Act ("Wall Street Reform Act") into law. The Wall Street Reform Act includes a provision that mandates reward payments by the Securities and Exchange Commission ("SEC") to whistleblowers who offer information about securities law violations.<sup>1</sup> The Wall Street Reform Act gives the SEC a deadline of April 15, 2011, to implement the reward program, which is codified in Section 21F of the Securities Exchange Act of 1934. On November 3, 2010, the SEC published proposed rules and recommendations for carrying out the Wall Street Reform Act's directive, titled Regulation 21F, and requested public comments on the proposed Regulation. Although the comment period ended on December 17, 2010, additional comments may still be submitted electronically via the SEC's website.<sup>2</sup>

The commentary that accompanies the proposed Regulation 21F offers some insight into the SEC's intentions with respect to investigating and prosecuting Foreign Corrupt Practices Act violations, as well as the SEC's views on corporate compliance programs. The SEC acknowledges that implementation of Section 21F could result in some conflict with past guidance on corporate compliance and attempts to address these issues directly.

### Effectiveness of Internal Compliance Programs

The SEC notes that there is potential to significantly undermine existing corporate compliance programs by encouraging employees to bypass reporting of possible violations internally in favor of reporting directly to the SEC in order to qualify for the cash reward. In response, the SEC has drafted Regulation 21F with the intention of encouraging continued internal reporting while still offering protection of the employee's whistleblower status. Regulation 21F allows a whistleblower to wait 90 days between providing information on potential violations internally and providing the information to the SEC without compromising his or her eligibility for a reward. The SEC hopes that this "grace period" will give corporations a sufficient amount of time to conduct an internal investigation and make an appropriate response to the whistleblower's information. Additionally, the SEC will consider the whistleblower's cooperation with his or her company's internal compliance program as a favorable factor in determining the percentage of recovery that the whistleblower will receive as reward.

In theory, these provisions are designed to preserve the efficacy of corporate compliance programs as well as to offer additional incentive for employees to follow internal policies and protocol, while still rewarding whistleblowers who provide information to the SEC. However, it is unclear whether the optional "grace period" would, in practice, afford a company the opportunity to investigate internally prior to SEC involvement.



## Sources of Information

Regulation 21F also attempts to address concerns about employees in sensitive positions, or with access to sensitive information, using their position improperly for the purpose of obtaining a cash reward. To this end, the proposed rules define certain phrases used in the Wall Street Reform Act narrowly. For instance, the Wall Street Reform Act creates a cash reward for whistleblowers who provide information derived from the whistleblower's "independent knowledge or analysis." Proposed Regulation 21F specifically excludes information obtained as a result of the whistleblower's position as an attorney, independent auditor, or corporate compliance personnel from the definition of "independent knowledge or analysis." There is, however, an exception to the exclusion when a whistleblower is corporate compliance personnel and has reported the information internally, but the company has failed to take appropriate action within a reasonable amount of time or has otherwise acted in bad faith.

While the determination of whether this exception applies in a particular situation will necessarily be case-specific, the SEC has offered some guidance on what it will consider "bad faith." The SEC advises that it will consider affirmative steps to hinder an investigation, such as destruction of documents or interference with witnesses, as well as the carrying out of a sham investigation, as evidence of bad faith. The SEC also warns that whistleblowers who play a role in causing the company to delay in responding to possible violations will not be permitted to claim this exception.

## False Reporting

Proposed Regulation 21F also attempts to mitigate the potential of false reporting. In part, Regulation 21F requires that information submitted to the SEC be submitted under penalty of perjury, and also requires any whistleblower wishing to submit information anonymously to be represented by counsel who has verified the whistleblower's identity.

Proposed Regulation 21F addresses many of the concerns immediately identified when the Wall Street Reform Act was passed, although some of the propositions raise additional concerns of their own. The SEC has made clear its interest in balancing an effective whistleblower program with encouraging active corporate compliance programs, and has sought comments to that end.

With the deadline for the SEC to implement Regulation 21F fast approaching, it is important for companies to consider the effect of the whistleblower reward program on their corporate compliance programs and to make adjustments as necessary. Locke Lord's White Collar Criminal Defense and Internal Investigations Group has extensive experience advising clients on corporate compliance, and stands ready to assist in evaluating current compliance programs, as well as in developing and implementing cost-effective and comprehensive compliance programs.

### Endnotes

- 1 A prior Client Alert titled "Wall Street Reform and Consumer Protection Act Provides a Cash Reward for FCPA Whistleblowers," published on July 21, 2010, gives a more detailed overview of this provision.
- 2 Approximately 230 submitted comments are available to the public by [clicking here](#) (last visited January 25, 2011).

For more information on the matters discussed in this *Locke Lord's QuickStudy*, please contact the authors:

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