Mitigate Negative Effects You May Have from the Cash Incentives of The Whistleblower Provision

By Cathleen Seneca

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Shortly after I agreed to draft this article, the CFO SmartBrief quote for 07/07/11 was:
"Distrust raises transaction costs higher than they might otherwise be, causing real dollar-and-cents losses. Without trust, a company needs a plethora of lawyers, managers, and accountants watching and recording and negotiating." Larry Prusak, author and consultant.

I believe our self regulated industry will experience great distrust and higher transaction costs under the current whistleblower provisions that were effective immediately as enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The general expectation is that whistleblower reports will rise over time by "deputizing" corporate America. The SEC has stated publicly that there has not been a spike in reports; however, the quality and extent of documentation supporting the tips has improved.

On May 25, 2011 the SEC implemented the Dodd-Frank Whistleblower provisions in the new Exchange Act Section 21F.

Under the rules adopted by the SEC, a whistleblower will become eligible for an award by voluntarily providing information not previously known to the SEC that leads to a successful enforcement action in which the SEC or authorities obtain monetary sanctions totaling more than $1 million.

Attorneys (including in-house counsel); Compliance and Internal Audit personnel; and Independent public accountants working on SEC audits are not generally eligible for a whistleblower award. Persons in these categories who would not otherwise be eligible for an award can qualify under certain limited circumstances, including the following:

- If they believe that disclosure may prevent substantial injury to the financial interest or property of the entity or investors.
- If they believe that the company is engaging in conduct that will impede an investigation.
- If the company's audit committee, Chief Legal Officer, or Chief Compliance Officer have been aware of the information for at least 120 days, and have not disclosed it to the SEC.

Whistleblowers need not report potential violation to their employers in order to qualify for an award, but the SEC rules provide some incentives for them to do so. A whistleblower who reports internally can be eligible for an award if the company subsequently informs the SEC about the violations. A whistleblower reporting internally can be treated as if he or she reported the information to the SEC as of that date, if the whistleblower provides the information to the SEC within 120 days after reporting to the company. In determining the amount of a whistleblower award, the whistleblower's voluntary participation in the company's internal compliance and reporting systems is a factor that may increase the amount of an award. Conversely, a whistleblower's interference with internal compliance and reporting is a factor that may decrease the amount of an award.

Of note, there is no new compliance program requirement; however, as Compliance Professionals, our goal should be to get ahead of the issues. The following is a proactive approach:

1) Focus on how you can better encourage personnel to internally report concerns about potential misconduct. Whistleblowers are not required to report their concerns internally; however, Dodd-Frank's whistleblower provisions place a high premium on the ability to detect and prevent illegal conduct and this is best accomplished by assuring that there are effective systems for individuals to report concerns about potential wrongdoing in your organization, and that those systems have credibility to the organization's employees and associated persons ("employees"). Convincing employees of this requires constant reinforcement of truly wanting the information and preparedness to handle it well at every level of the organization. Remind employees that violations of law and internal policy jeopardizes the organization's success and potentially the security of their own livelihood.

2) Be specific. Have easy to follow instructions on how to make a report and describe what will happen after the report is made. Include assurances that internal reporting will remain anonymous and those that disclose their identity are protected. Also include instructions of what to do if they suspect retaliation.

3) Act on any internal reports quickly. Conduct an internal investigation of the issue, consider a third party investigator, report findings up the chain and consider reporting back to the internal whistleblower results and corrective action, if any. Keep in mind you may have a self-reporting requirement of 30 days under FINRA Rule 4530 that counts as reporting to the SEC.

4) Make sure HR coordinates with you to reduce the risk of retaliation

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claims. Provide training for managers at all levels and adhere to best practices for employee evaluations by reviewing performance honestly and timely and documenting fully and accurately. Exercise extra caution with employees who may use the whistleblower provisions as an offensive strategy. Limit the number of individuals aware of identities of whistleblowers and do not seek to identify anonymous whistleblowers. Investigate prior whistleblower activity at the pre-hire stage. Respond promptly to disputes between employees and supervisors that could develop into whistleblower situations. Document carefully employment decisions regarding whistleblowers especially if relying on probable cause. Include in separation packages a representation about lack of knowledge of violations not internally reported. Have employees certify frequently that they understand the internal reporting policy and have reported all potential violations currently known. Lastly, be mindful in all these matters that the definition of whistleblower subject to anti-retaliation is much broader than the definition of whistleblower entitled to an award.

5) Anticipate how you will respond if contacted by the SEC's Enforcement Division about a whistleblower complaint. The SEC has stated that it expects to permit companies, in some circumstances, to conduct their own investigations of Dodd-Frank whistleblower allegations, and to report back to them. For this option to be available, the SEC Staff will need to be comfortable that the company will conduct a credible, good faith investigation of the matter, and that it will cooperate with the SEC on an ongoing basis.

6) In any situation involving a potential securities law violation, remain alert to the fact that almost anyone can be a Dodd-Frank whistleblower. This includes a wide range of other people who may take issue with the conduct of company personnel, such as competitors, former employees, investors, consultants, former spouses and significant others. Whistleblowers can qualify for an award even if they obtained their information improperly or, in some cases, illegally. The SEC rules provide for awards to be made unless a court finds that a report was based on information obtained in violation of federal or state criminal law.

The whistleblower provisions will likely interfere with our most robust compliance programs. Unfortunately, some will inevitably take their concerns directly to the SEC, either hoping to get a bounty or fearing retaliation or inaction by our organizations. In spite of this, we should continue to evaluate how we can be the first to learn of potential violations and how to respond quickly and appropriately.

Sources:
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