SEC Adopts Amendments to Whistleblower Rules to Enhance Program Efficiency and Effectiveness

September 24, 2020

In an effort to provide "greater clarity to whistleblowers" while also enhancing the whistleblower program's "efficiency and transparency," a divided U.S. Securities and Exchange Commission (the "SEC" or the "Commission") yesterday announced the adoption of several important amendments to the whistleblower rules set forth in Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act").[1] Most notably, the amendments are intended to give the SEC enhanced tools and flexibility to "appropriately reward meritorious whistleblowers." Commissioners Caroline Crenshaw and Allison Herren Lee dissented on the final rule.

The SEC's amended whistleblower rules come towards the end of a busy fiscal year for the whistleblower program a year that has seen approximately 25 whistleblower awards totaling more than $130 million, including the largest award to a single whistleblower in the program's history. Since its inception 10 years ago, the SEC's whistleblower program has awarded approximately $523 million to 97 individuals and has cemented its important role in the SEC's enforcement program.

ENHANCED TOOLS IN AWARD DETERMINATIONS

Size of the Award

The amended rules provide the SEC with additional flexibility in how it determines awards. For award amounts of $5 million or less (which comprise approximately 75% of whistleblower awards), the rules create a presumption that the SEC will award the statutory maximum of 30% of sanctions collected where none of the negative criteria specified in Rule 21F-6(b) apply.[2] For awards over $5 million, the SEC will continue to use the same factors set forth in Rule 21F-6 to determine the appropriate award which,

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1 https://www.sec.gov/rules/final/2020/34-89963.pdf. Section 21F of the Exchange Act authorizes the SEC to make monetary awards to eligible individuals who voluntarily provide original information that leads to successful enforcement actions resulting in monetary sanctions over $1 million.

2 Those negative factors include unreasonable delay in reporting a violation, the whistleblower involvement in the alleged misconduct and/or interference with internal compliance and reporting systems.

assuming none of the negative factors apply, "would be expected to be in the top third of the award range." The Commission did not adopt proposed Rule 21F-6(d)(2), which would have provided a more formalized process for the SEC to conduct an enhanced review of certain larger awards. That proposal had been the subject of heavy criticism by members of the whistleblower plaintiffs' bar.

Broadened Definition of "Action"

The new rules amend the definition of "action" to make clear that an award can be made regardless of whether the resolution of the action is by settlement, administrative action, deferred prosecution agreement or non-prosecution agreement. In addition, the amended rules also address the definition of "covered action" to clarify that law-enforcement or separate regulatory actions do not qualify as "related actions" if the SEC determines that there is a separate award scheme that more appropriately applies to such law-enforcement or separate regulatory action.

Enhanced Tools for Evaluation of Claims

The amended rules allow the SEC to bar individuals who repeatedly make frivolous award claims in Commission actions as well as applicants who submit materially false, fictitious or fraudulent statements in their whistleblower submissions. These streamlined processes are designed to reduce the amount of SEC staff time spent processing frivolous claims, thereby freeing up staff resources to focus on processing potentially meritorious tips.

UNIFORM DEFINITION OF "WHISTLEBLOWER"

In response to the U.S. Supreme Court's decision in *Digital Realty Trust, Inc. v. Somers*,[3] the amended rules establish a much-needed uniform definition of "whistleblower." Under the new definition, to qualify as a "whistleblower" for purposes of the rules, an individual must report information about possible securities law violations to the SEC "*in writing*" and must have done so prior to experiencing any alleged retaliation. This definition of "whistleblower" applies to all aspects of Section 21F, including the award program, the heightened confidentiality requirement and the employment anti-retaliation protections.[4] Commissioner Crenshaw issued a statement on the whistleblower rule amendments expressing concern that the requirement that information be submitted in writing failed to protect adequately would-be

[3] 138 S. Ct. 767 (2018).

[4] The interpretive guidance issued concurrently with the amended rules provides the scope of retaliatory conduct prohibited by Section 21F(h)(1)(A), which includes any retaliatory activity by an employer against a whistleblower that a "reasonable employee would find materially adverse."

whistleblowers, particularly those who might provide information to the SEC through interviews or testimony.

SEC'S INTERPRETIVE GUIDANCE ON "ORIGINAL INFORMATION"

The SEC also published interpretive guidance regarding the "independent analysis" standard under Rule 21F-4(b)(3). Under the rule, a whistleblower must provide "original information" based on "independent" knowledge or analysis. Original information has led to enforcement actions in which the Commission has obtained over $2.5 billion in financial remedies. The new guidance clarifies that to meet the "independent analysis" standard a whistleblower must provide information that is "not generally known or available to the public." To make the determination, the SEC will look at whether the whistleblower's information derives from "multiple sources" that are "not generally known or available to the public, including sources that, although publicly available, are not readily identified and accessed by a member of the public without specialized knowledge, unusual effort, or substantial cost[.]" Commissioner Crenshaw criticized the rule's "independent analysis" standard stating that the focus should not be on what the staff "could have" inferred from the information provided but on what the staff "did infer" prior to receiving the whistleblower tip. Commissioner Crenshaw went on to express concern that the new "independent analysis" standard would "inadvertently impact the perception of the type of information the Commission considers valuable."

TAKE-AWAYS

The amendments to the SEC's whistleblower rules provide important clarifications to Rule 21F that are useful not only for the SEC in managing the whistleblower program more broadly but also for issuers and whistleblowers alike. The amendments reflect lessons learned by the whistleblower program over the last 10 years, which the SEC believes will serve to enhance and strengthen the program as it moves forward. The amended rules continue to provide significant incentives for whistleblowers to come forward with tips and therefore serve as a reminder that companies must ensure that their internal policies and procedures provide adequate anti-retaliation protections for potential whistleblowers while also providing robust internal processes to address credible claims of alleged misconduct.

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Please do not hesitate to contact us with any questions.

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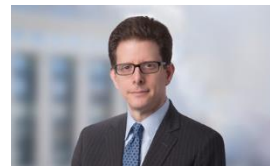
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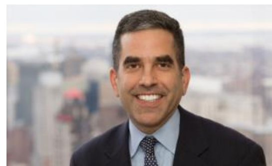
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