

**THOUGHT LEADERSHIP**

LEGAL UPDATES

PUBLISHED: DECEMBER 1, 2010

## SEC Issues Proposed Whistleblower Rules

New Section 21F to the Securities Exchange Act of 1934 (Exchange Act) directs the Securities and Exchange Commission (the Commission) to establish a regulatory framework under which the Commission may pay an award to eligible “whistleblowers” who voluntarily provide the Commission with certain information about a violation of the federal securities laws. Section 21F(h)(1) of the Exchange Act protects whistleblowers from retaliation and the new program is intended to encourage whistleblowers to report violations by offering significant monetary incentives. The Commission recently released proposed Regulation 21F to implement the whistleblower program.

### **Proposed Eligibility Requirements**

Proposed Regulation 21F defines an eligible whistleblower as an individual, who alone or jointly with others, voluntarily provides the Commission with information relating to a potential violation of the federal securities laws that leads to the successful enforcement by the Commission in federal court or an administrative action in which the Commission obtains monetary sanctions totaling more than \$1,000,000.

The proposed rules preclude eligibility for monetary awards if the individuals providing the information did not derive it from independent knowledge or independent analysis. These individuals include those who received their information:

1. Through a communication subject to the attorney-client privilege;
2. As a result of the legal representation of a client on whose behalf the whistleblower’s services, or the services of the whistleblower’s employer or firm, have been retained;

3. Through the performance of an engagement required under the securities laws by an independent public accountant, if the information relates to a violation by the engagement client or the client's directors, officers or other employees;
4. As a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity where such information was communicated to the person with the reasonable expectation that the person would take appropriate steps to cause the entity to respond to the violation, unless the entity did not disclose the information to the Commission within a reasonable time or the entity proceeded in bad faith;
5. From or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential non-compliance with applicable law unless the entity did not disclose the information to the Commission within a reasonable time or proceeded in bad faith;
6. In a manner that violates applicable federal or state criminal law; or
7. From any individual described in 1-6 above.

As proposed, the rules also prohibit the following individuals from receiving whistleblower awards:

1. An individual who is or was at the time he or she acquired the information, a member, officer, or employee of the Department of Justice, an appropriate regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board, or any law enforcement organization;
2. An individual who is or was at the time he or she acquired the information, a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority;
3. An individual convicted of a criminal violation that is related to the Commission action or to a related action for which the individual otherwise could receive an award;
4. An individual who obtained the information through an audit of a company's financial statements; or
5. An individual who obtained the information from any individuals listed in 1-4 above;
6. Spouses, parents, children or siblings of a member or employee of the Commission, or individuals who reside in the same household as a member or employee of the Commission; or

7. An individual, who in his or her whistleblower submission, dealings with the Commission, or dealings with another authority in connection with a related action, knowingly and willfully makes any false, fictitious or fraudulent statement or representation, or uses any false writing or document, knowing that it contains any false, fictitious or fraudulent statement or entry.

Under the proposed rules, eligible whistleblowers would be required to submit several forms to the Commission in order to claim an award:

1. Form TCR, setting forth the whistleblower's identity and original information;
2. Form WB-DEC, confirming the whistleblower's eligibility; and
3. Form WB-APP, in order to make a claim for a reward.

## **Proposed Awards**

The proposed rules contemplate that the Commission will pay an award based on amounts collected in certain related actions. Eligible whistleblowers would be entitled to between 10%-30% of the total monetary sanctions collected in the action. The specific amount of the award would be within the Commission's jurisdiction so long as the total amount paid to all whistleblowers does not exceed 30% of the monetary sanction.

## **Successful Enforcement**

As already noted, awards are conditioned upon the information leading to successful enforcement by the Commission in federal court or an administrative action in which the Commission obtains monetary sanctions totaling more than \$1,000,000. Proposed Rule 21F-4(c) defines when the information leads to "successful enforcement" as:

1. Where the information caused the Commission staff to open a new investigation, reopen one that had been closed by the Commission, or to inquire about new or different conduct as part of a current exam or investigation and the information significantly contributed to the success of the action; or
2. Where the information was related to conduct that was already under investigation by the Commission, Congress, any other federal, state or local authority, any self-regulatory organization, or the PCAOB (with exceptions), and the information would not otherwise have been obtained and was essential to the success of the action.

The Commission's proposed release indicates that it intends to apply the latter definition only in limited cases.

## **Comment Period**

Comment letters on the proposal are due by December 17, 2010 and should be filed as directed in the release.

## **What this Means to You**

Regulation 21F will likely have a significant impact on the compliance systems and processes employed by investment advisers and broker-dealers—especially larger firms. While the Commission seeks to maintain a balance between encouraging firms to internally address securities law violations on the one hand and not creating incentives for firm personnel to seek personal financial benefits on the other hand, the proposed rules will likely require firms to enhance the manner in which they address internal reports concerning violations of the securities laws.

## **Contact Info**

If you have questions concerning this or any other investment management issue, please contact your Husch Blackwell attorney.

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