United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510–6275

September 18, 2018

VIA ELECTRONIC SUBMISSION

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549–1090

Re: File No. S7-16-18, Amendments to the SEC's Whistleblower Program Rules

Dear Mr. Chairman:

I am writing in regard to the Commission's Proposed Amendments to the Whistleblower Program Rules, Release No. 34-83557; File No. S7-16-18, RIN 3235–AM11, 83 *Federal Register* 34702 (July 20, 2018) (hereinafter, "Proposed Rule(s)"). Please file this letter on the public record as a formal comment submitted by Senator Charles E. Grassley, Chairman of the U.S. Senate Committee on the Judiciary.

I. Award Determinations in Cases of Large Recoveries

The Commission proposes "a mechanism . . . to conduct an enhanced review of awards in situations where a whistleblower has provided information that led to the success of one or more covered or related actions that, collectively, result in at least $100 million in collected monetary sanctions."[1] As the Commission notes, under the statute the minimum total award for a whistleblower(s) who contributes to that success would be 10% for any "specific action," or $30 million as a "total payout for any award(s) resulting from the whistleblower's original information."[2]

[1] Proposed Rule 17 C.F.R. §§ 240.21F-1–17, *available at* Amendments to the Commission's Whistleblower Program at 43 (proposed July 20, 2018), https://www.sec.gov/rules/proposed/2018/34-83557.pdf (hereinafter "Proposed Rule").
[2] *See id.* at 44.

The Commission's proposed rule is replete with references to what it terms "not reasonably necessary," "exceedingly large," "extraordinarily large," and "unnecessarily large" awards in cases where monetary sanctions recovered due to the assistance of whistleblowers are themselves very significant. The Commission's primary, if not only, apparent concern with such awards is the fact that they are, indeed, large. The Commission suggests that awards that are apparently too large are not "appropriate."[3]

As an initial matter, it is worth noting that the Inspector General does not appear to share the Commission's concerns about award size. The program's award levels were evaluated by the Commission's Office of Inspector General (OIG) in 2013, pursuant to the Congressional mandate set forth in the Dodd-Frank Act of 2010.[4] The OIG was specifically required to evaluate "whether the minimum and maximum reward levels are adequate to entice whistleblowers to come forward with information and whether the reward levels are so high as to encourage illegitimate whistleblower claims."[5] The OIG's evaluation states that:

> "The SEC's whistleblower program's award levels are comparable to the award levels of other federal government whistleblower programs, and range from 10 to a maximum 30 percent. Based on our review of past experience of other whistleblower programs and practical concerns in the administration of the SEC's program, *we determined the SEC's award levels are reasonable and should not change at this time*."[6]

The Commission has not pointed to any compelling reason to veer from award levels that are working and that are comparable to other federal award programs. Moreover, the 2013 report also evaluated the "two most detailed empirical studies" addressing how monetary award levels influence whistleblowing behavior. Both studies concluded that "*high rewards* can motivate potential whistleblowers to come forward because the monetary amount may mitigate the cost of professional and social sanctions that can result."[7] Despite the Inspector General's report, the Commission proposes that it is in the "public interest" for the Commission to reduce a whistleblower's award in the most successful of cases, even if the award otherwise would fall below the 30% statutory maximum.[8]

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[3] *Id.* at 43–46.
[4] *See generally* Pub. L. No. 111–203 § 922(d) (2010).
[5] *Id.* § 922(d)(1)(D).
[6] *See* U.S. SEC. AND EXCHANGE COMM'N, Office of Inspector General, Office of Audits, *Evaluation of the SEC's Whistleblower Program*, Rep. No. 511 at v–vi (Jan. 18, 2013) (emphasis added), https://www.sec.gov/about/offices/oig/reports/audits/2013/511.pdf.
[7] *Id.* at 23 (emphasis added).
[8] *See* 17 C.F.R. § 240.21F-5(b) (2011); Proposed Rule at 44, n 102 (illustrating the Commission's proposed paragraph (d), noting that "[i]f the collected amount is $150 million, the Commission could exercise its discretion to reduce a potential payout of 25% ($37.5 million), but the Commission could not reduce the award below $30 million.").

The Commission offers two basic reasons to question the "appropriateness" of potentially large awards.[9]

First, the Commission asserts that large awards are not necessary to achieve the program's goals. But the Commission's analysis is incomplete. In establishing the whistleblower award program, Congress was not concerned about a reward figure being "too big." If anything, the legislative history shows that Congress was more concerned about potential whistleblower awards being too stingy. As the Senate Committee report opined: "[t]he Committee intends for [the whistleblower] program to be used actively with *ample rewards* to promote the integrity of the financial markets."[10] Merriam–Webster's Dictionary defines "ample" in several ways: (1) "*generous or more than adequate* in size, scope, or capacity"; (2) "*generously sufficient* to satisfy a requirement or need"; and (3) "*having a greater size, expanse, or amount than that deemed adequate*."[11] Far from intending that the Commission nickel and dime awards to the most successful whistleblowers, Congress placed great weight on the value of a predictably comfortable award margin.[12]

Further, Congress provided a set of criteria for the Commission to consider when determining the amount of a whistleblower award, and a guide to setting the outer boundaries—the minimum and maximum—of potential awards in each case.[13] Congress's criteria are: "(I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action; (II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action; (III) the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws; [and] (IV) such additional relevant factors as the Commission may establish by rule or regulation[.]"[14] Although Congress provided for the Commission to consider other relevant factors, it is instructive that those factors Congress explicitly noted were crucial for the success of the whistleblower program are directed to the value the whistleblower provides to the SEC in the particular case—the quality of assistance, significance of information, and the message the award sends to others potentially contemplating similar securities laws infractions. Moreover, by setting minimums and maximums in percentage terms, Congress instructed the Commission to weigh these factors and set the amount of the award specifically in relation to the amounts recovered. None of these factors contemplate the potential dollar number itself as a factor in determining the final warranted award.

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[9] Proposed Rule at 44, 46.
[10] S. REP. NO.111 –176 (2010) at 112 (emphasis added).
[11] *See* MERRIAM–WEBSTER'S DICTIONARY, https://www.merriam-webster.com/dictionary/ample (last visited on Sept. 17, 2018) (emphasis added).
[12] S. REP. NO. 111–176 (2010) at 110–112.
[13] 15 U.S.C. § 78u–6(c)(1)(B); *id.* § 78u–6(b).
[14] *Id.* at § 78u–6(c)(1)(B)(i). *See also* 17 C.F.R. § 240.21F-6 (2011) (providing that the Commission, when assessing the appropriate whistleblower award amount, consider: (1) the significance of information provided to the Commission; (2) the assistance provided in the Commission action; (3) law enforcement interest in deterring violation by granting awards; (4) participation in internal compliance systems; (5) culpability; (6) unreasonable reporting delay; and (7) interference with internal compliance and reporting systems.).

The Commission makes much of the notion that the $30 million/10% limitation is a *floor* and not a *ceiling*. That particular number may not be a ceiling, but the Commission's proposal nevertheless would operate as an arbitrary cap. It says that whistleblowers who provide information that results in very, very successful cases and who otherwise could receive a much larger award based on their assistance likely will have their potential awards docked for reasons that have nothing to do with the value of the whistleblower's information or the whistleblower's behavior.

Additionally, for all of its focus on the supposed lack of need for very large awards to achieve the program's goals, the proposal seems to underestimate the impact of very large awards on a potential whistleblower's decision whether to report, and does not adequately consider the deterrent effect of very large sanctions and awards on future potential violators. The counsel of whistleblower advocates familiar with these cases is instructive.[15] According to their experience, it appears that the strength of the anti-fraud message delivered by a whistleblower award (not to mention its effectiveness in encouraging reports in large, serious cases) is directly proportional to the award size. The bigger the award, the more potent the message sent to the nefarious-minded that while crime may pay in the short run, speaking up about it pays very well, too. Those individuals contemplating breaking the rules know their colleagues are watching them—and in cases of potentially very large awards will have significantly less to lose by disclosing bad conduct. This is even more important in cases of the most well-informed whistleblowers—who are usually the most highly-placed in a company, and who should not be subjected to artificial award limits when those who commit wrongdoing or stay silent will not likewise face artificially limited executive compensation rates.[16]

Second, the Commission asserts that it might be better to use the extra money it withholds from a whistleblower in very large cases to pay for something else. That, the Commission says, is "good public policy."[17] This reasoning is not supported by the text or the legislative history establishing the program. Congress made a very clear policy choice to prioritize *amply* rewarding a whistleblower above *other priorities*.[18] That is because there would be *no recovery at all* in these cases—to spend on *any* policy priority—were it not for the whistleblower.[19] It is difficult to understand how Congress could intend that "other priorities,"

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[15] Kohn, Kohn & Calapinto, LLP, *Submitted Comment on Proposed Rule: Amendments to the Commission's Whistleblower Program Rules* at 4–9 (July 24, 2018), https://www.sec.gov/comments/s7-16-18/s71618-4107169-170275.pdf.

[16] *Id.* at 5 (The Proposed Rule "creates an appearance of bias against whistleblowers, especially in light of the fact that there are no caps on executive compensation or other profit-based motives that proliferate the culture within the financial services industry.").

[17] Proposed Rule at 46.

[18] 15 U.S.C. § 78u–6(g)(3)(B) ("If the amounts deposited into or credited to the Fund under subparagraph (A) are not sufficient to satisfy an award made under subsection (b), there shall be deposited into or credited to the Fund an amount equal to the unsatisfied portion of the award from any monetary sanction collected by the Commission in the covered judicial or administrative action on which the award is based."); *see also* S. REP. NO. 111-176 (2010) at 112.

[19] S. REP. 111-176 (2010) at 111-112 ("[T]he intent of the Committee is to reward the whistleblower prior or at the same time as paying such victims, recognizing that were it not for the whistleblower's actions, there would have been no discovery of the harm to the investors and no collection of any sanctions for their benefit.") (emphasis added).

particularly those not even mentioned in the statute, should be a factor in determining the size of an award.

The statute also specifically directs the Commission not to take into account the dollar balance of the Investor Protection Fund (IPF) when determining the size of a whistleblower award.[20] This is another clear indication that Congress was not concerned about the dollar amount of a potential award, even in its relation to the size of the IPF. If it was, then Congress certainly would have said so here. Instead Congress did the opposite, by ensuring that even if the fund was depleted, the *whistleblower* would be first in line and would still receive her well-earned share of the recoveries.

Finally, unlike the case of awards under, for example, the False Claims Act, there is no ability for a whistleblower to appeal the size of an award outside of the Commission.[21] This means there is no way for a whistleblower to challenge the "appropriateness" of an award amount before an independent federal judge. The unavailability of an appeal dampens the assurances potential whistleblowers can have that awards are predictably and consistently determined and enforced.[22] That concern is only heightened when a potential award determination may be untethered to the standards Congress has clearly emphasized.

II. Confidentiality and Related Actions

In designing the Commission's whistleblower award program, Congress intended for the Commission to safeguard all information "which could reasonably be expected to reveal the identity of a whistleblower[.]"[23] The statute provides for limited sharing of information with other governmental agencies but "[w]ithout the loss of its status as confidential in the hands of the Commission"[24] Indeed, the statute requires entities that do receive the information to treat it as confidential.[25] This is because whistleblowers whose identity is exposed are often subject to reprisal and, in the private sector, blacklisting. A whistleblower who speaks up against a wealthy and well-connected corporation often finds him or herself unable to work in that industry ever again. Protecting a whistleblower's confidentiality is a linchpin of the SEC's program.

The Proposed Rule provides that "a law-enforcement action would not qualify as a related action if the Commission determines that there is a separate whistleblower award scheme that more appropriately applies to the enforcement action."[26] The proposed rule also requires whistleblowers to directly provide "original information" to agencies for which they may later

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[20] 15 U.S.C. § 78u–6(c)(1)(B)(ii) ("In determining the amount of an award . . . the Commission . . . shall **not** take into consideration the balance of the Fund.") (emphasis added).
[21] 15 U.S.C. § 78u–6(f).
[22] S. REP. 111-176 (2010) at 112.
[23] 15 U.S.C. § 78u–6(h)(2)(A).
[24] *Id.* § 78u–6(h)(2)(D)(i).
[25] *Id.* § 78u–6(h)(2)(D)(ii).
[26] Proposed Rule at 10.

seek a related action award.[27] However, although the Proposed Rule recognizes confidentiality as one of the "three key tenets" that is critical to the success of the whistleblower program, the Rule does not describe how it will safeguard a whistleblower's identity or information when it must be shared under these rules.

For example, not all award programs have or will have similarly strict confidentiality requirements. The Commission should seriously consider whether the denial of a related action award in cases of more relevant award programs, as well as the proposed information sharing requirements with other entities, would adequately protect the confidentiality of the whistleblower, and if so, how. The Commission also should take steps to ensure that wherever the whistleblower is required to share his or her information, or with whatever entity the Commission shares the information, that the entity will take all necessary steps to safeguard the whistleblower's identity.

III. Internal Reporting

Given the Supreme Court's recent decision in *Digital Realty Trust*, *Inc. v. Somers*, whistleblowers are no longer protected for reporting wrongdoing internally.[28] Under this framework, the Commission should cease to promote internal reports by considering them as a factor in award determination analysis.[29] It makes no sense to increase an award to a whistleblower for doing something that leaves him legally defenseless, and withhold such an increase from a whistleblower who acts to protect himself. It is simply not practical to assume that whistleblowers will always be able to submit reports simultaneously to the Commission and to an internal compliance program. The Commission also should consider withdrawing rules that effectively deny protections to certain classes of employees, who are required under the rule to report internally first and must wait six months before reporting to the Commission.[30]

IV. Delays

The current delays are contrary to both the Administrative Procedure Act, and the Congressional purposes behind the creation of the whistleblower program.[31] Therefore, the Commission is right to be concerned about delays.

Congress, in requiring the Inspector General of the Commission to conduct a study and publicly report on "whether the Commission is prompt in responding to information . . . and applications for awards filed by whistleblowers" clearly expects the Commission to avoid delays.[32] Further, the text of the Dodd-Frank Act highlights the importance of the Commission's

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[27] *Id.* at 37.
[28] 138 S. Ct. 767 (2018).
[29] *See* 17 C.F.R. § 240.21F-6(a)(4).
[30] *See id.* § 240.21F-4(b)(4)(iii).
[31] *See* 5 U.S.C. § 706(1) (stating that agency action shall not be "unreasonably delayed.").
[32] *See* Pub. L. No.111-203 § 922(d)(1)(C)(i)(I)–(II).

timely handling of whistleblower reports. For example, Congress specifically emphasized the need for the Inspector General to determine whether the Commission is communicating with, and updating whistleblowers about their award applications.[33]

According to the Proposed Rule, it is the Commission's belief that the changes being proposed will allow the Commission to "more efficiently process award applications, among other potential benefits."[34] The Commission is right to be concerned about delays. However, the Proposed Rule only offers a single attempt to address the severely long delays, which are sometimes years.[35] The Commission proposes to bar repeat whistleblowers that submit multiple frivolous claims, thereby helping to speed up the award determination process for other submissions. While this specific attempt is a start, the Commission's Proposed Rule fails to adequately address the long delays experienced in whistleblower cases that are not frivolous.[36] Should the Commission allow these long delays to persist, the resulting lengthy award determination process could deter future potential whistleblowers.[37]

Thank you for consideration of these comments. Please contact my committee staff at (202) 224-5225 with any questions.

Sincerely,

Charles E. Grassley
Chairman

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[33] *Id.* at § 922(d)(1)(C)(ii)–(iii).
[34] Proposed Rule at 9.
[35] Kohn, Kohn & Calapinto, LLP, *Submitted Comment on Proposed Rule: Amendments to the Commission's Whistleblower Program Rules* at 20 (July 24, 2018) (noting that based on the firm's "direct experience" the "undue delay" can be as long as four years, which is unacceptable).
[36] *See id.* at 21 (suggesting that the Commission consider moving the award determination decision to an earlier point in the process before sanctions are obtained, as in FCA cases, rather than waiting until the end and permitting any person to file an award application); Rachel Louise Ensign & Jean Eaglesham, *SEC Backlog Delays Whistleblower Awards*, Wall St. J. (May 4, 2015, 11:44 AM), https://www.wsj.com/articles/sec-backlog-delays-whistleblower-awards-1430693284 (last visited Sept. 17, 2018) (stating that "Of the 297 whistleblowers who have applied for awards since 2011, about 247--or roughly 83%--haven't received a decision from the SEC, according to data obtained by The Wall Street Journal in response to a public-records request. Some of the award claims have been delayed more than two years.").
[37] Rachel Louise Ensign & Jean Eaglesham, *SEC Backlog Delays Whistleblower Awards*, Wall St. J. (May 4, 2015, 11:44 AM), https://www.wsj.com/articles/sec-backlog-delays-whistleblower-awards-1430693284 (last visited Sept. 17, 2018) ("Experts worry that long delays, if allowed to persist, could deter future tipsters.").