

**MEMORANDUM FOR THE COMMISSION
WHISTLEBLOWER PROGRAM RULE AMENDMENTS**

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**ENSURING THE INTEGRITY OF THE INVESTOR PROTECTION FUND
WHILE TIMELY AND PROPERLY PAYING WHISTLEBLOWER CLAIMS**

The National Whistleblower Center hereby submits this proposal as a formal supplemental comment to the public record regarding the Whistleblower Program Rule Amendments, Rel. No. 34-83557. This proposal is submitted in order to ensure that whistleblowers can be properly paid in accordance with the Congressional intent and plain language of the Dodd-Frank Act, without threatening the integrity of the Investor Protection Fund.

A. Understanding the “Related Action” Provision

One of the most important features of the U.S. government’s whistleblower programs is that reward payments are generated directly from sanctions obtained by fraudsters. As there is an uppermost award limit set at a percentage of the collected proceeds, which in the case of the SEC is 30%, the U.S. government profits from the ability of whistleblowers to detect frauds and provide the government with high quality information, even distinct from any other benefits that whistleblower tips provide to the government’s law enforcement capacity. When the SEC is the organ of government collecting the sanctions obtained in whistleblower cases, the process works quite well. In such situations, the SEC claims between 70% - 90% of the monies recovered as a result of whistleblower cases; as a result, there should always be ample funding for any SEC case.

In order to ensure that whistleblowers are adequately compensated, Congress established the Investor Protection Fund, as part of the Dodd-Frank Act.¹ This Fund is required to maintain a minimum balance in order to ensure the payments required under law.² When funding for the Fund

¹ 15 U.S.C. § 78u-6(g)

² 15 U.S.C. § 78u-6(g)(3)

drops below that balance, the SEC is required to use sanctions it obtains from enforcement cases to replenish the Fund.³

The SEC fulfills its obligation to provide monetary rewards to whistleblowers who voluntarily provide the SEC with original and high-quality information which results in a successful prosecution – at no expense to the taxpayer or those that have been wronged by criminal actions. When the SEC announce a whistleblower reward, the statement notes:

“The money paid to whistleblowers comes from an investor protection fund established by Congress at no cost to taxpayers or harmed investors. The fund is financed through monetary sanctions paid by securities law violators to the SEC. Money is not taken or withheld from harmed investors to pay whistleblower awards.”

However, the SEC is not always the government entity which collects the sanctions obtained in whistleblower cases in which the whistleblower voluntarily submitted the original information to the SEC. The Dodd-Frank Act also contains a provision concerning “Related Actions.”⁴ The provision authorizes the SEC to pay a financial award to a whistleblower based not only on the voluntary disclosure of the original information provided to the SEC and resulting in a successful prosecution, but also as a result of successful prosecutions (or other decisions that result in monetary sanctions) that are based on the same information but to another government enforcement entity or under another law. A whistleblower is entitled to a reward based on collected proceeds obtained from fraudsters in “related action” cases. This system rewards whistleblowers no matter how their information is used, recognizing that the law enforcement would not be possible without the assistance of the whistleblower – even if the fraud is not brought to justice by the SEC itself.

However, because the sanctions obtained by the U.S. government in a related action case are not paid directly to the SEC, the SEC does not receive the direct source of funding to pay rewards in related action cases. Instead, the money to pay a reward in a related action case must come from sanctions obtained in SEC cases. The dilemma that this creates is readily apparent. If the SEC is required to pay a large related action-based reward, the monies for that reward must come from SEC cases, in which the recoveries may be far smaller. Additionally, the related action reward requirement is triggered whenever the SEC issues a sanction of \$1 million, regardless of the size of the related action.⁵ Even if smaller, these amounts can add up and be potential problematic as well. As a result, paying such related action rewards could result in the exhaustion of monies in the Investor Protection Fund and paralyze the ability of the SEC to pay rewards, at least until the SEC collects sufficient additional funds through its own law enforcement efforts.

Here’s an example: Take a case in which the SEC has sanctioned Company “A” for \$1 million. If the SEC paid the maximum reward (\$300,000), there would be ample funds at the SEC from

³ Id.

⁴ Under the statute, the term “related action” is defined as “any judicial or administrative action brought by an entity described in subclauses (I) through (IV) of subsection (h)(2)(D)(i) that is based on upon the original information provided by a whistleblower...” 15 U.S.C. § 78u-6(a)(5). The use of the term “commission action” means “Covered judicial or administrative action” as defined by subsection (a)(1).

⁵ 15 U.S.C. § 78u-6(b)(2).

this very sanction to compensate the whistleblower. The amount available in the Investor Protection Fund is not at risk in this situation, as the funding mechanisms governing that Fund provide ample authority for ensuring that rewards predicated on sanctions obtained from Commission actions are available for whistleblowers. *See* 15 U.S.C. § 78u-6(g)(3). This includes a very broad worst-case scenario funding mechanism.⁶ However, if in the same case, the DOJ issues a related action sanction against the same company for \$100 million, the SEC the ability of the SEC to pay the reward could be placed in jeopardy. For example, even if the SEC only paid a 10% reward on this related action claim, the SEC would owe the whistleblower \$10 million. Yet, the SEC itself only collected \$1 million from the fraudster; the rest of the money (the \$100 million) is not part of the SEC's available funds and the risk of depleting the fund too fast is real once several related action awards are paid.

As a result, even if a related action at a different agency would result in an award larger than the total amount sanctioned by the SEC, the SEC still must pay a whistleblower reward on the related action amount.

Based on the public record, a related action collection can often be much larger than a direct SEC action. As such, the potential for related action recoveries to exhaust the Investor Protection Fund is an appropriate concern.

This concern can have a significant detrimental impact on the entire whistleblower program. It could result in the SEC attempting to narrowly construe related actions as a means to preserve funding for SEC action-based awards, even if such behavior in the determination process is in fact explicitly prohibited in the statute.⁷ Whistleblowers, who should be and are otherwise incentivized to voluntarily submit information and continue to work with the government during the case investigation, may see that their efforts with other agencies are not in their best interests. Moreover, the premature exhausting of the Investor Protection Fund would result in the delay of payments to other future whistleblowers in SEC cases, a particularly egregious result as many of those payments are small rewards to whistleblowers who have lost their jobs or otherwise need the compensation.

B. A cap is not the solution

Crucially, just as setting precedents to narrowly construe related actions cases would create problematic disincentives, a whistleblower reward cap (a hard number rather than a percentage as utilized in other U.S. whistleblower reward programs) is not a solution to this concern. Aside from

⁶ 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.”)

⁷ Congress has explicitly prohibited the SEC from taking into consideration the amount of money in the Investor Protection Fund when making an award determination. 15 U.S.C. § 78u-6(c)(1)(B)(ii).

risking violating the express terms of the Dodd-Frank Act itself, a reward cap would not address the core problem: it would still allow for the premature exhaustion of funds in the Investor Protection Fund in certain circumstances. As demonstrated in a comparison of FIRREA and FCA reward provisions and the efficiency of these laws over three decades, a reward amount cap pulls the rug out from any incentive a whistleblower has to step forward and has proven to be bad public policy. As a result, it is an incomplete solution that comes packaged with significant downsides as well, and as such should be wholly rejected.⁸

Reward programs with caps don't incentivize whistleblowers: There are many different types of whistleblowers. On one end of the spectrum is a whistleblower who has blown the whistle, is known to and was retaliated against by an employer, and has already filed information with the SEC. Yet other whistleblowers may be at an extremely high level in their organization or professional career. While this individual knows about wrongdoing, they are not known as a whistleblower and can remain anonymous. As a result, this individual is still in a position to choose whether to blow the whistle. In fact, this is the type of whistleblower who could be most valuable to the SEC, as this individual is likely to voluntarily come forward with high-quality information about significant wrongdoing – if motivated to do so. It is this whistleblower that tip and enforcement programs mandated by Congress are designed to target. If incentivized, this whistleblower will do the right thing and come forward. Yet, it is exactly this whistleblower who will take into consideration the reward potential when making a decision on whether to come forward. As a result, whistleblower reward caps are particularly dis-incentivizing to potential whistleblowers, as reward caps undermine the psychological surety that the government will, at the end, make sure that a whistleblower is made whole from the suffering they endure as a result of their decision to bravely blow the whistle.

The data proves that programs with caps are certain to fail: The NWC examined the data from over three decades from the Securities Financial Instruments Reform, Recovery and Enforcement Act (FIRREA), as well as the False Claims Act. The data clearly demonstrates that the reward cap built into the FIRREA whistleblower reward provision has acted as a deterrent to whistleblowers coming forward with information, muting the abilities of law enforcement to hold accountable financial fraud. In comparison, the significant successes of the FCA, specifically in providing law enforcement the ability to claw back millions and millions of dollars of illicit funds as sanctions and fines, has been powered by whistleblowers who voluntarily submit high-quality information

⁸ Arguments against any form of cap were set forth by numerous respected experts on whistleblower/fraud detection/securities enforcement during the comment period. See, e.g. See [Kohn](#), [Kohn and Colapinto, LLP Comment filed on July 24, 2018](#); [Harry Markopolos Comment filed on September 14, 2018](#); [Professor William Jacobson, Cornell University School of Law Comment filed on September 17, 2018](#); [Taxpayers Against Fraud Comment filed on September 18, 2018](#); [National Whistleblower Center Comment filed on September 17, 2018](#); [Corporations and Society Initiative, Stanford University Graduate School of Business, Comment filed on September 18, 2018](#); [Americans for Financial Reform Education Fund Comment filed on September 18, 2018](#); [Public Citizen Comment filed on September 18, 2018](#); [Chairman of the Senate Judiciary Committee Comment filed on September 18, 2018](#); [Better Markets Comment filed on September 18, 2018](#); [Law 360: The Problem With SEC's Plan To Cap Whistleblower Awards](#).

and are rewarded following the conclusion of a success case. In fact, government agencies which administer the whistleblower reward programs recognize the essential contribution of whistleblowers and oppose reward caps as ineffective. It would be extremely detrimental to the success of the existing SEC whistleblower program to implement any reward cap.

C. The SEC has discretion on timing the payout

While the SEC is prohibited from considering the balance of funds as a factor in determining the amount paid to a whistleblower, it has been granted some flexibility by Congress in structuring other aspects of its whistleblower reward program.⁹ Namely, the SEC has clear legal authority to structure the timing of payments (rather than the amount to be paid) in order to ensure that the lack of monies in the Investor Protection Fund does not result in undue delays in the payment of rewards to needy whistleblowers or other whistleblowers who have waited years for a final decision, nor create a disincentive based on delays triggered by a lack of funding available to pay rewards.¹⁰ This would also ensure that the whistleblower program be a drain on funds for the SEC, as originally intended and anticipated by Congress.

This valid concern can be resolved by spreading out the payment, rather than cutting it and running afoul with practices prohibited in the law.

Thus, the SEC should modify its current rules regarding the timing of payments in certain cases. This adjustment can be done by formal rulemaking, as is currently under consideration, or by an internal operating procedure published to the whistleblower community. With this modification to the program, the SEC's ability to control the timing of payments would mitigate any potential harm caused by the reduction of monies in the Investor Protection Fund due to large related action type awards.

Finally, such a proposal would be a familiar structure to many in the whistleblower community. Indeed, deferred payments are common in whistleblower employment cases. In these cases, a structured payment plan over time provides benefits to the whistleblower themselves, such as an opportunity to lower their tax burden, fund retirement plans over time, and provide long-term financial stability after what is often a career interrupted as a result of retaliation from blowing the whistle. It is likely that existing whistleblowers and potential future whistleblowers would welcome such a plan, just as those in the whistleblower advocacy community would understand that this proposal is both consistent with the law as well as addresses a legitimate concern for the SEC whistleblower program without unduly limiting or capping awards.

⁹ Significantly, when Congress set the criteria for payment, it clearly excluded any form of monetary cap in the definition. 15 U.S.C. § 78u-6(c)(1)(B). However, concerning the determination of the amount of reward, there is no reference to the timing of the payment.

¹⁰ Although it is clear that the SEC may not take the balance of the fund into consideration when determining the (size of) an award, it is also clear that the SEC has rulemaking authority to ensure that the program is administered "consistent with the purposes" of the Dodd-Frank Act's whistleblower reward provision. 15 U.S.C. § 78u-6(j). It is apparent that ensuring that the payment of SEC awards are not unfairly delayed because of a temporary exhaustion of the fund stemming from a higher related action reward is consistent with the aims of the Act.

D. Deferred or Bifurcated Payment Structure

The SEC should adopt a deferred partial payment rule, which would bifurcate the payment structure of rewards for whistleblowers. An amendment to the current rules could simply provide the SEC with the authority to make deferred partial payments in which payments in a related action case which could either exhaust the monies available to make payments in SEC actions and/or could reasonably be anticipated to result in undue delays in payments for SEC actions. This would allow the SEC to retain flexibility in the timing of the payments of reward, and such bifurcation would create a more effective and efficient SEC whistleblower reward program.

A deferred payment program should include the following aspects, subject to further modification by the SEC:

1. The deferred payment program would only be needed in a very small number of cases that meet the following criteria: (a) the whistleblower was immediately given a partial payment of \$30 million; (b) the reward payment above the \$30 million threshold concerned a reward that was generated pursuant to the “related action” provision of the DFA, i.e. the sanctions were collected by an agency which did not provide the SEC with the funding to cover the award; (c) the SEC staff concluded that paying the full award would deplete the monies available in the Investor Protection Fund and result in undue delays in the payment of rewards under the \$30 million threshold. All three criteria must be met before a deferred payment plan was approved.
2. In regard to setting the minimum payment threshold of \$30 million, this number is based on the amount currently being proposed by the SEC in the proposed rule. This proposal should not be construed as an endorsement of this amount, but rather a good faith proposal based on the Commission’s calculations. The NWC maintains that this amount is not sufficient to adequately incentivize potentially high-quality/well placed whistleblowers, whose annual compensation could be higher than \$15 million per/year.¹¹ But because the whistleblower would ultimately be properly rewarded in accordance with Congressional intent and the criteria approved in the 2011 rules, the adverse impact resulting from deferred payments on the incentive nature of the DFA rewards should be sufficiently mitigated. It is not uncommon in other contexts that large awards are paid other time.
3. The deferred payment program would only cover the large “related action” awards. There would be no deferred payment for Commission actions, as the monies necessary to fully and immediately pay those awards would be derived directly from sanctions obtained in the whistleblower’s case, which always result in a minimum profit to the SEC of between 70-90%.
4. For a “related action” award there would be no delay in payment for any award at the \$30 million or lower level. But if a total award was over \$30 million, the Commission would have the discretion to delay payments above the \$30 million threshold as set forth below:

¹¹ <https://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law>

- A. Compensation should only be delayed over a maximum period of five years. The whistleblower needs to be informed of the precise dates and procedures that would be implemented in a structured payment plan, and have an opportunity to comment on the plan. For tax planning purposes, the rule or internal operating procedure should require that the Commission staff discuss the deferred payment procedures with the whistleblower, and attempt to work out an agreeable process so that whistleblower can engage in appropriate financial planning.
- B. If a deferred payment is authorized, the Commission should increase the percentage of an award in order to compensate the whistleblower for the delay in obtaining payments.
- C. A whistleblower should always be able to obtain, up front, an amount equal to ten years front-pay. Thus, in a case in which a high-level executive is paid the average executive bonus of \$15 million per/year (as identified in fn. 10), that executive should be able to provide the Commission with documentation as to his or her executive bonus and obtain immediate compensation for any loss that exceeds \$30 million over a ten-year period.
- D. An exception should be made for hardship cases, such as if the whistleblower is terminally ill or has any legitimate need for an immediate payment.

Ultimately, Congress should amend the DFA and require that agencies that obtain collected proceeds in “related action” cases compensate the SEC’s Investor Protection Fund whenever a reward is paid. But until such time, this bifurcated or deferred payment procedure both protects the program from the valid concern of premature exhaustion of funds in the Investor Protection Fund that is necessary to timely pay whistleblowers the rewards they need and are entitled to. The NWC strongly supports the SEC attempts to ensure that its whistleblower reward program remains an effective and crucial aspect of its law enforcement capacity, and a model for whistleblower reward programs throughout other government entities.