

AFR Americans for Financial Reform

Education Fund

September 18, 2018

Secretary

Securities and Exchange Commission

100 F ST NE

Washington, DC 20549

File Number S7-16-18

RE: Amendments to the Commission's Whistleblower Program Rules.

To Whom It May Concern:

Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the above referenced amendments to the U.S. Securities and Exchange Commission (the "SEC" or "Commission") Whistleblower Program (the "Program") rules. AFREF is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of the AFR Education Fund include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.¹

AFREF supports the SEC Whistleblower Program for its widely recognized success as a highly effective post crisis enforcement mechanism.² Since the Office of the Whistleblower was established, the valuable information and cooperation whistleblowers offer have become critical tools for the SEC to detect fraud, protect investors, and maintain fair, orderly markets that facilitate capital formation. Through the end of 2017, whistleblowers have provided over 22,000 tips that have led the Commission to obtain more than \$1.4 billion in financial penalties from wrongdoers.³ Harmed investors have been or are scheduled to be compensated from those funds. The Commission has also ordered over \$266 million in awards to 55 whistleblowers for the information and cooperation they provided.⁴

We appreciate the Commission's efforts to improve the Program and we support some of the proposed amendments that could enhance the ongoing success of the Program by incentivizing more whistleblowers to come forward. Specifically, we support the proposed amendment authorizing upward adjustments of whistleblower awards for certain potential awards that would yield a payout of less than \$2 million. We also strongly support allowing payment awards to whistleblowers based on deferred prosecution and non-prosecution agreements (DPAs and

¹ The Americans for Financial Reform Education Fund is an unprecedented coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith-based and business groups. A list of coalition members is available at: <http://ourfinancialsecurity.org/about/our-coalition/>

² Notably, all SEC Commissioners lauded the Program as crucial for SEC enforcement efforts on their respective statements regarding the Proposed Amendments to the Program rules. The statements are available at: <https://bit.ly/2OCBqDH>.

³ See Proposed Rule at 34703. Available at: <https://bit.ly/2xmwVGJ>.

⁴ Ibid.

NPAs, respectively) entered by the U.S. Department of Justice (“DOJ”) or a state attorney general in a criminal case, or a settlement agreement with the SEC outside of a judicial or administrative action based on the eligible whistleblower’s original information. Given the large number of instances in which DPAs and NPAs are used even in cases where clear wrongdoing takes place, we consider it crucial that whistleblowers be rewarded in such cases.

However, while we generally support the proposed amendments mentioned above, we are concerned that a number of other proposed changes would initially undermine the Whistleblower Program and ultimately weaken the SEC ability to discover fraud, protect investors, and facilitate stable markets. This is especially true for large-award cases that may be most crucial to the public interest. We address those concerns below.

Below we express our support or concerns with specific issues raised by questions in the proposal.

Question 1. Should DPAs and NPAs entered by DOJ or a state attorney in a criminal case be treated as administrative actions, and the monetary payments obtained through these DPAs and NPAs treated as monetary sanctions, for purposes of making whistleblower awards? Should the same result follow for settlement agreements entered by the Commission to resolve securities law violations? Why or why not?

We strongly support amending the definition of the term “administrative action” to expressly include monetary payments from DPAs and NPAs. This change would provide greater incentives for whistleblowers to come forward. The way in which prosecutors and regulators choose to pursue a case is out of the hands of the whistleblower. Headline-grabbing settlements of eye-popping dollar amounts give prosecutors their own incentives to enter into these agreements, and risk averse prosecutors might choose the safety of settling instead of battling to prove their case in court.⁵ In such cases, under current rules, the whistleblower could be deemed ineligible for a monetary award. This leaves would-be whistleblowers with a high degree of uncertainty about a potential reward payment—they would not receive an award if the prosecutors fail to win monetary sanctions over \$1 million, nor if the prosecutors choose to take the easy win.

Removing such uncertainty would be beneficial to the Program, especially given the increasing frequency into which federal and state prosecutors are entering DPAs and NPAs with corporations. A recent study found that out of 500 of these settlements dating from 1992 through September 2018, almost 80 percent have been entered in the last ten years.⁶ We believe that using DPAs and NPAs settlements as a default enforcement action is corrosive for regulatory institutions, and instead many cases should be pursued to the full extent of the law—after all no top banker from the major financial firms were prosecuted for their role in the 2008 financial

⁵ See: Jesse Eisinger, *The Chickenshit Club: Why The Justice Department Fails To Prosecute Executives*, NY: Simon and Schuster, 2017.

⁶ Brandon L. Garret and Jon Ashley, Corporate Prosecution Registry, University of Virginia School of Law and Duke University School of Law, <http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/about.html>

crisis. However, a meritorious whistleblower should clearly be rewarded when a DPA or NPA brings resolution to a DOJ or state attorney general investigation, as well as when the SEC resolves an enforcement action outside of the context of judicial or administrative proceedings.

Question 7. Is the proposed “direct or relevant” standard appropriate for assessing whether an action should qualify as a related action? Are there alternative formulations that should be adopted instead?

Under current rules, any whistleblower who obtains a payment award based on a Commission enforcement action may still be eligible for an additional award based on monetary sanctions collected in a “related action” by other authorities, based on the same original information provided by the whistleblower to the Commission and that led to the successful Commission enforcement action.⁷ We object to the proposed amendments to Exchange Act Rule 21F-3(b)(1) that seek to modify the definition of the term “related action” to make it impossible for whistleblowers to collect both SEC awards and potential additional awards from separate monetary programs established at Federal or state level or by a self-regulatory organization.

The proposed rule states that “when Congress established the Commission’s whistleblower program, it set a firm ceiling on the maximum amount that should be awarded for any particular action—‘not more [Proposed Rule emphasis] than 30 percent, in total, of what has been collected of the monetary sanctions imposed’ in the action.”⁸ The Commission uses that language to argue that it was Congress’ intention to place a cross-agency, cross-whistleblower-program award ceiling of 30 percent of any monetary action over \$1 million. Respectfully, we disagree with the Commission’s read of Congress’s intent, as the language regarding awards in the Securities Exchange Act is clearly referring to what *the Commission* “shall pay” and shall pay “from the [SEC Investor Protection] Fund,”⁹ and is in no way addressing nor placing any ceiling on the maximum amount a whistleblower *could receive* from different, separate whistleblower programs by other Federal, state agencies or self-regulatory organizations.

The proposed amendments also provide that “even if the Commission determines to deem the action a related action, the Commission will not make an award to [the whistleblower] for the related action if you have already been granted an award by the authority responsible for administering the other whistleblower award program.” The Commission provides no logic for this course of action, and does not contemplate exemptions for cases where multiple awards would not even reach the supposed ceiling mentioned above. For example, the IRS awards to meritorious whistleblowers have averaged only 18.4 percent of the amounts collected for last three fiscal years—considerably under the 30 percent cap authorized by Congress.¹⁰

⁷ Proposed Rule at 34709.

⁸ Proposed Rule at 34710.

⁹ 15 U.S.C. 78u-6(b), Securities and whistleblower incentives and protection.

¹⁰ See: IRS Whistleblower Program, Fiscal Year 2017, Annual Report to Congress, available at: <https://bit.ly/2mvBzNd>.

This amendment could lead to greatly increasing uncertainty and delay for whistleblowers concerning the reward they are eligible for from the Commission, or indeed, whether they will receive any reward at all. It goes against the stated goals in the proposed rule of “further [enhancing] the incentives for an individual to come forward”¹¹ and “[increasing] the speed and efficiency of the award determination process . . . as well as the payment of awards.”¹² Moreover, even “if the Commission makes an award before an award determination is finalized by the authority responsible for administering the other award scheme, the Commission would condition its award on the meritorious whistleblower making a prompt, irrevocable waiver of any claim to an award from the other award scheme.”¹³ Again, the Commission provides no rationale why whistleblowers could not, at least, wait for the other program’s award determination and then choose which award they prefer.

These proposed amendments to the Exchange Act Rule 21F-3(b)(1) defining “related action” would dramatically increase the uncertainty potential whistleblowers face in advance of a life-changing decision to blow the whistle on—by definition—some of the most complex, widespread, multi-level illegal activities that would require the jurisdiction of several agencies and authorities. All while the individuals are risking their careers, reputations, and sometimes even their own and their families’ safety.

Q 8. Instead of adopting the proposed rule, which would authorize the Commission on a case-by-case basis to consider whether an action should qualify as a related action, should the Commission adopt a categorical exclusion from the definition of related action for any judicial or administrative action that may have an alternative applicable award scheme?

Definitely no, that would be inappropriate for the reasons explained above. The SEC should not use the SEC whistleblower program as a club to require whistleblowers to waive other applicable awards in order to receive the Commission’s.

Question 10. With respect to proposed paragraph (c), is it appropriate to consider increasing smaller awards and would doing so help to further incentivize insiders and others to come forward with tips? If so, is the \$2 million ceiling for invoking the rule appropriate or is it either too high or too low? Please explain.

We would support this change. According to the frequency distribution of whistleblower awards, from 2012 through April 2018, 62 percent of individuals who came forward voluntarily with material information about fraudulent activities have received awards of less than \$2 million.¹⁴ Given that the majority of awards have historically fallen under the \$2 million threshold, the discretion to revise smaller awards upwards is likely to create additional incentives to potential

¹¹ Proposed Rule at 34710.

¹² Proposed Rule at 34743.

¹³ Proposed Rule at 34709.

¹⁴ Proposed Rule at 34735.

whistleblowers, especially on small amount frauds that hurt retail investors but that would not grant a large award payout.

Question 11. Would the proposed amendments to paragraph (d) of Rule 21F–6 appropriately balance the Commission’s various programmatic interests, in particular encouraging company insiders and others to come forward while also ensuring that awards are not unnecessarily large beyond an amount that is sufficient to compensate whistleblowers and achieve the Commission’s law-enforcement interests? If not, is there an alternative formulation of the proposed rule that the Commission should adopt to guard against payouts that are in excess of amounts that are reasonably necessary to further the Commission’s goals?

We oppose this change and do not believe the Commission has legal authority to make it. Under the current rules, individuals who provided valuable information and cooperation that led to a successful enforcement action that resulted in more than \$1 million in monetary sanctions shall receive from the Commission—specifically, from the Investor Protection Fund—between 10 and 30 percent of what has been collected of the monetary sanctions imposed in the action.¹⁵ Potential whistleblowers know this, and can calculate their expected payouts with to obtain some degree of confidence about the financial incentive to come forward.

The proposed rule, however, would give the Commission discretion to revise downwards award payments on actions that collected over \$100 million in monetary sanctions. Obscuring the award calculations and introducing a discretionary element for payments above \$100 million does not further the Commission’s goal of uncovering the fraudulent activities. The negative effects of this change are likely to be most pronounced for the largest, most significant frauds and the highest ranking whistleblowers – precisely the cases that pose the greatest threat to the public interest.

The proposed rule argues that the principle underlying these change is the potential for significant diminishing marginal benefit to the program from really large payments—that is, payments that are vaguely described as not “reasonably necessary to achieve the program’s goals.”¹⁶ The Commission does not present any study, data, or reference any evidence to back up that vague claim, nor does the Commission explain to the public how they arrived at the \$30 million threshold at which the next additional dollar in payment awards results in smaller incentives for future whistleblowers and smaller benefits to the program.

The \$30 million threshold is not a quantitative determination, instead is a qualitative, subjective assessment that runs the risk of becoming an unofficial barrier for necessary large payouts. This “glass ceiling,” as Commissioner Stein put it in her statement regarding the proposed rule, could prevent top executives who already are making millions of dollars from coming forward with

¹⁵ 15 U.S.C. 78u–6(b).

¹⁶ Proposed Rule at 34716.

material information.¹⁷ The largest financial institutions, like Goldman Sachs, tie their most senior bankers and partners with nondisclosure agreements (NDAs) that prevent them from discussing potential concerns with regulators or even board members—in a recently reported case, a Goldman partner signed an NDA in exchange for up to \$10 million in stock compensation, and walked away from the firm after exhausting all internal whistleblower channels to report a range of unethical practices.¹⁸ This is an example of precisely the individual with extensive insider knowledge and better situated to have a bird’s eye view of the implications and the systemic risks of pervasive fraudulent activities.

Moreover, the proposed rule also states that large awards could “substantially diminish the IPF [Investor Protection Fund], requiring the Commission to direct more funds to replenish the IPF rather than directing those funds to the United States Treasury.”¹⁹ This, as well as other references to the balance of the Investor Protection Fund through the proposed rule, are inappropriate in the context of a determination of the amount of an award. Congress expressly provided that the Commission “shall not take into consideration the balance of the Fund” when considering the amount of an award.²⁰

Question 31. Should any aspect of the interpretation be codified in rule text? For example, should the Commission adopt rule text that would make clear that for a whistleblower to be credited with providing “original information” through “independent analysis,” the whistleblower’s examination and evaluation should contribute “significant independent information” that “bridges the gap” between the publicly available information and the possible securities violations?

We oppose codifying the proposed interpretative guidance regarding the meaning and application of “independent analysis” in rule text. The language in the guidance is overly vague and leaves several aspects of the supposed clarification ambiguous and needing further interpretation.

Under established rules, to qualify for an award a whistleblower needs to provide “original information” “derived from the independent knowledge or analysis of a whistleblower.”²¹ The difference in the definitions of the terms “independent knowledge” and “independent analysis” is that the former “is not derived from publicly available sources” and the later includes “examination and evaluation of information that may be publicly available, but which reveals information that is not known or available to the public.”²²

¹⁷ Kara M. Stein, Statement on Proposed Amendments to the Commission’s Whistleblower Program Rules, SEC Public Statement, June 28, 2018, available at: <https://bit.ly/2NmZQo2>.

¹⁸ Emily Flitter, Kate Kelly and David Enrich, “A Top Goldman Banker Raised Ethics Concerns. Then He Was Gone,” *The New York Times*, September 11, 2018, available at: <https://nyti.ms/2NAuWaV>.

¹⁹ Proposed Rule at 34704 and at 34739.

²⁰ 15 U.S.C. 78u–6(c)(1)(B)(ii).

²¹ 15 U.S.C. 78u–6(a)(3).

²² 17 CFR § 240.21F-4

The proposed amendments would make it very difficult for “independent analysts” to qualify as eligible whistleblowers based on their insights from publicly available information. The independent analysis standard would require that whistleblowers provide “evaluation, assessment, or insight *beyond what would be reasonably apparent to the Commission* [emphasis added] from publicly available information.”²³ What would be “reasonably apparent,” is not explained in the proposed rule, except for a sentence providing that if the Commission’s own review determines that “the violations could have been inferred from the facts available in public sources ... without more, then the whistleblower has not contributed significant independent information that reveals the violations.”²⁴

The Commission should not deprive whistleblowers of incentives based on the fact that the violation *could* have been inferred from publicly available information if there is no evidence that the Commission’s staff has in fact analyzed this data and found the misconduct independently of the whistleblower’s information. For example, if a whistleblower detects a Ponzi scheme based on publicly available information and informs the Commission of this violation, it would be plainly unfair to deprive the analyst of compensation because the Commission could hypothetically have detected the scheme but failed to do so.

Concluding comments

While we appreciate the Commission’s effort to strengthen one of the most effective enforcement mechanisms to come out of the Dodd-Frank Act, we are concerned that the positive and helpful amendments here are accompanied by other amendments that would undermine and weaken the Whistleblower Program. Any proposal to build upon successes of the Program should not increase uncertainty for potential whistleblowers in the largest and most significant cases. However, key changes in this proposal would do so.

Thank you for the opportunity to comment on this Proposed Rule. If you have questions, contact AFREF’s Policy Researcher, Oscar Valdes-Viera, at oscar@ourfinancialsecurity.org.

Sincerely,
Americans for Financial Reform Education Fund

²³ Proposed Rule at 34728.

²⁴ Proposed Rule at 34731.