

## **Proposed Regulation 21F: The SEC's New Whistleblower Program**

The Securities and Exchange Commission (the "SEC" or "Commission") has proposed Regulation 21F to implement Section 21F of the Securities Exchange Act of 1934 ("Exchange Act"), entitled Securities Whistleblower Incentives and Protection.<sup>1</sup> Section 21F, which was added to the Exchange Act by the Dodd-Frank Wall Street Reform and Consumer Protection Act,<sup>2</sup> requires the SEC to pay an award to whistleblowers who have "voluntarily provided original information to the Commission that led to the successful enforcement of a judicial or administrative action, or related action," in which monetary sanctions exceeding \$1,000,000 were imposed and actually collected.<sup>3</sup> The purpose of the Section 21F is to "elicit high-quality tips by motivating persons with inside knowledge 'to come forward and assist the Government to identify and prosecute persons who have violated the securities laws.'"<sup>4</sup>

The proposed rules and the Release accompanying them set forth the Commission's views on their implementation in detail. The Commission is seeking public comment on the proposed rules through December 17, 2010. This memorandum summarizes select provisions of the proposed rules.

### **I. Definition of a Whistleblower**

Proposed Rule 21F-2(a) defines a whistleblower as "an individual who, alone or jointly with others, provides information to the Commission relating to a potential violation of the securities laws."<sup>5</sup> Only natural persons are eligible for an award. The term "potential violation" is used to make clear that the anti-retaliation protections set forth in Section 21F(h)(1), which includes a private cause of action for alleged retaliation for disclosure of information, will apply even if the ultimate adjudication of the alleged violation or the whistleblower fails to satisfy all the award consideration requirements.<sup>6</sup>

### **II. Award Eligibility**

Proposed Rule 21F-3 summarizes the general requirements to receive an award. Under Proposed Rule 21F-3(a), awards will be considered for whistleblowers who:

- (1) voluntarily provide the Commission
- (2) with original information
- (3) that leads to the successful enforcement by the Commission of a federal court or administrative action or related action

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<sup>1</sup> Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Release No. 34-63237, 17 CFR § 240 and 249 (the "Release").

<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010).

<sup>3</sup> Exchange Act § 21F(b)(1).

<sup>4</sup> SEC Annual Report on Whistleblower Program at 3 (2010) (quoting S. Rep. No. 111-176 at 110 (2010)) ("Annual Report").

<sup>5</sup> Release at 6.

<sup>6</sup> Release at 7.

(4) in which the Commission obtains monetary sanctions totaling more than \$1,000,000.<sup>7</sup>

A submission is “voluntary” if the whistleblower “provide[s] the Commission with the information before . . . [the whistleblower] or anyone representing [the whistleblower] (such as an attorney) receives any request, inquiry or demand from the Commission, the Congress, any other federal, state or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board about a matter to which the information in [the whistleblower’s] submission is relevant.”<sup>8</sup> A request, inquiry or demand that is directed to an employer is also deemed to be directed to employees who possess information within the scope of the request to the employer. Disclosures will not be considered voluntary if the whistleblower has “a clear duty to report violations of the type at issue.”<sup>9</sup>

For information to be “original”, it must derive from the whistleblower’s “independent knowledge or analysis” and the SEC must not already be aware of the information.<sup>10</sup> “Independent knowledge” is factual information not obtained from publicly available sources.<sup>11</sup> The knowledge “may be obtained from any of the whistleblower’s experiences, observations, or communications” regardless of whether the information is first hand.<sup>12</sup> “Analysis” is the “examination and evaluation of information that may be generally available, but which reveals information that is not generally known to the public.”<sup>13</sup>

Proposed Rule 21F-4(b)(4) lists circumstances in which information is not considered to be derived from a whistleblower’s “independent knowledge” or “analysis.” These include

- (1) information obtained from attorney-client privileged communications that may not be disclosed;
- (2) information attorneys obtain in the course of legal representation;
- (3) information obtained by independent public accountants in performing duties required under the securities laws;
- (4) information obtained through legal, compliance, audit, supervisory, or governance responsibilities for the purposes of addressing potential non-compliance with applicable law;
- (5) information otherwise obtained through an entity’s legal, compliance, audit or other similar processes for addressing potential law violations; and
- (6) information obtained illegally.<sup>14</sup>

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<sup>7</sup> Proposed Rule § 240.21F-3(a). *See* Release at 8 and 125.

<sup>8</sup> Proposed Rule § 240.21F-4(a)(1). Release at 127.

<sup>9</sup> Proposed Rule § 240.21F-4(a)(3). Release at 14 and 128.

<sup>10</sup> Release at 17.

<sup>11</sup> Proposed Rule § 240.21F-4(b)(2). *See* Release at 18 and 128.

<sup>12</sup> Proposed Rule § 240.21F-4(b)(2). *See* Release at 18 and 128.

<sup>13</sup> Proposed Rule § 240.21F-4(b)(3). *See* Release at 18 and 128.

<sup>14</sup> Proposed Rule § 240.21F-4(b)(4)(i)-(vi). *See* Release at 129-30.

A whistleblower’s original information can lead to “successful enforcement” in two circumstances: (1) where the whistleblower’s information causes the staff to commence an investigation, and (2) where the whistleblower provides information about conduct already under investigation.<sup>15</sup>

In the first situation the information must “significantly contribute” to the success of an enforcement action for the whistleblower to be eligible for an award. This limits awards to high quality, reliable, and specific information “that had a meaningful connection to the Commission’s ability to successfully complete its investigation . . . .”<sup>16</sup> This standard would be met “if a whistleblower were to provide the Commission staff with strong, direct evidence, of violations that supported one or more claims in a successful enforcement action.”<sup>17</sup> It is also met if the information “played a critical role in advancing the investigation by leading the staff directly to evidence that provided important support for one or more of the Commission’s claims.”<sup>18</sup>

In the second situation, where the whistleblower provides information about conduct already under investigation, the information must be “essential to the success of the action” to be eligible for an award.<sup>19</sup> Because the SEC believes awards should generally be limited to information about violations not already under investigation, the SEC will apply this standard “in a strict fashion . . . such that awards under this standard would be rare.”<sup>20</sup>

In determining whether the \$1,000,000 threshold has been met, all the claims against all the defendants or respondents of a single action are considered without regard to which specific defendants or respondents, or which specific claims, were included in the action as a result of the information provided by the whistleblower.<sup>21</sup> But “the Commission [will] not aggregate sanctions that are imposed in separate judicial or administrative actions for purposes of determining whether the \$1,000,000 threshold is satisfied, even if the actions arise out of a single investigation.”<sup>22</sup>

### III. Amount of Award

If all reward requirements are met, the Commission will pay an award of “at least 10 percent and no more than 30 percent of the monetary sanctions that the Commission and other authorities are able to collect.”<sup>23</sup> Where an action involves multiple whistleblowers entitled to an award, the Commission will independently determine award percentages for each whistleblower, but total award payments, in the aggregate, must be between 10 and 30 percent of the monetary sanctions collected.<sup>24</sup>

In determining an award amount, the Commission will consider:

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<sup>15</sup> Proposed Rule § 240.21F-4(c).

<sup>16</sup> Release at 39 [emphasis in original].

<sup>17</sup> Release at 39.

<sup>18</sup> Release at 40.

<sup>19</sup> Release at 41.

<sup>20</sup> Release at 41.

<sup>21</sup> Proposed Rule § 240.21F-4(d). See Release at 44 and 132.

<sup>22</sup> Release at 45.

<sup>23</sup> Proposed Rule § 240.21F-5(a). See Release at 48 and 133.

<sup>24</sup> Proposed Rule § 240.21F-5(b). See Release at 48 and 133.

- (1) The significance of the information provided by a whistleblower to the success of the Commission action or related action;
- (2) The degree of assistance provided by the whistleblower and any legal representative of the whistleblower;
- (3) The interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers; and
- (4) Whether the award otherwise enhances the Commission's ability to enforce federal securities laws, protect investors, and encourage the submission of high quality information from whistleblowers.<sup>25</sup>

These criteria are meant to “afford the Commission broad discretion to weigh a multitude of considerations in determining the amount of any particular award.”<sup>26</sup>

To prevent a whistleblower who has engaged in culpable conduct from benefiting from the Whistleblower Program, the SEC will not take into account any monetary sanctions that the whistleblower himself/herself is ordered to pay in determining whether the \$1,000,000 threshold has been satisfied.

#### **IV. Confidentiality of Submissions**

Section 21F(h)(2) prevents the Commission from disclosing information that could reveal the identity of a whistleblower. Proposed Rule 21F-7(a) provides exceptions where disclosure is required by a federal or state court or an administrative agency; the Commission finds it necessary to protect investors and disclosure is permitted under the Section 21F(h)(2) confidentiality requirements; or disclosure is permitted in accordance with the Privacy Act of 1974.<sup>27</sup>

Information may be submitted anonymously provided the whistleblower is represented by an attorney in connection to the submission of information and the claim for an award. However, the whistleblower's identity must be revealed to the Commission before an award will be given.

#### **V. Procedures for Submitting and Claiming an Award**

The submission of information involves a two-step process. First, the whistleblower's information must be submitted on either a standard form or through the Commission's online database. Second, the whistleblower must complete the Whistleblower Office's form WB-DEC consisting of threshold eligibility questions and name and contact information.

Proposed Rules 21F-10 to 21F-13 set forth the procedures for making a claim for a whistleblower award. For SEC actions, once a monetary sanction of more than \$1,000,000 is imposed, the Whistleblower Office will publish a “Notice of Covered Action” on the Commission's website. A whistleblower seeking an award must then file a Form WB-APP with the Whistleblower Office within sixty calendar days of the Notice of Covered Action. The Whistleblower Office will review the application and send the whistleblower a Preliminary Determination setting forth whether the claim should be allowed or denied. Whistleblowers may contest the

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<sup>25</sup> Proposed Rule § 240.21F-6. *See* Release at 49 and 133-34.

<sup>26</sup> Release at 49.

<sup>27</sup> 5 U.S.C. § 552a.

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Preliminary Determination by submitting a written response to the Whistleblower Office setting forth any objections. The Claims Review Staff will consider the objections and make a Proposed Final Determination to the Commission. Any Commissioner may request the Proposed Final Determination be reviewed by the Commission. If no such request is made, the Proposed Final Determination will become the Final Order of the Commission. If a Commissioner requests a review, the Commission as a whole will review the record relied on by the Claims Review Staff and issue its Final Order.

The process for claiming an award stemming from a “related action” is substantially the same except that no “Notice of Covered Action” will be published on the Commission’s website. Instead, the whistleblower must file a Form WB-APP within sixty days of the issuance of a final order imposing sanctions of more than \$1,000,000.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); or John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com).