MEMORANDUM

TO: File on S7-33-10, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

FROM: Christian L. Broadbent
Counsel to Commissioner Elisse B. Walter

DATE: March 16, 2011

RE: Meeting with members and representatives of National Whistleblowers Center ("NWC")

On February 15, 2011, Commissioner Walter and Christian Broadbent of Commissioner Walter's office met with the following members and representatives of NWC to discuss the above-referenced proposal:

1. Stephen M. Kohn, NWC Executive Director
2. Dean Zerbe, NWC Special and Former Senior Counsel and Tax Counsel for Senator Grassley
3. Lindsey M. Williams, NWC Director of Advocacy and Development
4. Michael D. Kohn, NWC President
5. Gerard M. Waites, O'Donoghue and O'Donoghue LLP
6. Randy Defrehn, Executive Director of the NCCMP - National Coordinating Committee of Multi-Employer Plans
7. Donna Boehme, former Group Compliance and Ethics Officer, BP plc, and Principal, Compliance Strategist LLC

The agenda and other materials submitted are attached to this Memorandum.

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Agenda for Meeting with Commissioner Walter

February 15, 2011

I. Introduction – Stephen M. Kohn, NWC Executive Director

II. Overview of *qui tam* – Dean Zerbe, Former Senior Counsel and Tax Counsel for Senator Grassley

III. Impact of *qui tam* laws on enforcement and compliance – Kohn

IV. Overview of concerns from compliance officials – Donna Boehme, former Group Compliance and Ethics Officer, BP plc, and Principal, Compliance Strategists LLC

V. Overview of concerns from National Coordinating Committee of Multi-Employer Plans (NCCMP) - Gerard M. Waites, O'Donoghue and O'Donoghue LLP and Randy Defrehn, NCCMP Executive Director

VI. Recommendations for Rule changes

NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

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December 17, 2010

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 [File Number S7-33-10; RIN 3235-AK78]

Dear Ms. Murphy:

On behalf of the National Coordinating Committee for Multiemployer Plans (NCCMP), we submit these comments in response to the Securities and Exchange Commission's ("Commission") Proposed Rule for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934.

The NCCMP is the only national organization devoted exclusively to protecting the interests of the approximately ten million workers, retirees, and their families who rely on multiemployer plans for retirement, health and other benefits. Our purpose is to assure an environment in which multiemployer plans can continue their vital role in providing benefits to working men and women. The NCCMP is a nonprofit organization, with members, plans and plan sponsors in every major segment of the multiemployer plan universe, including in the building and construction, retail food, trucking and service and entertainment industries.

Multiemployer plans are institutional investors that rely heavily on investment returns to provide promised pension and welfare benefits to the millions of workers who rely on those benefits. Single employer plans rely just as heavily on investment returns but those plans have a greater ability to adjust contributions, and to a limited extent benefits, in response to market fluctuations. Contributions to and often benefits of multiemployer plans are collectively bargained in bargaining cycles may be from two (2) to five (5) years. Therefore, multiemployer plans have less ability than single employer plans to adjust to market fluctuations.

Market fluctuations, even extreme fluctuations, are part of the risk of investing. But neither institutional nor individual investors should be subject to additional market risk created by violations of the securities laws. These proposed regulations can provide additional protections to institutional and individual investors and to the pension benefits and health benefits provided by multiemployer plans.

I. The Importance of the Proposed Rulemaking

The recent financial crisis has demonstrated the painful and calamitous effects that are felt by all Americans when the federal securities laws are evaded. These laws play a vital role in protecting the American economy and safeguarding the decision of both large and small investors to place their money into the hands of companies who then use it to create jobs and increase the wealth of its officers and employees, in addition to its shareholders. However, not all companies have played by the rules. The most notable and flagrant examples in recent years have been the widespread accounting fraud that led to the bankruptcy of Enron and the massive ponzi scheme orchestrated by financier Bernard Madoff. Unfortunately, the Enron and Madoff scandals may just be the tip of the iceberg of corporate malfeasance in which almost all Americans have felt the impact.

On July 21, 2010, the *Wall Street Reform and Consumer Protection Act* (also referred to as the "Dodd-Frank" law after its chief sponsors) was enacted into law putting into place a number of new safeguards for policing the financial industry and preventing another economic collapse from occurring.

A key problem with combating acts of theft and fraud is that such conduct is, by nature, conducted in secret, deliberately hidden from government regulators, investors and public view. Without detection, an Enron or Madoff type networks of fraud may be launched, expanded and perpetrated into multi-billion dollar schemes until it is too late. The harm done shakes our financial and economic system to the core and leads to literally tens of billions of dollars of losses to individual and institutional investors, including pension funds created to protect the life-savings of millions of working families. The latest scandals very nearly caused complete economic collapse for many of their victims, including a number of multiemployer pension funds which were heavily invested in them.

One of the few ways to expose such conduct is to motivate individuals with knowledge of it to step forward and speak out. Some will do this simply as a matter of conscience. But those persons are often concerned, and rightfully so, about threats to their jobs and livelihoods, which can be protected by anti-retaliation measures provided under whistleblower protection laws, measures which fortunately were included in the Dodd-Frank Act. In addition, however, experience with the federal False Claims Act, also known as the Qui Tam Act, has demonstrated that to effectively fight serious fraud the indisputably best tool is a provision that provides for a reward to individuals, i.e., whistleblowers, who risk their jobs, future careers and even their lives, by having the courage to detect, expose and report illegal conduct to the proper authorities. Recognizing this reality, the Dodd Frank Act, in another prudent move, provides that substantial financial rewards should be provided to such persons

Thus, the whistleblower protection and reward provisions adopted by Dodd-Frank were envisioned to create a strong, effective, and user-friendly system to combat serious wrongdoing by encouraging whistleblowers to disclose valuable information. Specifically, Section 922 of Dodd-Frank directs the Securities Exchange Commission to establish a new awards program that would provide whistleblowers who voluntarily report original information that leads to a successful enforcement action in which the Commission obtains monetary sanctions of over

$1,000,000 a bounty of between 10-30% of the amount collected. This provides a concrete and tangible award for whistleblowers and will encourage the reporting of valuable information that could stop a securities violation before it escalates into a massive fraud that could cost investors tens of millions of dollars.

The Commission was authorized under Dodd-Frank to issue regulations to implement this new whistleblowers award program. It is essential that the new rules faithfully follow the statute they are intended to serve and that the whistleblower protection features of the law are implemented in the most effective manner possible to fully protect investors and the general public. The recommended reforms to the proposed rules set forth in these comments are designed to help realize these goals. We appreciate the thoughtfulness of the Commission in its proposed rules but also believe that substantial changes need to be made for the final regulations to be true to the requirements specified by the statute and for it to be effectively implemented to protect investors and the American people.

II. Overview of NCCMP Recommendations to Proposed Rulemaking

We suggest that the Commission adopt the seven recommendations below that we believe properly reflect the Congressional intent behind Section 922 of Dodd-Frank. If adopted these recommendations will help to ensure that the newly implemented whistleblower award program is able to most effectively combat serious wrongdoing by the financial industry to protect the hard-earned investment dollars of millions of Americans.

1. **Streamline Whistleblower Application Process:** The Commission should adopt a process similar to the whistleblower process adopted by the Internal Revenue Service, which is more user-friendly and provides an efficient system for rewarding whistleblowers who report tax law violations. The proposed rule currently requires a whistleblower to submit three (3) separate forms and also track the progress of an action that was initiated by the original information that he or she provided in order to claim an award.

2. **Limit Excluded Classifications Per Statute:** In Section 922 of Dodd-Frank, Congress provides a specific list of certain limited categories of individuals who have a legal responsibility to disclose information pertaining to securities violations and excludes them from participating in whistleblower recoveries. (Such persons cannot be considered to be making "voluntary" disclosures as required by the Act). Allowing these exceptions to be expanded in too broad a fashion would undermine the statute's central purpose of uncovering fraud and abuse. Thus, the Commission should not adopt a blanket exclusion of "*other similarly situated persons*" as proposed, but should institute a case-by-case analysis as to whether a potential whistleblower should be precluded from a recovery due to a pre-existing legal duty.

3. **Mandatory Self-Reporting of Violations to the Commission:** The Commission should ensure that the internal compliance programs are as effective as possible by requiring that any violation of the securities laws by an internal compliance program be reported to the Commission. Moreover, companies should be obligated to adopt more stringent internal

compliance programs similar to those required by other federal agencies. In addition, a person who reports a potential violation through an internal compliance program that leads to a successful action by the Commission should be given up to one (1) year from the date of making a report to the internal compliance program to file an application with the Commission to participate in a whistleblower recovery.

4. **Effective Use of Internal Compliance Programs:** A company's internal compliance program is not a surefire method of preventing or uncovering securities violations (which have, in fact, continued to increase even as more companies have adopted such programs). Therefore, the Rule should not unfairly limit recoveries of whistleblowers that bypass an internal compliance program and choose to go directly to the Commission with violation disclosures, but should protect the recovery rights of such persons since there could likely be reasonable grounds for not using an internal compliance program (such as a legitimate fear of retaliation, etc.).

5. **Regulatory Violation for Whistleblower Retaliation:** The Commission should demonstrate its commitment to preventing retaliation against whistleblowers by finding that any company that retaliates against a whistleblower commits *a separate and independent violation* of the securities laws that subjects the company to the maximum penalties for such violation provided for under the law, up to and including a delisting of the company.

6. **Public Disclosure of the Rights of Whistleblowers:** The effectiveness of the Commission's award program is dependent upon all potential whistleblowers knowing that it exists and the benefits that could come from reporting and disclosing violations of the securities laws. The Commission should establish simple and easy to understand materials that companies must distribute to their employees fully informing them of their rights as a potential whistleblower.

7. **Establish Reasonable Whistleblower Appeal Rights:** A whistleblower who provides information that the Commission decides not to pursue should be given the opportunity to appeal the decision declining to pursue the alleged violation to the Commission's Office of Inspector General. Otherwise, wholly legitimate claims that could expose fraud and other serious violations could be dismissed without appropriate investigation.

III. NCCMP Recommendations to Proposed Rulemaking

The reasons why we are suggesting that the Commission adopt these seven recommendations are discussed in greater detail below.

1. **Streamline Whistleblower Application Process:**

The most effective means for the Commission to expand the number of individuals who take advantage of the awards program and disclose information pertaining to potential violations of the securities laws is to make the process as simple as possible. The proposed regulations require the whistleblower to complete "a two-step process" for submitting original information

and making a claim for an award. (Proposed Rule ("P.R.") 60.) The whistleblower must submit to the Commission both a form detailing the original information that led to a successful enforcement action and also a declaration form attesting to the veracity of the information provided and the whistleblower's eligibility for an award. (P.R. 60.)

However, that is not the end of the process for the whistleblower. It becomes particularly onerous when the Commission requires a whistleblower to track on the Commission's website the disposition of the covered action. (P.R. 69.) Within sixty days after a notice is posted on the Commission's website, without any notification by the Commission to the whistleblower that his original information did lead to a successful enforcement action, a third form has to be submitted by the whistleblower to actually request the award that he or she is entitled to under the statute. (P.R. 70.) This is a far too complicated and burdensome process for whistleblowers to file not only a claim but also to make a separate application to receive the award. Successful whistleblower programs provide an easy process to submit a claim and are otherwise user-friendly. Whistleblowers place much at risk when choosing to disclose information of securities violations. Congress understood this when it adopted the award program and knew that it would serve a vital purpose in encouraging whistleblowers to come forward with information.

The Commission must ensure that the process is as simple as possible. There is no administrative reason why each individual who submits original information and submits a declaration form is not assigned a case number. If a claim leads to a successful enforcement action, the Commission should be able to have a record of who submitted the original information thereby eliminating the need for the whistleblower to submit another form later in the process. In particular, the sixty-day period after a notice of covered action has been listed online is far too narrow a window to allow the whistleblower to complete an application for his or her award. It creates the possibility that a whistleblower who courageously reports original information about a securities violation may unintentionally forfeit the award. This would be an absurd result under the clear Congressional mandate of Dodd-Frank. The Commission instead should implement a procedure similar to the whistleblower program established by the Internal Revenue Service for whistleblowers who report an underpayment of taxes. *See* 26 U.S.C. § 7623. In such instances, the whistleblower only has to submit IRS Form 211. *See* IRS Notice 2008-4. It is unnecessary for the whistleblower to file any subsequent forms after the IRS has concluded that he or she is entitled to an award. *Id.* There is no reason why a process that is good enough to protect the interests of taxpayers should not be adopted by the Commission to protect the interests of shareholders and investors.

2. **Limit Excluded Classifications Per Statute:**

Dodd-Frank explicitly excludes an award from being made to "a member, officer, or employee of – (i) an appropriate regulatory agency; (ii) the Department of Justice; (iii) a self-regulatory organization; (iv) the Public Company Accounting Oversight Board; or (v) a law enforcement organization . . . or to any whistleblower who gains the information through the performance of an audit of financial statements required under the securities laws . . . ." 15 U.S.C. § 78u-6(c)(2). Congress sought to establish a delicate balance of the need to encourage whistleblowers to come forward with information versus not wanting to reward individuals who were already required to disclose relevant information. The legislation was enacted with a clear

and definitive list of those individuals who should be excluded from eligibility for an award. Congress made a conscious decision not to include other categories of individuals in that list. It recognized that this would dampen the incentive for whistleblowers to report serious allegations that should be made known to the Commission or other relevant agencies.

The Commission has inappropriately and unnecessarily sought to expand that definition by including "other similarly-situated persons who are under a pre-existing legal duty to report information about violations to the Commission." (P.R. 14.) This is against the clear intent of Congress to provide a set limit on the types of individuals who would be ineligible for an award. The Proposed Rule provides examples of government contracting officers or city employees whose pre-existing duty to report violations would automatically deny them the right to claim an award. (P.R. 14.) There is no limit as to how broadly such a pre-existing duty could be expanded to exclude an untold number of individuals who hold a variety of positions from being able to participate in the award program. This would erode the program's ability to perform the crucial function that Congress intended.

It would be inappropriate for the Commission to adopt a blanket rule that would exclude individuals in "similarly situated positions" from the program. Only Congress can determine what groups of individuals should not be eligible to participate in the program, and no such language was inserted into Dodd-Frank to preclude "other similarly-situated" individuals. While the Commission should not be awarding certain individuals who are legally directed or obligated to turn over pertinent information, the Commission should not base such a determination just on the position the individual holds. The Commission would still have the discretion to determine on a case-by-case basis whether an individual failed to voluntarily disclose information because the person had a preexisting legal duty. It is not necessary for the Commission to a priori decide that the position a person holds precludes him or her from submitting information voluntarily.

All individuals should be encouraged to come forward with information that could be critical for ascertaining whether the securities laws have been violated. The role of the Commission should not be to find ways of denying whistleblowers access to this critical program. Instead, it should respect the careful balance adopted by Congress. Whistleblowers whose positions are not specifically excluded under Dodd-Frank should be eligible for an award.

3. **Mandatory Self-Reporting of Violations to the Commission:**

The Commission must adopt a policy of mandatory self-reporting by companies that violate the securities laws. The information reported must be made available to the public and the investing community. This is especially important in circumstances where a company's internal compliance program has detected and cured a securities violation. A violation of the securities law occurs regardless of whether a company is able to remedy the situation before the Commission has to initiate an action. Investors have to be confident that the companies in which they invest adhere to the securities laws, and the failure of a company to do so is legitimate information for an investor to have. The risk to an investor's portfolio is enormous when a company surreptitiously violates the law and then never discloses it. This only encourages a cycle of violations followed by belated fixes.

This problem has been solved in similar circumstances where it has been taxpayers who were defrauded instead of investors. The "Close the Contractor Fraud Loophole" requires that the Federal Acquisition Regulations include provisions "that require timely notification by Federal contractors of violations of Federal criminal law or overpayments in connection with the award or performance of covered contracts or subcontracts." P.L. 110-252, § 6102. The same policy should be adopted for violations of the securities laws. The markets are only able to work properly if investors and the public are aware of securities violations and can take appropriate actions to safeguard their money.

Internal compliance programs should also be bolstered to ensure that they are able to properly perform their role of detecting instances of fraud. The Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67064, provide important guidance as to how company's internal compliance programs should be strengthened to ensure that violations are detected and that appropriate action is taken to prevent their recurrence. This regulation applicable to federal contractors not only provides for stronger internal controls but also requires mandatory self-reporting of violations to an agency's Office of Inspector General. These are reasonable and effective methods of providing a check on the internal compliance programs to ensure that they are actually ensuring proper compliance with the laws and not just rubberstamping dubious company actions. Just as taxpayer should not be forced to bear the brunt of renegade contractors, investors have an equally important interest in ensuring that companies are playing by the rules.

4. **Effective Use of Internal Compliance Programs**

At the same time that the Commission should require stronger and more effective internal compliance programs, whistleblowers should not in any way be obligated to use such programs. Internal compliance programs are just one method to ensure that the federal securities laws are being properly enforced. While the proposed rule notes that "compliance with the federal securities laws is promoted when companies have effective programs for identifying, correcting, and self-reporting unlawful conduct," (P.R. 33), these programs often fail to provide an effective means for employees to feel comfortable about reporting potential violations. Dodd-Frank explicitly envisions that whistleblowers who report information directly to the Commission would be eligible for an award. *See* 15 U.S.C. § 78u-6(a)(6) (defining whistleblower as an individual who provides "information relating to a violation of the securities laws *to the Commission*) (emphasis added).

The proposed rules should not seek to punish employees who choose to bypass an internal compliance program. The Commission should abide by the clear statutory language. The Commission should remove as a consideration for the amount of an award "whether, and to the extent to which, a whistleblower reported the potential violation through effective internal whistleblower, legal or compliance procedures before reporting the violation to the Commission." (P.R. 51.) Although the proposed rule states that "whistleblowers will not be penalized if they do not avail themselves of this opportunity for fear of retaliation or other legitimate reasons," (P.R. 51), this should not be a consideration employed by the Commission at all in determining the amount of an award. It detracts from the overall purpose of the legislation to encourage employees to disclose relevant information to the Commission—not to an internal

compliance program. The Commission is obligated to do whatever it can to ensure that whistleblowers who come forward with valuable information are properly rewarded. Unnecessarily limiting the award that whistleblowers are able to receive provides impediments to the success of the program.

5. **Regulatory Violation for Whistleblower Retaliation:**

Whistleblowers are a critical resource in stopping securities violations. The best means for a crooked company to persist in its illegal actions is to prevent whistleblowers from reporting violations to the authorities. A company that retaliates against a whistleblower sends a clear message to all employees that their jobs and livelihoods are at risk if information is disclosed. The Commission should institute strong penalties against companies that engage in such flagrant violations of the law. Retaliation against an employee whistleblower should be recognized as a separate and independent violation of the securities laws. For instance, the Nuclear Regulatory Commission provides that an employer cannot retaliate against an employee who provides the agency with information about an alleged violation of the law. *See* 10 C.F.R. § 50.7. An employer that takes retaliatory action is found to have committed an independent violation of the law, and there would then be sufficient grounds for the license of that company to be revoked or suspended, in addition to having civil penalties levied against it.

The Commission should send a strong message to employers that taking action against whistleblower employees cannot be tolerated at any level. A company that retaliates against an employee for disclosing information about a potential violation of the securities laws should subject itself to the maximum penalties under the law. These penalties should be mandatory and widely disseminated to all companies. It should be abundantly clear to a company what the consequences are if it retaliates against an employee. When retaliation is combined with a serious infraction of the securities laws, evidenced by monetary sanctions in excess of $1,000,000, the Commission should have the ability to de-list the company from any applicable stock exchange in order to ensure that similar violations are not allowed to reoccur.

6. **Public Disclosure of the Rights of Whistleblowers:**

The Commission should also adopt regulations requiring that information about the whistleblower award program be advertised widely. Employees should realize that disclosure of potential securities violations is not just the right thing to do. The federal government through the Commission should actively encourage the reporting of original information as demonstrated by its willingness to pay significant sums of money to individuals who report potential violations. The Commission has the authority to employ any number of methods to accomplish this task, including the implementation of a notice posting requirement or dissemination of information to newly hired employees. The Commission should also develop a brochure explaining in simple and easy to understand terms the requirements of the new whistleblower awards program and how individuals with original information can submit it to the Commission and file a claim. This is an easy and effective method of ensuring that the awards program can accomplish the purpose intended by Congress.

Prior to the enactment of Dodd-Frank, the SEC had a predecessor bounty program that existed for more than twenty years to award individuals who reported information leading to a recovery of civil penalties for an insider trading violation. A March 29, 2010 Assessment of the SEC's Bounty Program by the Commission's own Inspector General noted serious deficiencies in the program that led to very few payments and an inability of the program to serve its stated function. Office of Inspector General, S.E.C., Assessment of the SEC's Bounty Program at iii (Mar. 29, 2010). In this report, the Inspector General noted that: "The SEC bounty program has made very few payments to whistleblowers since its inception and received a relatively small number of bounty applications. As a result, the program's success has been minimal and its existence is practically unknown." *Id.* at 4. The Commission must make sure that the whistleblowers award program is not plagued by the same problems. The whistleblower awards program under Dodd-Frank is the best tool available to the Commission to learn about and prevent securities violations. The Inspector General report also noted that while a pamphlet made about the program is "a good tool for marketing [it]," there was "no evidence that staff members are generally aware of the pamphlet and provide it routinely to potential bounty applicants." *Id.* at 7. Even the Commission's staff had varying knowledge about the existence of that program. *Id.* The lack of any discussion in the regulations as to how information about the program would be disseminated to potential whistleblowers and the general public, in addition to the Commission's staff who could assist whistleblowers in submitting original information, must be corrected in the final regulations. The success of the program is dependent upon an awareness of its existence.

7. **<u>Establish Reasonable Whistleblower Appeal Rights:</u>**

The Commission must establish reasonable appeal rights for whistleblowers in instances in which the Commission has determined not to pursue an enforcement action. This process should allow a whistleblower to file an appeal with the Commission's Office of Inspector General after the Commission has decided not to follow through with information of a potential violation. This is a necessary check on the actions of the Commission to maximize its effectiveness in pursuing all credible leads that could demonstrate that a company has violated the securities laws. The risk faced by whistleblowers in disclosing original information about a potential violation of the law is the same regardless of whether the Commission decides to pursue an enforcement action against a company. The possibility of serious repercussions against the whistleblower still exists. The awards program provides an effective incentive to the whistleblower if it is evident that it works fairly. Providing an appeal mechanism overseen by the Commission's Office of Inspector General in instances in which the Commission decides not to pursue a claim provides reassurances to the whistleblower of the integrity of the program and also provides an additional layer of oversight to ensure that all possible violations are properly evaluated and that appropriate administrative action has been taken.

IV. <u>Conclusion</u>

We urge the Commission to adopt the proposed recommendations discussed above. We believe that these measures provide the necessary steps to ensure that all companies are properly adhering to the securities laws and that violators will be exposed. The whistleblowers award program provided for under Dodd-Frank provides an invaluable tool to the Commission to obtain

crucial information to prosecute instances of securities violations, which ultimately safeguards the money of investors and the American public. It is essential that the Commission take the necessary steps now while the program is being developed to allow it to be as effective as possible for years into the future.

Thank you for the opportunity to provide comments on this important proposed rule. We will be pleased to provide any additional information that you might find useful.

Sincerely,

Randy G. DeFrehn
Executive Director

February 10 2011

Special SEC Briefing: Dodd-Frank Whistleblower Rules and Procedures

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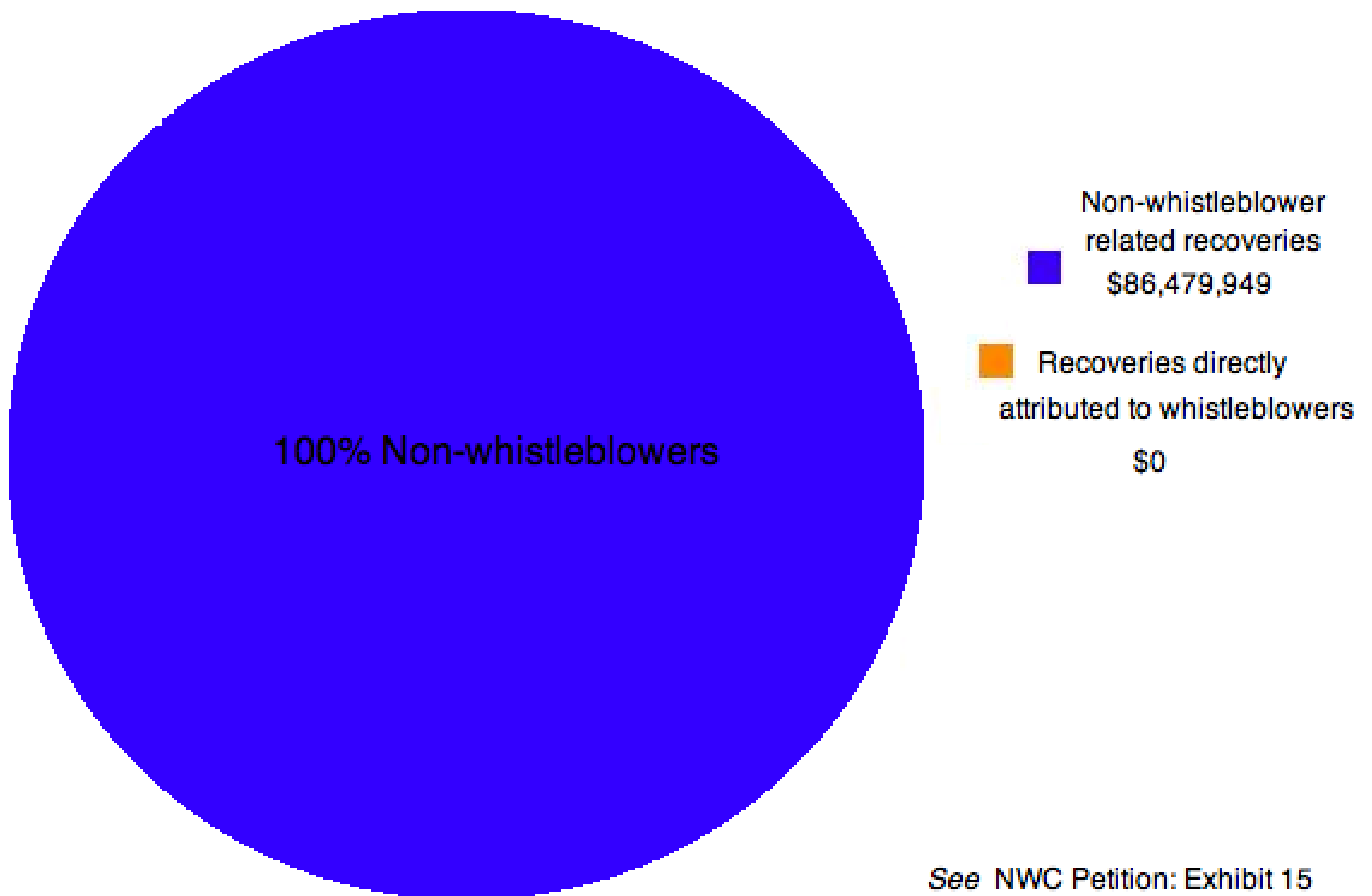
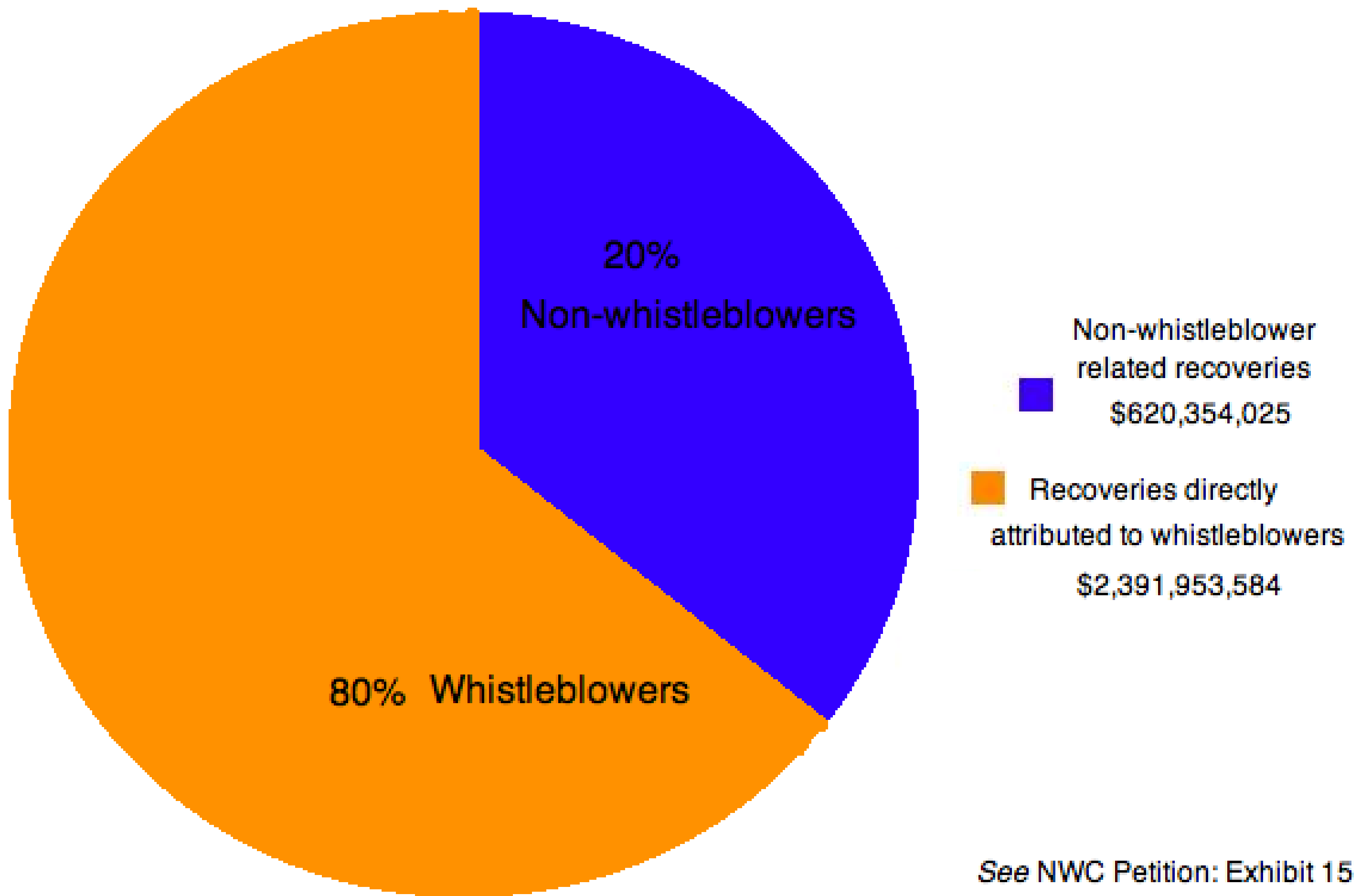
Part I:
The False Claims Act Is the Most Successful Model for Improving the Disclosure of Fraud


US Civil Fraud Recovery Statistics
Under FCA 1987
100% Non-whistleblowers
Non-whistleblower related recoveries
$86,479,949
Recoveries directly attributed to whistleblowers
$0
See NWC Petition: Exhibit 15


US Civil Fraud Recovery Statistics
Under FCA 2010
20%
Non-whistleblowers
80% Whistleblowers
Non-whistleblower related recoveries $620,354,025
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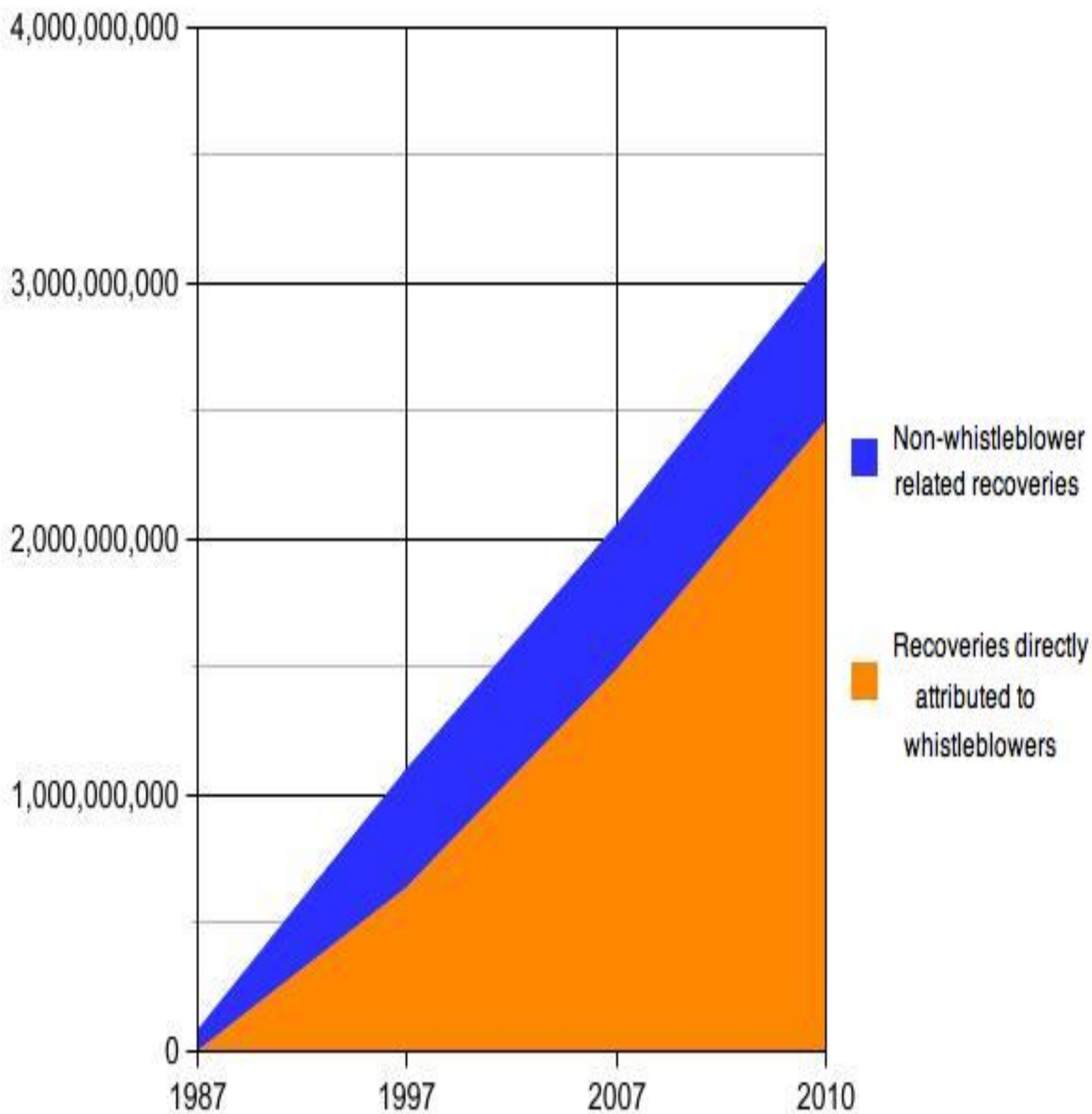
See NWC Petition: Exhibit 15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1987
1997
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2010
Non-whistleblower related recoveries
Recoveries directly attributed to whistleblowers

"I have based [the False Claims Act] on the old fashion idea of holding out on temptation and 'setting a rogue to catch a rogue', which is the safest and most expeditious way of bringing rogues to justice."

Senator Howard,

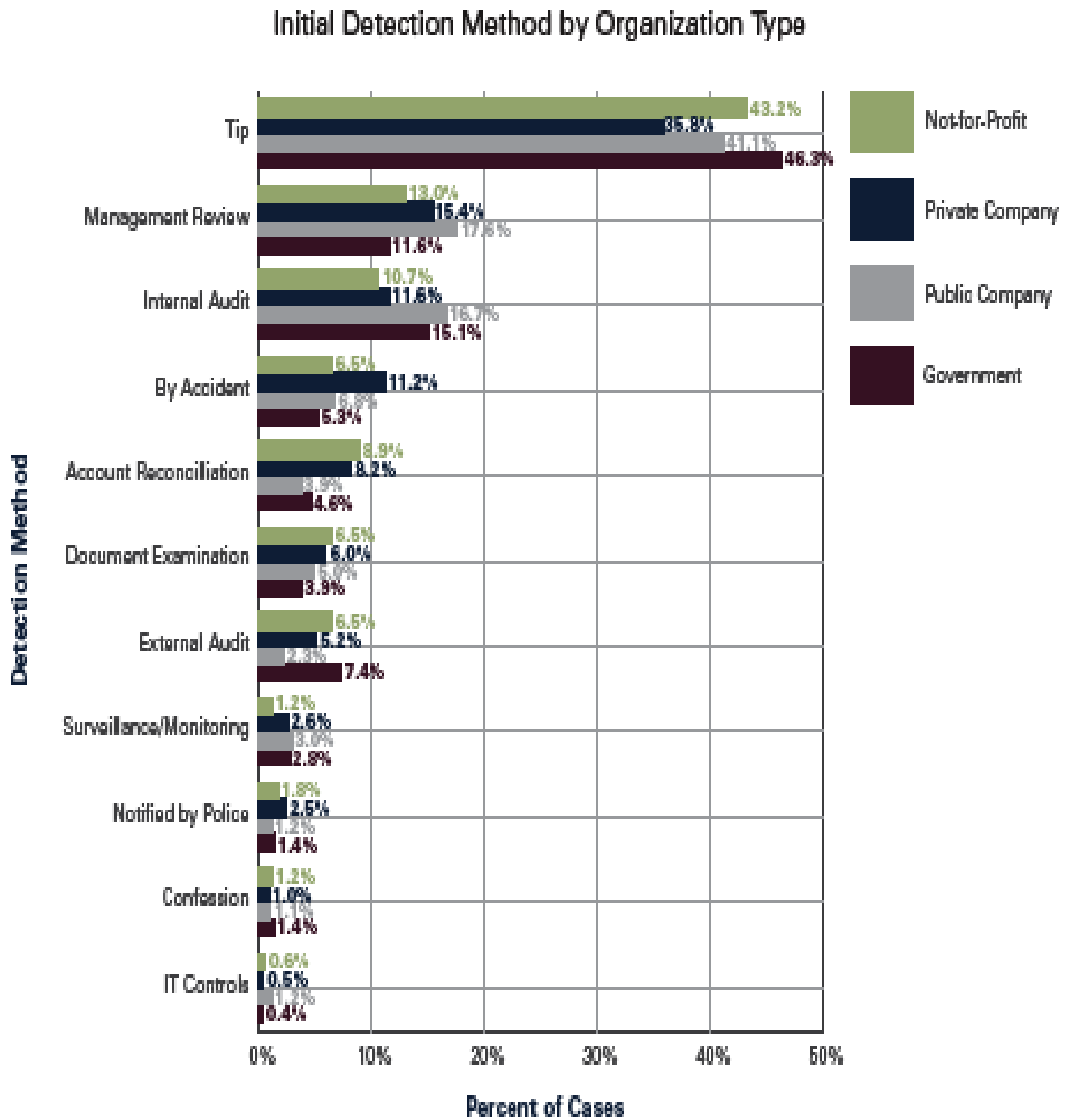
Congressional Globe, March 1863

"Incorporate best practices obtained from DOJ and the IRS into the SEC bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program."

SEC Inspector General,
OIG Report, March 2010

Part II:
Why *Qui Tam* Works:
Employee Disclosures Are the Most Effective Means to Detect Fraud

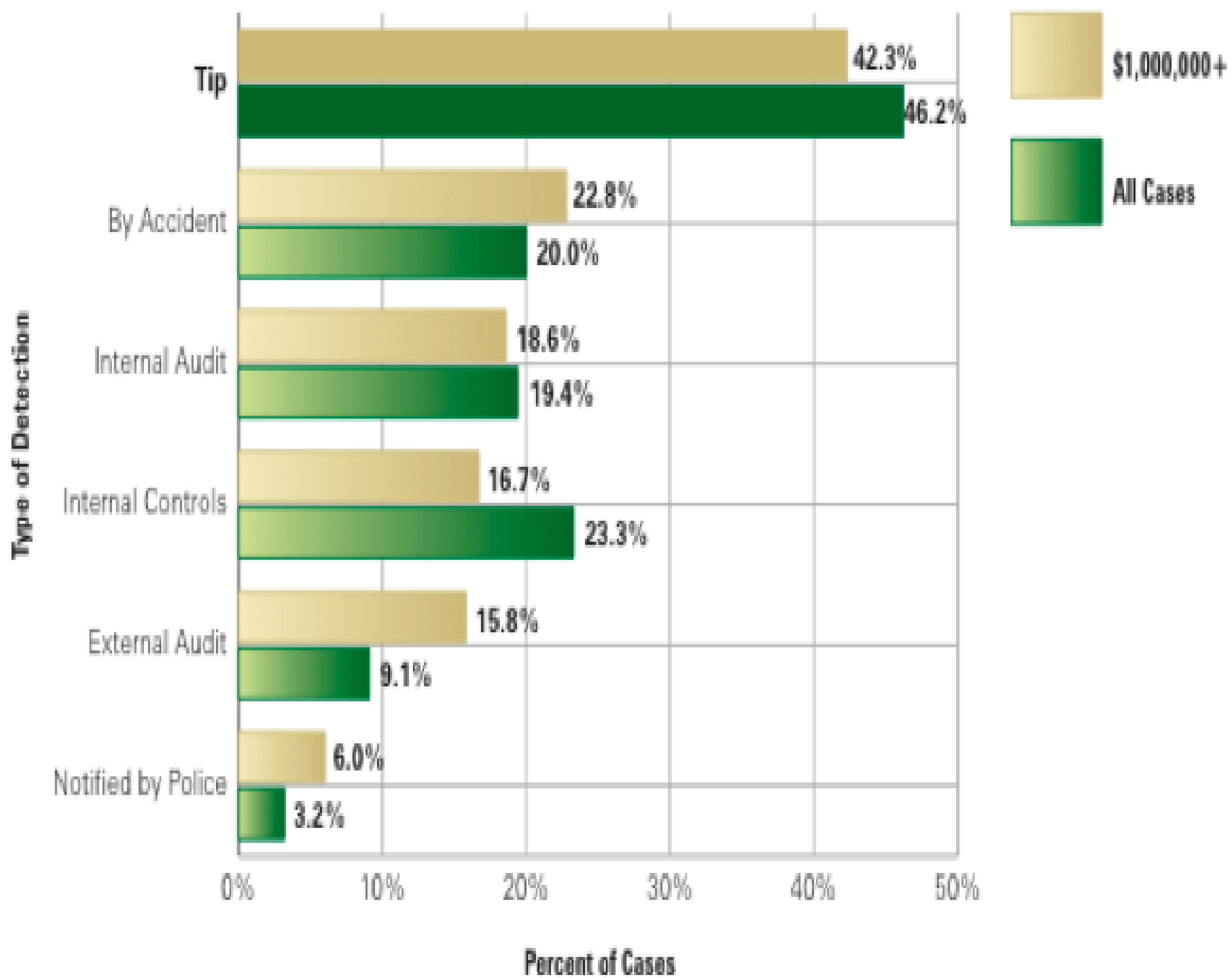
WHO DETECTS FRAUD?



[1]

[1] Source: Association of Certified Fraud Examiners, 2010 Global Fraud Study (page 19)

Initial Detection Method for Million Dollar Schemes[6]



[6]The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

"While tips have consistently been the most common way to detect fraud, the impact of tips is, if anything, understated by the fact that so many organizations fail to implement fraud reporting systems."

Association of Certified Fraud Examiners
– Global Fraud Study, 2010

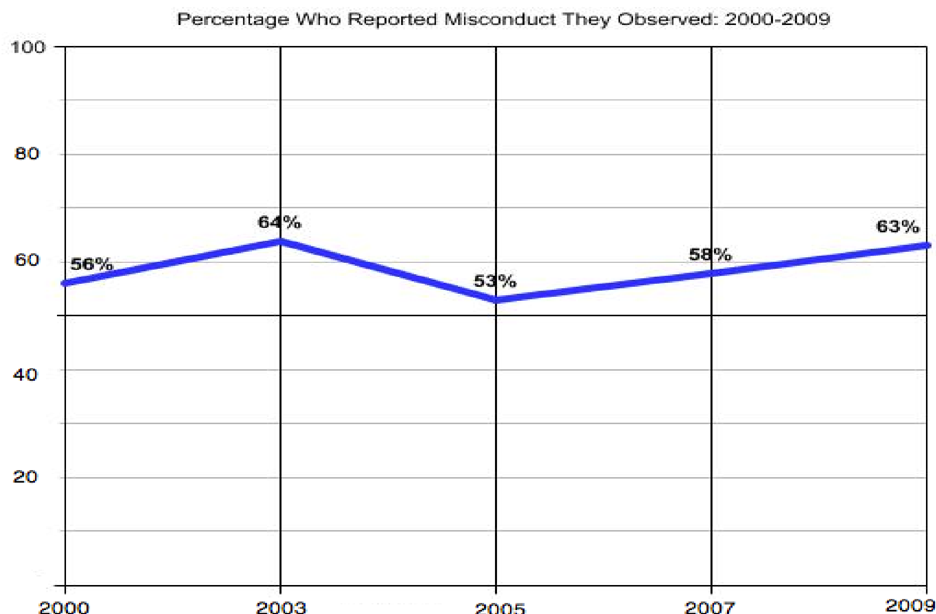
Part III:

Employees Are Reluctant to Report Fraud

Employee Reporting Behaviors

The Ethics Resource Center ("ERC") studied employee reporting behavior trends between 2000 and 2009. *See* ERC, "Blowing the Whistle on Workplace Misconduct," NWC Petition: Exhibit 15. [2]

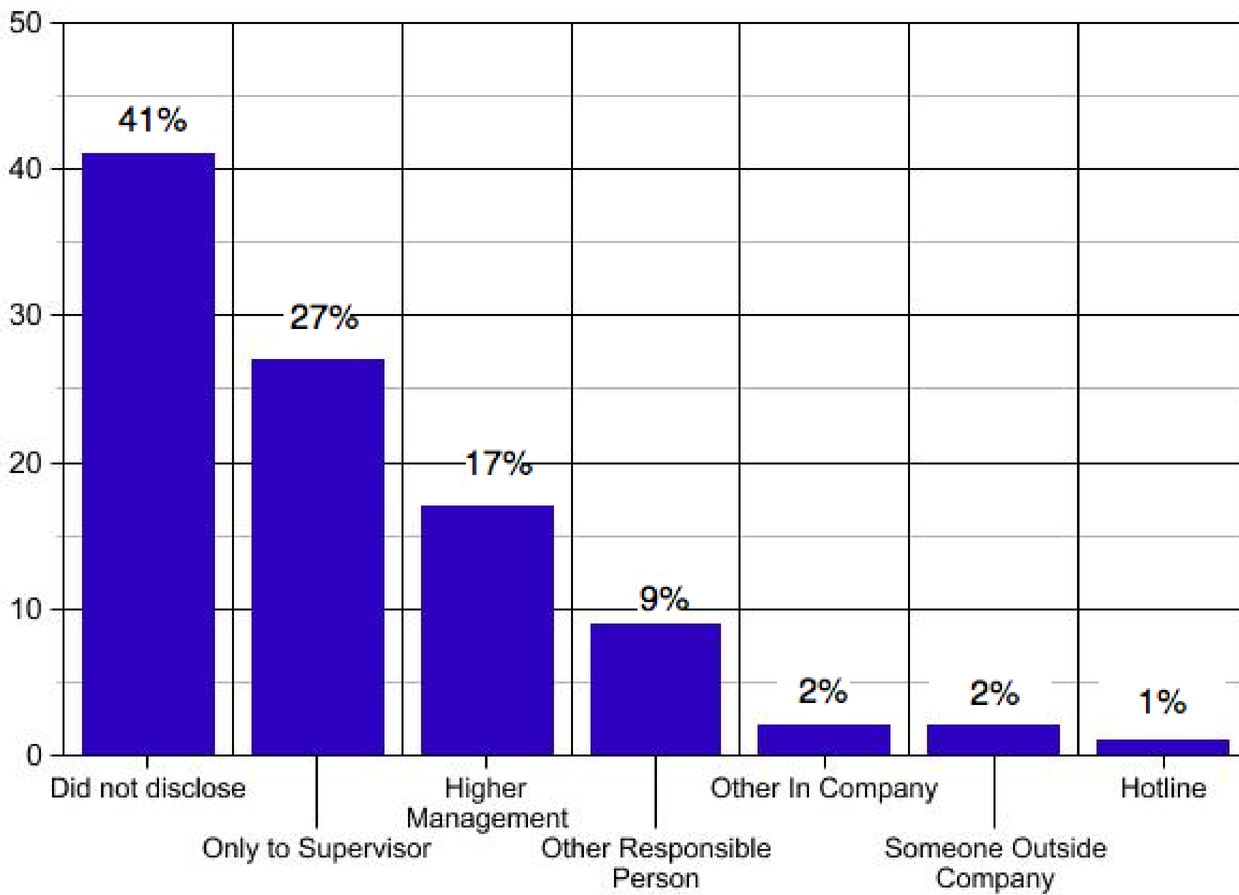
As set forth in the following chart, approximately 40% of employees who witness fraud or misconduct do not report this misconduct to *anyone*. The percentage of employees who report has somewhat fluctuated over the ten year period surveyed by ERC and averages 41% of employees not reporting misconduct to anyone. The numbers reported have remained relatively constant, even after the enactment section 301 of Sarbanes-Oxley Act. Moreover, there is no decline in numbers based on the existence of the False Claims Act and the enactment of the IRS whistleblower law for tax fraud in 2006.



*Based directly on the 2010 ERC Whistleblowing Report, *See* Exhibit 15

[2] The ERC was founded in 1922 and describes itself as "America's oldest nonprofit organization devoted to the advancement of highly ethical standards and practices in public and private institutions". According to its website, ERC is predominantly sponsored by the regulated community including corporations such as BP, Raytheon, Dow, Lockheed, Martain, and Lilly. It also receives support from the Ethics and Compliance Officer Association.

Little or No Progress in Voluntary Corporate Efforts to Increase Reporting



*Based directly on the 2010 ERC Whistleblowing Report, See NWC Petition: Exhibit 15

"One of the critical challenges facing both [Enforcement and Compliance] officers and government enforcement officials is convincing employees to step forward when misconduct occurs."

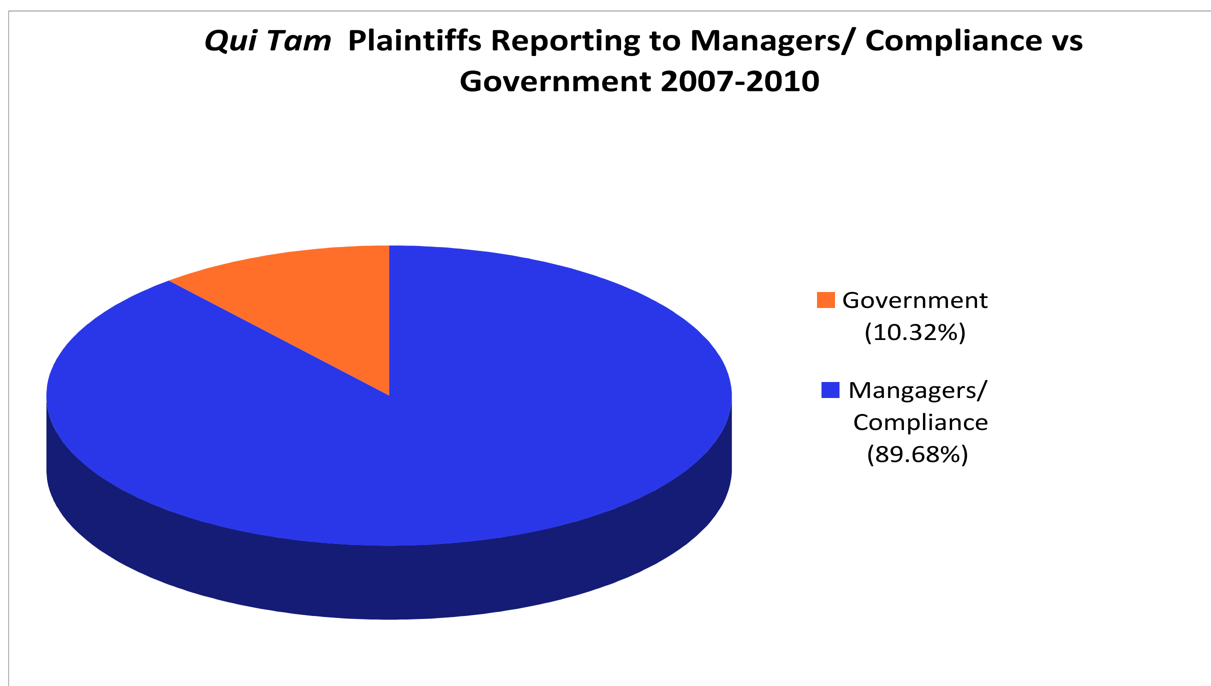
Ethics Resource Center Report,
December 2010

Part IV:

Qui Tam Laws Have No Negative Impact on Corporate Compliance Programs

Impact of *Qui Tam* Laws on Internal Reporting

The existence of a *qui tam* whistleblower reward program has no impact on the willingness of employees to internally report potential violations of law, or to work with their employer to resolve compliance issues. Our statistical study of *qui tam* cases decided in the past four years demonstrates that approximately 90% of all employees who would eventually file a *qui tam* lawsuit initially attempted to resolve their disputes internally.



**See* Exhibit 2

These statistical findings are consistent with other reviews. For example, in its May 13, 2010 issue, the New England Journal of Medicine published a "Special Report" examining the behaviors of *qui tam* whistleblowers who won large False Claims Act judgments against the pharmaceutical industry. *See* Exhibit 2, Special Report. This report also found that "nearly all" of the whistleblowers "first tried to fix matters internally by talking to their superiors, filing an internal complaint or both." In fact, 18 of the 22 individuals in the control group initially attempted to report their concerns internally. The four individuals who reported their concerns to the government were not employees of the defendant companies (i.e. they

were "outsiders" who "came across" the frauds in the course of their business), and therefore had no "internal" avenues through which to voice their concerns. It would thus be fair to say that every *qui tam* whistleblower who had the opportunity to report internally in fact did so.

Moreover, many of the cases in the NWC's study where employees reported directly to the government involved very special circumstances. For example, in one case, the initial report to the government was testimony before a Grand Jury. It clearly would have been inappropriate for that employee to discuss confidential Grand Jury testimony with his or her employer.

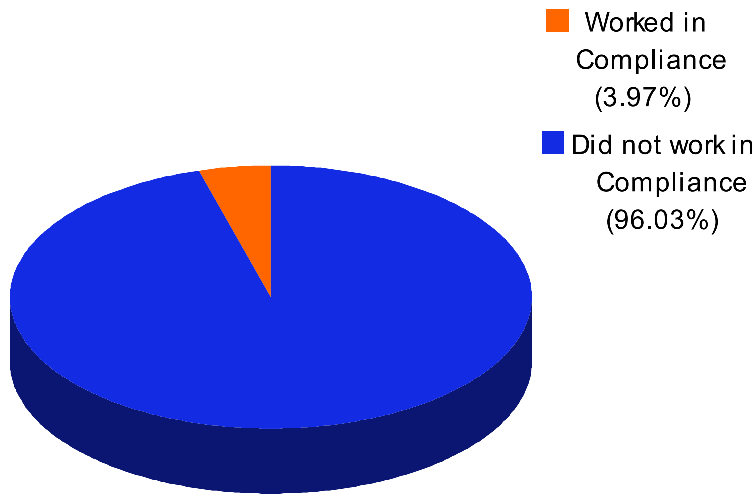
The Journal's conclusion that "nearly all" of the whistleblowers try to report their concerns internally is entirely consistent with the larger study conducted by the NWC and stands squarely contrary to the baseless concerns raised by industry that "greedy" employees will avoid internal compliance programs in pursuit of "pie in the sky" rewards. The truth is that the overwhelming majority of employees who eventually file *qui tam* cases first raise their concerns within the internal corporate process.

The *qui tam* reward provision of the False Claims Act has existed for more than 20 years and has resulted in numerous large and well-publicized rewards to whistleblowers. However, contrary to the assertions by corporate commenters, the existence of this strong and well-known *qui tam* rewards law has had *no effect whatsoever* on whether a whistleblower first brings his concerns to a supervisor or internal compliance program. There is no basis to believe that the substantively identical *qui tam* provisions in the Dodd-Frank law will in any way discourage internal reporting.

Part V:

Qui Tam Laws Have No Negative Impact on the Conduct of Compliance Related Employees

Participation of Compliance Employees in *Qui Tam* Reward Cases



**See* NWC Petition: Exhibit 2

The existence of large *qui tam* rewards did not cause compliance employees to abandon their obligations and secretly file FCA cases and seek large rewards:

- 3.97% of Plaintiff Employees worked in compliance
- Only 1 Plaintiff Employee contacted a Government Agency without first raising the concern within the corporation

The fact that compliance officials could learn of frauds, and file *qui tam* lawsuits to obtain significant monetary rewards had no impact on the reporting processes of employees working in compliance departments. Only 3.97% of *qui tam* relators worked in compliance programs. There was no spike in the number of compliance-associated employees filing *qui tam* cases and there is no reasonable basis to believe that permitting employees who work on compliance to file *qui tam* suits will in any way undermine internal compliance reporting.

Of those compliance-relators, only *one case* concerned an employee who reported his concerns directly to the government, without first trying to resolve the issues internally.

This one case is clearly an exception. In that case, *Kuhn v. Laporte County Comprehensive Mental Health Council*, the Department of Health and Human Services Inspector General was conducting an audit of the company's Medicaid billing. During the audit, the whistleblower learned that the company's internal "audit team" was altering documents to cover-up "numerous discrepancies," including a "forged" signatures and so-called "corrections" to "billing codes." The employee reported this misconduct directly to the United States Attorney's Office. The disclosures to the government were *not* provided as part of a *qui tam* lawsuit. Instead, the employee believed that these disclosures would help "protect" the employer from "federal prosecution" based on the voluntary disclosures.

Indeed, this case highlights exactly why it is important to permit compliance employees to report directly to the government. When the compliance department itself is engaged in misconduct, where else could this whistleblower have gone?

Part VI:

The Sarbanes-Oxley Act Prohibits the SEC from Adopting Rules that Require Internal Reporting

The Sarbanes-Oxley Act Prohibits the SEC from Adopting Rules that Require Internal Reporting

"Whoever knowingly, with the intent to retaliate, takes any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense shall be fined under this title or imprisoned not more then 10 years, or both."

18 U.S.C. § 1513(e)

Federal Law creates a near absolute protection for employees who contact any federal law enforcement agency regarding the violation of any federal law. Section 1107 of the Sarbanes-Oxley Act, codified as 18 U.S.C. § 1513 (e) *criminalizes* any attempt to interfere with the right of any person to contact the SEC concerning any violation of law. The section sets forth an overriding public policy, implicit or explicit in every federal whistleblower law, that employees can *always* choose to report concerns directly to law enforcement, regardless of any other program, private contract, rule or regulation. This provision was explicitly included in the Dodd-Frank Act's anti-retaliation provision, section 21F(h)(1)A)(iii) and in other provisions of law.

Part VII:
Conclusions and Recommendations to SEC

Conclusion # 1: The existence of a strong *qui tam* reward program will have no impact on internal employee reporting activities.

Conclusion # 2: The evidence does not support employer concerns that Dodd-Frank will interfere with existing compliance programs.

Conclusion # 3: The systemic problems with corporate internal compliance programs are not related to *qui tam* law rewards and exist regardless of whether employees file whistleblower complaints with the government.

Conclusion # 4: The SEC must ensure, through a formal rule, that reports to internal compliance programs are fully protected. The decades-long history of regulated companies opposing such protections in judicial proceedings must be ended. The definition of protected disclosures should conform to the standards recommended by the Association of Certified Fraud Examiners.

Conclusion # 5: The recommendations of the SEC's Inspector General should be fully implemented in a manner consistent with the requirement that the Dodd-Frank reward provisions be "user-friendly".

Conclusion # 6: Any action by an employer that in any way limits an employee's right or incentive to contact the SEC, regardless of whether or not the employee first utilized a compliance program, is highly illegal and constitutes an obstruction of justice.

Conclusion # 7: The exclusion of employees who work for foreign state-owned industries or government agencies must be modified or eliminated.

Conclusion # 8: All whistleblower rewards must comply with the 10 – 30% range mandated by the statute.

About the National Whistleblowers Center

The National Whistleblowers Center (NWC) is an advocacy organization with a more than 20 year history of protecting the rights of individuals to speak out about wrongdoing in the workplace without fear of retaliation. Since 1988, the NWC has supported whistleblowers in the courts and before Congress, achieving victories for environmental protection, nuclear safety, government ethics and corporate accountability. The NWC also sponsors several educational and assistance programs, including an online resource center on whistleblower rights, a speakers bureau of national experts and former whistleblowers, and a national attorney referral service run by the NWC's sister group the National Whistleblower Legal Defense and Education Fund (NWLDEF). The National Whistleblowers Center is a non-partisan, non-profit organization based in Washington, DC.

This report was prepared under the direction of Stephen M. Kohn, Executive Director of the National Whistleblowers Center. The National Whistleblowers Center would like to recognize the contributions of Director of Advocacy and Development Lindsey M. Williams and Staff Attorney Erik D. Snyder for his legal research, analysis, and editorial contributions to this Report. In addition, the National Whistleblowers Center would like to thank Law Clerks Zach Chapman, Greg Dobbels, Katie Mee, Andrew Palmer and David Simon for their assistance in reviewing the False Claims Act cases. Finally, the National Whistleblowers Center would like to thank legal interns Marshall Chriswell and Shane Swords for their work on preparing this presentation.

CONFERENCE PROCEEDINGS

Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds

What the Policy Community Should Know

Michael D. Greenberg

Center for Corporate Ethics and Governance

A RAND INSTITUTE FOR CIVIL JUSTICE CENTER

APPENDIX C: INVITED PAPERS FROM PANEL PARTICIPANTS

From Enron to Madoff: Why Many Corporate Compliance and Ethics Programs Are Positioned for Failure

Donna Boehme, Compliance Strategists, LLC

Remarks presented on March 5, 2009

Introduction: "Where Was the Ethics Officer"?[1]

With the wreckage of the first generation of Enron-type corporate scandals in the rear view mirror, and the chaos of Madoff and the subprime meltdown now all around us, commentators are asking "Where were the ethics officers?" and "Are corporate compliance and ethics programs just window dressing?" These are fair questions, given that in the 18 years since the 1991 promulgation of the U.S. Organizational Sentencing Guidelines (which set out the roadmap for companies to detect and prevent wrongdoing),[2] several studies have indicated that little progress has been made,[3] and recent events in the corporate world suggest that effective mechanisms to prevent corporate misconduct are lacking. This paper sets out a response to these two questions from some leading practitioners in the field of corporate compliance and ethics. This paper also suggests a path forward, moving beyond the sometimes unrealistic assumption of policymakers, boards and management that integrity and compliance can be achieved simply by establishing basic elements such as a formal code of conduct, an "ethics officer," a training program, monitoring, and/or an employee helpline, and then expecting that good results will necessarily follow. In short, we believe that it is time for companies to get serious about corporate culture, accountability, compliance and ethics, and that the key initial step in achieving this involves the creation of a C-level, empowered compliance and ethics officer: someone with the experience, positioning, mandate and clout to actually make things happen in the organization.

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[1] For convenience, the term "ethics officer" is intended to encompass the role of the chief compliance and ethics officer, in its many variations.

[2] The guidelines, including the 2004 amendment, are available at http://www.ussc.gov/guidelin.htm. The amendment became effective on November 1, 2004.

[3] The Ethics Resource Center's 2007 National Business Ethics Survey, based upon interviews with 2,000 employees at a broad range of public and private U.S. companies, found "little if any meaningful reduction in the enterprise-wide risk of unethical behavior at U.S. companies." ERC Press Release, November 28, 2007, available at http://www.ethics.org/about-erc/press-releases.asp?aid=1146.

The "Kumbaya" Approach to Ethics and Compliance

On paper, many companies have established a wide range of compliance and ethics programs since 1991.[4] Moreover, companies were subsequently required to add to their compliance infrastructure by Sarbanes-Oxley in 2004, and by other government efforts to impose elements of compliance programs. Today, most major corporations have at least some compliance and ethics infrastructure, including formal codes of conduct and confidential employee hotlines, and the new management role of "chief ethics and compliance officer" (CECO) is rising in demand. Most companies in highly regulated industries, such as financial services, health care, and defense, also have developed detailed compliance procedures. But there is a critical distinction between compliance and ethics programs that have all the designated features on paper, and those that have real "teeth" and the potential for success. The former might be described as adopting a "Kumbaya"[5] approach — an optimistic but rather naive expectation that once a code is published, a hotline activated, a rousing speech and memorandum from the CEO is delivered, and an "ethics officer" appointed, then all the employees and managers will join hands in a "Kumbaya" moment, and the program will somehow magically work as envisioned. This kind of program may look good at first, but without continuing, empowered leadership on compliance and ethics issues, together with tangible management commitment to making hard choices, such a program is unlikely to succeed in preventing, detecting, and addressing real world problems. We would note that Enron had a 64-page code of ethics and an employee hotline in place prior to the exposure of the scandals that ultimately brought that company down. Similarly, today's newspaper headlines are full of allegations of corporate fraud and crime, at companies with relatively hollow, check-the-box compliance and ethics programs.

Leading Integrity: The Critical Role of the Chief Ethics and Compliance Officer

We believe an effective approach to integrity and corporate ethics starts with a senior-level chief ethics and compliance officer (CECO) who understands the compliance and ethics field, is empowered and experienced, and who has the independence, clout, a "seat at the table" where key senior management decisions are made, and resources to lead and oversee a company's ethics and compliance program — even when that program appears at odds with other key business goals of the company. A well-implemented compliance and ethics program doesn't spring from the void ex nihilo — it requires a strong leader to engage others in the

[4] The U.S. Sentencing Guidelines, requiring organizations to establish an "effective program" to prevent and detect violations of law, were initially promulgated in 1991 and further amended in 2004. See footnote 2.

[5] Kumbaya, a 1930s Southern spiritual that some trace to the former slaves living in the sea islands of South Carolina and Georgia, is sometimes used to describe a "naively optimistic view of the world and human nature" — see http://en.wikipedia.org/wiki/Kumbaya.

organization, including powerful senior managers, to surface and resolve issues and challenges, and to make a culture of transparency, accountability and responsibility a reality.

But accomplishing this is easier said than done. To a great extent, the evolving role of the CECO was initially viewed by companies as a lower-level management or even administrative role, often positioned within the legal department or another function such as finance, audit or even HR, and with little empowerment, mandate or independence to fulfill the important accountabilities of the role. When compliance programs have been mandated by government rules and regulations, programs have tended to devolve into hyper-technical efforts devoid of senior-level participation and commitment.

In a serious compliance and ethics role, the CECO is often required to challenge the established way of doing things, or to introduce new concepts such as stricter controls on senior managers, increased transparency, and consistent standards of discipline. Imagine a CECO being called into the office of a powerful Andy Fastow-type CFO and being ordered to drop a confidential investigation, change a report to the Board, or otherwise compromise the responsibilities of the role. This is corporate ethics' "dirty little secret": In many companies today, the CECO is still poorly positioned, and lacking in the empowerment and independence needed for successful discharge of the critical role he or she is expected to play.[6] It is important to note that the "expectations" of having an effective CECO and ethics and compliance program come, not only from the organization itself, but also from regulators, from policymakers and other stakeholders, and from the general public.

This view is expressly endorsed by a startlingly candid white paper published last year on the topic, entitled "Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer" — a collaboration of five leading nonprofit organizations supporting the profession.[7] Echoing the sentiment that "most CECOs do not believe they have been given sufficient authority and resources to achieve their mission," the white paper comments that "many executives and boards have not yet realized the potential of their CECOs" and that "a CECO that serves as window dressing likely does more harm than good, especially in times of difficulty." The CECO's line of reporting is the "single biggest influence on his or her credibility within the organization" and should be a direct reporting relationship to either the CEO or the board, with "direct, unfiltered access to the Board." The CECO must be "independent to raise matters of concern without fear of reprisal or a conflict of interest." Further, a reporting line to the general counsel, one of the most common structures in

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[6] As reported by the *Financial Times* on June 29, 2007, "Siemens Anti-Graft Chief Quits," Daniel Noa, a former German prosecutor with "impeccable credentials" appointed to the post as part of Siemens' response to the corruption scandal in 2007, quit the role involuntarily after only six months on the job. The paper quoted one source: "He was alone and lacked support. He came up against a lot of people who didn't want him to succeed in his job." Media reports cite a changed reporting relationship that "undermined" Noa, "infighting" and "lack of support."

[7] See Ethics Resource Center (2007), *Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer (CECO)*. This report is available for download at http://www.ethics.org/CECO/.

companies today, is not viewed as effective positioning – since the aim of reducing external litigation risk is not always well-aligned with the aim of promoting ethics and compliance within the organization. Thus for companies serious about integrity, merely establishing a new ethics management position is not sufficient as a foundation for a strong compliance and ethics program. Rather, close attention must also be paid to empowerment, mandate, a seat at the table, independence, and reporting relationships of the CECO. Without proper positioning, a CECO (and ultimately, the compliance and ethics program that he or she administers) is likely to be ineffective and in serious danger of failure.

That brings us back to the two questions we posed in the introduction, with regard to the most recent wave of corporate scandals: Question: "Where was the ethics officer?" Answer: "Present, but most likely lacking empowerment, positioning and independence (and probably not even a true 'officer' of the corporation)." Question: "Are corporate compliance and ethics programs just window-dressing?" Answer: "In many companies, probably yes."

Policymakers Need to Support Effective Programs

Congress and regulators can also do more to support effective CECOs, and (by extension) effective corporate compliance and ethics programs. For instance, the New York Stock Exchange (NYSE) listing rules have been hailed for requiring all listed companies to have a code of ethical conduct. This is certainly an important starting point in establishing a good compliance and ethics program, but by itself, a formal code of conduct can become an empty gesture unless that code is implemented effectively. Similarly, the Sarbanes-Oxley reforms of 2002 responded to a stream of corporate accounting and fraud scandals by mandating new ethics hotlines, codes of conduct, and stronger internal controls and reporting efforts, but here again, these steps are only part of the overall compliance and ethics approach needed to support a culture of integrity at a corporation. Two key ideas have been missing from related government regulations. First, any single element of a corporate compliance and ethics program, taken in isolation, is unlikely to be effective by itself. Thus, formal codes of conduct, employee hotlines, and internal controls ideally should all be implemented as parts of an overall, holistic compliance and ethics program. Second, such programs should ideally be led and overseen by a senior-level, empowered chief compliance officer, with the clout and independence to make things happen in the organization. Without both of these elements, an NYSE-style paper requirement for a formal code of conduct (for example) is unlikely to succeed in achieving its aims. In sum, more is needed from government and policymakers to make more plainly stated the expectations for an effective CECO and a strong corporate compliance and ethics program – ultimately, prerequisites for protecting the interests of the organization itself, and for maintaining accountability to other stakeholders and to the public interest. In a companion paper in this document (titled "What Government Can Do to Prevent Corporate Crime"), our colleague provides some specific suggestions on how policymakers can help to support more effective ethics and compliance programs and stronger CECOs.

How Can Companies Put Integrity Back In Business?

Perhaps the underlying question here is, how do we move beyond corporate compliance and ethics programs that look good on paper, but that are ineffective at achieving real world results? More generally, CEOs of successful companies know that little is accomplished in business without first having a plan, resources, and an accountable, effective leader in place to implement the plan. A company's program for compliance and ethics is no different from any other aspect of business enterprise. Where the stated goal is to change the culture of an entire organization, to identify and address key compliance and ethics risks, and to encourage good business judgments among all managers and employees, a serious approach and commitment of resources is needed. We've already described the first step of creating an empowered, independent CECO position, filling it with someone who is knowledgeable about compliance and ethics, and giving that person a seat at the senior management table. The rest of the formula, which the CECO will drive, has to do with implementing and integrating a range of compliance and ethics initiatives, supported by management at all levels of the organization. Without diminishing the key role of formal codes of conduct and help lines, establishing those features is a relatively easy part of a company's compliance and ethics effort. The more difficult aspects of the effort involve incorporating the company's code of conduct and policies into the DNA of its business operations, and all of the resulting tough choices management needs to make along the way in doing so. This is where many compliance and ethics efforts fall short, whether by lack of management resolve, loss of focus, or lack of leadership by a strong CECO in driving the program on a daily basis. Here are some examples of features we view as essential indicia of a serious compliance and ethics program (i.e., one with "teeth"):

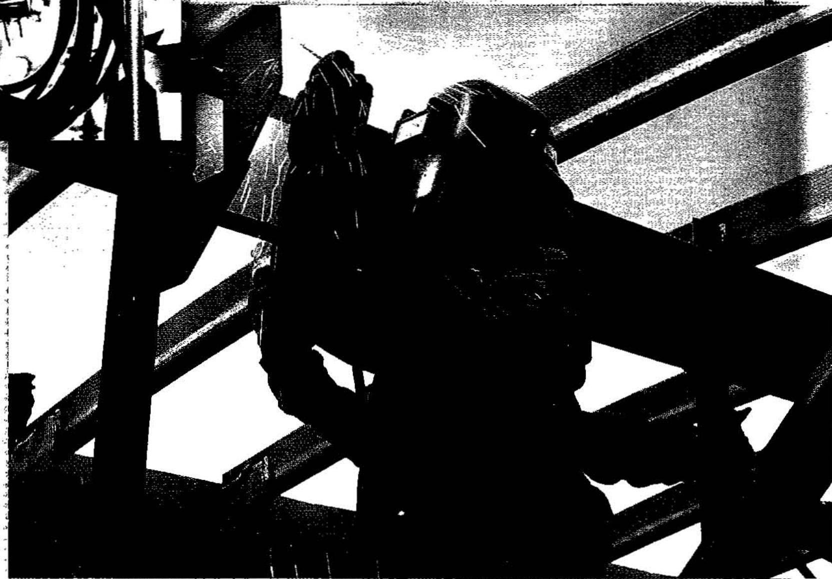
- Executive and management compensation linked to compliance and ethics leadership
- Consistent enforcement of the company's code of conduct and policies, especially at senior levels
- Confidential, professional management of the help line, including investigations
- Vigorous enforcement of non-retaliation policies
- Effective and ongoing compliance and ethics risk-assessment
- Integration of clear, measurable compliance and ethics goals into the annual plan
- Direct access and periodic unfiltered reporting by the CECO to a compliance-savvy board
- Strong compliance and ethics infrastructure throughout all parts of the business
- Real compliance audits designed to uncover lawbreaking
- Practical and powerful action (not merely words) by the CEO and management team to promote compliance and ethics
- Shared learning within the company based on actual disciplinary cases.

Conclusion and Way Forward

With committed management support, together with empowerment, independence, a seat at the table, resources and appropriate reporting structure for its CECO, a company can forge beyond window-dressing in its compliance and ethics effort. This is an essential first step toward establishing a corporate culture of transparency, openness and integrity, in which ethical and compliance problems are more likely to be detected earlier rather than later – so that the company can seek to prevent fires, rather than put them out after the fact. Unless we want to keep asking "Where was the ethics officer?", it's time for companies – and policymakers – to reject a check-the-box approach to compliance and ethics programs, and get much more serious about putting integrity back into the heart of business.

Multiemployer Pension Plans:

Main Street's Invisible Victims of the Great Recession of 2008



The Results of the NCCMP 2009 Survey of the Funded Status of Multiemployer Defined Benefit Plans

www.nccmp.org

Randy G. DeFrehn ■ Joshua Shapiro

CONFERENCE PROCEEDINGS

Directors as Guardians of Compliance and Ethics Within the Corporate Citadel

What the Policy Community Should Know

Michael D. Greenberg

Center for Corporate Ethics and Governance

A RAND INSTITUTE FOR CIVIL JUSTICE CENTER

U.S. Securities and Exchange Commission

Office of Inspector General

Office of Audits

Assessment of the SEC's Bounty Program

March 29, 2010
Report No. 474

OFFICE OF
INSPECTOR GENERAL

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MEMORANDUM

March 29, 2010

To: Robert Khuzami, Director, Division of Enforcement

From: H. David Kotz, Inspector General, Office of Inspector General (OIG)

Subject: *Assessment of the SEC's Bounty Program,* Report No. 474

This memorandum transmits the U.S. Securities and Exchange Commission OIG's final report detailing the results of our assessment of the Commission's bounty program. This review was conducted in accordance with our annual audit plan.

Based on the written comments received to the draft report and our assessment of the comments, we revised the report accordingly. This report contains nine recommendations. Your office concurred with all the recommendations. Management's full comments to this report are included in the appendices.

Within the next 45 days, please provide OIG with a written corrective action plan that is designed to address the recommendations. The corrective action plan should include information such as the responsible official/point of contact, time frames for completing the required actions, milestone dates identifying how you will address the recommendations cited in this report, etc.

Should you have any questions regarding this report, please do not hesitate to contact me. We appreciate the courtesy and cooperation that you and your staff extended to our auditor.

Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman
Diego Ruiz, Executive Director, Office of the Executive Director
Joan McKown, Chief Counsel, Division of Enforcement

Assessment of SEC Bounty Program

Executive Summary

Background. There is evidence that bounty programs are an effective tool to encourage whistleblowers to come forward and provide necessary incentives for outside entities to bring complaints about possible illegal activity.

Section 21A(e) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78u-1(e), authorizes the Securities and Exchange Commission (SEC or Commission) to award a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader, from a person who tipped information to an insider trader, or from a person who directly or indirectly controlled an insider trader. All bounty determinations, including whether, to whom, or in what amount to make payments, are within the sole discretion of the SEC. However, the total bounty may not currently exceed 10 percent of the amount recovered from a civil penalty pursuant to a court order.

The SEC recently sent to Congress proposed legislation to expand its authority to permit bounties for any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1,000,000. The proposed legislation was included in the Investor Protection Act of 2009 (H.R. 3817), which was introduced in the U.S. House of Representatives on October 15, 2009 by Representative Paul Kanjorski (D-Pa.) and referred to the House Committee on Financial Services. Variations of this legislation are being considered by both the U.S. House of Representatives and U.S. Senate.

Objectives. This review was conducted as a result of an issue that we identified during the OIG's investigation into the SEC examination and investigations of Bernard L. Madoff and related entities, OIG's Report of Investigation, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme,* Report No. 509, August 31, 2009.

The primary objectives of the review were to:

- Assess whether necessary management controls have been established and operate effectively to ensure bounty applications are routed to appropriate personnel and are properly processed and tracked; and
- Determine whether other government agencies with similar programs have best practices that could be incorporated into the SEC bounty program.

Results. Although the SEC has had a bounty program in-place for more than 20 years for rewarding whistleblowers for insider trading tips and complaints, our review found that there have been very few payments made under this program. Likewise, the Commission has not received a large number of applications from individuals seeking a bounty over this 20-year period. We also found that the program is not widely recognized inside or outside the Commission. Additionally, while the Commission recently asked for expanded authority from Congress to reward whistleblowers who bring forward substantial evidence about other significant federal securities law violations, we found that the current SEC bounty program is not fundamentally well-designed to be successful.

More specifically, we found that improvements are needed to the bounty application process to make it more user-friendly and help ensure that bounty applications provide detailed information regarding the alleged securities law violations. We also found that the criteria for judging bounty applications are broad and the SEC has not put in place internal policies and procedures to assist staff in assessing contributions made by whistleblowers and making bounty award determinations. Additionally, we found that the Commission does not routinely provide status reports to whistleblowers regarding their bounty applications, even if a whistleblower's information led to an investigation. Moreover, we found that once bounty applications are received by the SEC and forwarded to appropriate staff for review and further consideration, they are not tracked to ensure they are timely and adequately reviewed. Lastly, we found that files regarding bounty referrals did not always contain complete documentation, such as a copy of the bounty application, a memorandum sent to the whistleblower to acknowledge receipt of the application, and a referral memorandum showing the office or division and official to whom the bounty application was referred for further consideration.

We wish to note that the SEC has begun to take steps to correct the deficiencies identified in its whistleblower/bounty program. The SEC has had consultations with the Department of Justice (DOJ), Internal Revenue Service (IRS), and other agencies, as well as the Financial Industry Regulatory Authority, to identify best practices from existing well-defined whistleblower programs. The SEC has also attempted to incorporate some of these best practices into legislation which it is seeking from Congress to include expanded authority to reward whistleblowers for securities law violations. The proposed legislation also takes into account some issues identified in this report in connection with the existing insider trading bounty program.

We believe that it is critical for the SEC to implement the following recommendations to ensure that it has a fully-functioning and successful whistleblower program in place as its authority is potentially expanded.

Summary of Recommendations. Specifically, the review recommends that the Division of Enforcement:

(1) Develop a communication plan to address outreach to both the public and SEC personnel regarding the SEC bounty program. The plan should include efforts to make information available on the SEC's intranet, enhance information available on the SEC's public website, and provide training to employees who are most likely to deal with whistleblower complaints.

(2) Develop and post to its public website an application form that asks the whistleblower to provide information, including, for example:

a) The facts pertinent to the alleged securities law violation and explanation as to why the whistleblower believes the subject(s) violated the securities laws;
b) A list of related supporting documentation in the whistleblower's possession and available from other sources;
c) A description of how the whistleblower learned about or obtained the information that supports the claim, including the whistleblower's relationship to the subject(s);
d) The amount of any monetary rewards obtained by the subject violator(s) (if known) as a result of the securities law violation, and how the amount was calculated; and
e) A certification that the application is true, correct, and complete to the best of the whistleblower's knowledge.

(3) Establish policies on when to follow-up with whistleblowers who submit applications to clarify information in the bounty applications and obtain readily available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.

(4) Develop specific criteria for recommending the award of bounties, including a provision that where a whistleblower relies partially upon public information, such reliance will not preclude the individual from receiving a bounty.

(5) Examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing non-public or confidential information during the course of an investigation or examination.

(6) Develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of Enforcement's tips, complaints, and referrals processes and systems for

other tips and complaints. These controls should provide for the collection of necessary information and require processes that will help ensure that bounty applications are reviewed by experienced Commission staff, decisions whether to pursue whistleblower information are timely made, and whistleblowers who provide significant information leading to a successful action for violation of the securities laws are appropriately rewarded.

(7) Require that a bounty file (hard copy or electronic) be created for each bounty application. The file should contain at a minimum the bounty application, any correspondence with the whistleblower, documentation of how the whistleblower's information was utilized, and documentation regarding significant decisions made with regard to the whistleblower's complaint.

(8) Incorporate best practices obtained from DOJ and the IRS into the SEC bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.

(9) Establish a timeframe to finalize new policies and procedures for the SEC bounty program that incorporates the best practices from DOJ and IRS as well as any legislative changes to the program.

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Background and Objectives

Background

There is evidence that bounty programs are an effective tool to encourage whistleblowers to come forward and provide incentives for outside entities to bring complaints about possible illegal activity. We identified two government agencies, the Internal Revenue Service (IRS) and Department of Justice (DOJ), that have well-defined whistleblower functions.

Section 21A(e) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78u-1(e), authorizes the Securities and Exchange Commission (SEC or Commission) to award a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader,[1] from a person who tipped information to an insider trader, or from a person who directly or indirectly controlled an insider trader. All bounty determinations, including whether, to whom, and in what amount to make payments, are within the sole discretion of the SEC. However, the total bounty may not currently exceed 10 percent of the amount recovered from a civil penalty pursuant to a court order.

Section 21A(e) of the Exchange Act was added by the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSEA), Pub L. No. 100-704. ITSEA embodied a series of statutory changes that Congress viewed as necessary at that time to augment existing methods of detection and punishment of insider trading behavior. Particularly in light of the stock market crash in October 1987, Congress viewed the changes as an essential ingredient to restore the confidence of the public in the fairness and integrity of the securities markets.

The Commission has adopted regulations to provide for administration of the process for making bounty requests. These regulations are included in the Code of Federal Regulations, Title 17: *Commodity and Securities Exchanges, Part 201- Rules of Practice, Subpart C-Procedures Pertaining to the Payment of Bounties Pursuant to Subsection 21A(e) of the Securities Exchange Act of 1934,* Sections 201.61-201.68. The SEC bounty program regulations require that applications be in writing, and that applications be filed within 180 days after the entry of the court order requiring payment of the insider trading penalty from which the bounty is to be paid.[2] An application for a bounty must contain, among

[1] The term "insider trading" refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust or confidence, while in possession of material, nonpublic information about the security. Insider trading violations may also include tipping such information, securities trading by the person tipped and security trading by those who misappropriate such information. (http://www.sec.gov/answers/bounty.htm.)

[2] 17 C.F.R. §§ 201.62 and 201.63.

other things, information concerning the dates and times upon which, and the means by which, information was provided, as well as the identity of the Commission staff to whom the information was provided.[3]

The SEC bounty program is administered by the Division of Enforcement (Enforcement). While the program has been in place for more than 20 years, there have been very few payments by the Commission under the program. Likewise, the Commission has not received a large number of applications from individuals seeking a bounty. The SEC bounty program is limited to insider trading cases and the stated criteria for judging bounty applications are broad, somewhat vague and not subject to judicial review. Moreover, there is no entitlement to a reward even if the whistleblower's information causes the government to recover money from wrongdoers.

In testimony before the House Subcommittee on Financial Services and General Government Appropriations of the House Committee on Appropriations in March 2009, SEC Chairman Mary Schapiro spoke about the possible expansion of the SEC's authority to award whistleblowers.[4] Chairman Schapiro stated that "right now, the main reward for being a whistleblower is the good feeling you get of having done something important, because [the SEC does not] have the authority to pay except where the whistleblowing relates to insider trading."[5] Chairman Schapiro added that "[w]histleblowers tend to do a lot of the work for you, hand you something that is pretty fully baked."[6] She further stated that expanding authority would enable the SEC to "run with that kind of information and to pursue cases in a much more aggressive way."[7]

The SEC recently sent to Congress proposed legislation to expand the authority of the program, in addition to other reforms, to permit bounties for any judicial or administrative action brought by the Commission under the securities laws that result in monetary sanctions exceeding $1,000,000. The proposed legislation was included in the Investor Protection Act of 2009 (H.R. 3817), which was introduced in the U.S. House of Representatives on October 15, 2009 by Representative Paul Kanjorski (D. PA) and referred to the House Committee on Financial Services. Variations of this legislation are being considered by both the U.S. House of Representatives and the U.S. Senate.

[3] 17 C.F.R. § 201.64.
[4] Securities and Exchange Commission Actions Relating to the Financial Crisis: Hearing Before the Subcommittee on Financial Services and General Government of the H. Comm. on Appropriations, 111 Cong. (2010) (testimony of Mary Schapiro, Chairman, Securities and Exchange Commission).
[5] Id.
[6] Id.
[7] Id.

Objectives

This review was conducted in accordance with our annual audit plan, as a result of an issue that we identified during the OIG's investigation into the SEC examination and investigations of Bernard L. Madoff and related entities, OIG Report of Investigation, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme,* Report No. 509. The primary objectives of the review were to:

- Assess whether necessary management controls have been established and operate effectively to ensure bounty applications are routed to appropriate personnel and are properly processed and tracked; and

- Determine whether other government agencies with similar programs have best practices that could be incorporated into the SEC bounty program.

Findings and Recommendations

We found that while a bounty program has been in place at the SEC for more than 20 years, there have been very few payments made by the Commission under the program. Likewise, the Commission has not received a large number of applications from individuals seeking a bounty. The program is also not widely recognized inside or outside the Commission. We also found that the SEC bounty program is limited to insider trading cases and the stated criteria for judging bounty applications are broad, somewhat vague and not subject to judicial review.

In addition, we generally found that bounty applications the Commission received were acknowledged in writing and were then forwarded to appropriate senior-level staff in headquarters and the regional offices for further consideration. However, bounty applications were not adequately tracked to ensure timely and adequate handling of the information. We did find that the Commission made formal determinations and notified bounty claimants, accordingly, with respect to all persons the Commission deemed eligible for award in accordance with the statute. We also found that on the few occasions when the Commission has made an award, it has paid the maximum allowed by the statute.

We further identified areas that need increased management controls with regard to the bounty application process, maintenance of files pertaining to bounty applications, and correspondence with whistleblowers regarding the status of their bounty applications.

Lastly, we identified several best practices utilized by agencies with similar programs that should be adopted by the SEC in developing a successful bounty program.

Finding 1: SEC Bounty Program Has Made Very Few Payments and Received a Relatively Small Number of Bounty Applications

> The SEC bounty program has made very few payments to whistleblowers since its inception and received a relatively small number of bounty applications. As a result, the program's success has been minimal and its existence is practically unknown.

Since the inception of the SEC bounty program in 1989, the SEC has paid a total of $159,537 to five claimants as detailed in Table 1 below.

Table 1: Bounty Payments to Whistleblowers

Bounty Claimant	Year	Bounty Amount
1) Claimant 1	1989	$3,500
2) Claimant 2	2001	$18,152
3) Claimant 3	2002	$29,079
4) Claimant 4	2005	$17,500
4) Claimant 4	2006	$29,920
4) Claimant 4	2009	$55,220
5) Claimant 5	2007	$6,166
Total		**$159,537**

Source: OIG Generated

As Table 1 illustrates, Claimant 4 received three payments because the information provided by the claimant led to the filing of three separate insider trading cases. All payments were for the 10 percent maximum amount permitted by statute.

The Commission also formally denied five bounty applications since the inception of the program as summarized below.

- In 1990, the Commission denied a bounty request to Claimant 6 on the grounds that the statute did not authorize payment for information provided prior to its effective date.

- In 1990, the Commission denied a bounty request to Claimant 7 on the same ground asserted in the aforementioned bounty request for Claimant 6.

- In 1996, the Commission denied a bounty request to Claimant 8 because, as with the aforementioned two bounty requests, Claimant 8 had provided information prior to the effective date of the statute. However, Claimant 8 also provided additional information after the effective date of the statute. SEC staff recommended denial of the bounty request on the grounds that the latter information did not result in the addition of any defendants, securities transactions or violations to the complaint.

- In 2001, the Commission denied the bounty request of Claimant 9. The Commission asserted that Claimant 9 had provided fictitious information that resulted in the unnecessary use of staff resources, and falsely claimed to have provided information to the Chicago Board Options Exchange, which had earlier alerted the Commission to suspicious trading.

- In 2004, the Commission denied the joint bounty request of Claimant 10, Claimant 11, and Claimant 12, three brokerage employees. The Commission recommended denial on the grounds that the initial information about insider trading had been provided by the brokerage firm's general counsel's office. The SEC did not seek or obtain any information directly from Claimant 11 or Claimant 12.

In addition to the aforementioned bounty applications that were formally approved or denied by the Commission, we determined that from January 1, 2005 to January 1, 2010, the SEC received approximately 30 other bounty applications, but did not formally take action to approve or deny any of them and did not notify the bounty applicant accordingly. The person responsible for overseeing the SEC bounty program stated that this occurred because the Commission only makes a formal bounty determination and provides notice to an applicant when the bounty information results in the recovery of an insider trading civil penalty in accordance with the Exchange Act. Thus, while the Commission has made formal determinations with respect to all persons that it deemed eligible for award in accordance with the statute, the 30 bounty applicants were never notified of the results of the SEC's review.

Further, we found that while the Commission reported in its 2009 Performance and Accountability Report that only 6 percent of the Commission's Enforcement cases in Fiscal Year 2009 related to insider trading,[8] the SEC filed or initiated 37 insider trading cases in 2009. However, only one payment was approved under the SEC bounty program during Fiscal Year 2009. Additionally, the SEC filed or initiated a total of 204 insider trading cases between Fiscal Years 2005 - 2008, but only approved three payments under the SEC bounty program. Based on the number of insider trading cases initiated by the Commission during the past five years, it would appear that there could have been more utilization of the SEC bounty program.

We believe that the minimal use of the SEC bounty program can be attributed primarily to the fact that the program has not been widely publicized, internally within the agency or externally to the public. We found that general information

[8] http://www.sec.gov/about/secpar2009.shtml, Chart 2.10, at page 34.

on how to apply for a bounty can be found on the SEC's public website, but there is no contact information or e-mail address to which potential bounty claimants can send questions. Also, there is no application form, only instructions on what type of information should be included in a narrative format.[9] The SEC also developed an informational pamphlet for the bounty program that was intended to be used as an educational device to be routinely sent by staff to individuals who provide information that might lead to award of a bounty. While the pamphlet is a good tool for marketing the program, we found no evidence that staff members are generally aware of the pamphlet and provide it routinely to potential bounty applicants. In addition, the SEC has publicly released only limited information on Commission decisions regarding bounty awards and denials. Commission officials provided information showing that with the exception of one payment and one denial, the identity of bounty applicants has not been disclosed publicly, nor has the SEC disclosed that all bounty payments have been for the maximum 10 percent permitted by the statute. The years in which bounties have been awarded and the total amount of the payments, however, have been disclosed.

In addition, based on discussions with various senior Enforcement staff in headquarters as well as the regional offices, we found varying degrees of knowledge regarding the SEC bounty program among Commission staff. Some staff who had received bounty applications for further consideration remarked that they knew nothing about the bounty program, while others had some knowledge of the workings of the program and associated laws and regulations. Therefore, more extensive marketing of the program both internally and externally is necessary to ensure Commission staff, as well as potential whistleblowers, are aware of the program. This holds especially true for staff who are in positions where they evaluate whistleblower information.

We learned through discussions with responsible Commission officials that there has been extensive work performed by the Office of the Chairman, Enforcement, and the Office of General Counsel (OGC) on drafting proposed legislation to revamp the current bounty program in the wake of the Bernard Madoff scandal. The proposed legislation, among other things, would provide expanded authority for the program to permit bounties in connection with any judicial or administrative action brought by the Commission under the securities laws that result in monetary sanctions exceeding $1,000,000. The proposed legislation was included in the Investor Protection Act of 2009 (H.R. 3817), which was introduced in the U.S. House of Representatives on October 15, 2009 by Representative Paul Kanjorski and referred to the House Committee on Financial Services. We are encouraged by the actions the Commission has taken and support the timely passage of the proposed legislation as a necessary step to develop a successful SEC whistleblower/bounty program. Additionally, the SEC

[9] http://www.sec.gov/divisions /enforce/insider.htm.

has begun to explore ways to more extensively market the bounty program in an effort to increase awareness both inside and outside the Commission.

Recommendation 1:

The Division of Enforcement should develop a communication plan to address outreach to both the public and Securities and Exchange Commission (SEC) personnel regarding the SEC bounty program. The plan should include efforts to make information available on the SEC's intranet, enhance information available on the SEC's public website, and provide training to employees who are most likely to deal with whistleblower cases.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Finding 2: Standardized Bounty Application Forms Would Help Make the Bounty Application Process More User Friendly for Whistleblowers

Information on the SEC's public website regarding how an individual may apply for a bounty can be misleading and potentially a deterrent to prospective whistleblowers.

With regard to how and when a prospective whistleblower may apply for a bounty, the SEC's public website currently states in a section entitled, "How and When Do You Apply for a Bounty?" as follows:

> An application must be clearly marked as an "Application for Award of a Bounty," and must contain the information required by the Commission's rules. The application must give a detailed statement of the information that the applicant has about the suspected insider trading.
>
> Any person who desires to provide information to the Commission that may result in the payment of a bounty may do so by any means desired. The Commission encourages

> persons having information regarding insider trading to provide that information in writing, either at the time they initially provide the information to the Commission or as soon as possible afterwards. Providing information in writing reduces the possibility of error, helps assure that appropriate action will be taken, and minimizes subsequent burdens and the possibility of factual disputes. In any event a written application for a bounty must be filed with 180 days after the day on which the court orders payment of the civil penalty.[10]

The SEC's website also includes in a subsequent section entitled, "Statutory and Regulatory Provisions," the Commission rules for bounty applications. Rule 64 Form of application and information required, states that "[e]ach application pursuant to this subpart shall be identified as an Application for Award of a Bounty and shall contain a detailed statement of the information provided by the applicant that the applicant believes led or may lead to the imposition of a penalty."[11] The rule also states that "[w]hen the application is not the means by which the applicant initially provides such information, each application shall contain: the dates and times upon which, and the means by which, the information was provided; the identity of the Commission staff members to whom the information was provided; and if the information was provided anonymously, sufficient further information to confirm that the person filing the application is the same person who provided the information to the Commission."[12]

Based on this language, a bounty applicant may be unclear as to what constitutes an acceptable application, i.e., what level of detail should be provided, if supporting documents should be included or referenced, etc. During our review we found that many bounty applications were essentially generalized tips and complaints about potential insider trading based on public information without any real evidence or actual knowledge that an individual or individuals used material non-public information when purchasing or selling securities.

To illustrate, one bounty application included in our sample that was referred to a senior official in headquarters by the bounty program for further consideration stated:

> Company A doubled in price with extremely high volume prior to the announcement that Company B had loaned them (Company A) millions of $ to help in preventing bankruptcy. This possible insider trading occurred on Tuesday Aug 18. [13]

[10] http://www.sec.gov/divisions/enforce/insider.htm, at p. 2.
[11] Id. at 4.
[12] Id.
[13] Information obtained from SEC bounty file maintained by the Office of Chief Counsel within the Division of Enforcement.

Because the bounty application was vague, the senior official that received it stated that it was not useful or relevant to his ongoing investigation into the subject. Additionally, the senior official dismissed the tip without contacting the bounty applicant to determine if he had further information.

For another bounty application, the bounty applicant alleged the existence of a "wide ranging community of individual investors and investing business entities who willingly participate in, for lack of a better term, a group that trades on selected equities in various ways for the purpose of can't lose investment transactions." [14] The senior-level official who received the bounty application for further consideration stated that the complaint was not specific as to the securities (or even category of securities) in which the alleged insider trading occurred and contained no information on how insider trading information was allegedly shared. Further, the bounty applicant had submitted previous complaints of wide-ranging conspiracies that the official deemed to lack credible support upon which to base an investigation. Therefore, the bounty application was dismissed without further action.

As part of our review, we contacted some bounty applicants to obtain feedback regarding the bounty application process. One individual stated that it would be useful if the SEC had a link on its website to an application form that can be downloaded. Another individual stated that he had additional information to support his bounty application, but that no one from the SEC had contacted him to follow up and ask for supporting information.

To help ensure that bounty applications are complete and the information provided is useful, we believe the Commission should develop a standardized electronic form that can be downloaded. Also, at a minimum, whistleblowers should be asked to provide the following information, in addition to relevant contact information:

- The facts pertinent to the alleged securities law violation and explanation as to why the subject(s) violated the securities laws.

- A list of related supporting documentation in the whistleblower's possession and/or available from other sources.

- A description of how the whistleblower learned about/and or obtained the information that supports the claim, including the whistleblower's relationship to the subject(s).

[14] Id.

- The amount of any monetary rewards reaped by the subject violator (if known) as a result of the securities violation and how the amount was calculated.

- A certification that the application is true, correct, and complete to the best of the whistleblower's knowledge.

Additionally, the Commission should follow up with whistleblowers, where appropriate, regarding their applications to ensure all available information has been obtained in order to effectively evaluate whether the information should result in further investigation.

Recommendation 2:

The Division of Enforcement should develop and post to its public website an application form that asks the whistleblower to provide information, including:

(1) The facts pertinent to the alleged securities law violation and an explanation as to why the subject(s) violated the securities laws;
(2) A list of related supporting documentation in the whistleblower's possession and available from other sources;
(3) A description of how the whistleblower learned about or obtained the information that supports the claim including the whistleblower's relationship to the subject(s);
(4) The amount of any monetary rewards obtained by the subject violator(s) (if known) as a result of the securities law violation and how the amount was calculated; and
(5) A certification that the application is true, correct, and complete to the best of the whistleblower's knowledge.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Recommendation 3:

The Division of Enforcement should establish policies on when to follow up with whistleblowers who submit applications to clarify information in the bounty applications and obtain readily available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Finding 3: Criteria for Judging Bounty Applications Are Broad and Somewhat Vague

> The criteria for judging bounty applications are broad, somewhat vague and not subject to judicial review. As a result, the criteria may not be consistently applied by Enforcement staff.

Although the Commission adopted bounty program regulations to provide a structure for the orderly administration of the process for making bounty payments, the regulations essentially repeat, instead of clarifying or supplementing, much of the language found in the statute regarding bounty determinations.

The Code of Federal Regulations (CFR), Title 17: *Commodity and Securities Exchanges, Part 201- Rules of Practice, Subpart C - Procedures Pertaining to the Payment of Bounties Pursuant to Subsection 21A(e) of the Securities Exchange Act of 1934*, Section 201.61, *Scope of Subpart*, states as follows:

> Section 21A of the Securities and Exchange Act of 1934 authorizes the courts to impose civil penalties for certain violations of that Act. Subsection 21A(e) permits the Commission to award bounties to persons who provide information that leads to the imposition of such penalties. Any such determination, including whether, to whom, or in what amount to make payments, is in the sole discretion of the Commission. This subpart sets forth procedures regarding applications for the award of bounties pursuant to Subsection 21A(e). Nothing in this subpart shall be deemed to limit the discretion of the Commission with respect to determinations under subsection 21A(e) or to subject any such determination to judicial review.

Additionally, Section 201.68, *No promises of payment,* states as follows:

> No person is authorized under this subpart to make any offer or promise, or otherwise to bind the Commission with respect to the payment of any bounty or the amount thereof.

Because of the use of language such as "information that leads to the imposition of such penalties" and "in the sole discretion of the Commission," the criteria for a bounty award are broad and subject to interpretation. In addition, Enforcement does not have internal policies and procedures to assist Commission staff in assessing contributions that are made by whistleblowers and recommending bounty award determinations. The Commission should establish internal policies and procedures to provide more specific guidelines for awarding bounties.

Recommendation 4:

The Division of Enforcement should develop specific criteria for recommending the award of bounties, including a provision that where a whistleblower relies partially upon public information, such reliance will not preclude the individual from receiving a bounty.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Finding 4: More Frequent Communication with Whistleblowers is Needed

The Commission does not routinely provide status reports to whistleblowers regarding their bounty applications, even if there is an ongoing investigation or examination. This practice could discourage individuals from continuing to utilize the program and from providing useful follow-up information to their bounty applications.

We found that the SEC bounty program only provides written notification to whistleblowers regarding the status of their bounty applications to:

(1) Acknowledge receipt of the applications; and
(2) Notify them if formal determinations are made by the SEC with respect to their bounty applications.

According to Commission officials, a formal determination is made only if the information provided by the whistleblower leads to an insider trading civil penalty being imposed by the court in a Commission civil action, and the penalty has actually been paid by the defendant. Consequently, if a whistleblower's information was never pursued for one reason or another, or was pursued but did not lead to an insider trading penalty being recovered, the whistleblower would typically not receive any correspondence from the SEC regarding the status of his or her bounty request, other than the initial acknowledgement letter. This may result in a whistleblower wondering if the information provided even made it into the right hands. The initial acknowledgement letter sent to whistleblowers includes the following language:

> This is to acknowledge receipt of your Application for Award of a Bounty, dated XX.
>
> You may be assured that the information you have provided will receive full consideration by the Commission's staff. Information from members of the public is an important source of information to the Commission in the conduct of its law enforcement functions.
>
> As a matter of policy, the Commission staff can neither affirm nor deny the existence of any investigation arising from the information you have provided until it files a public enforcement action. This policy is intended to prevent premature disclosure of information that may interfere with the successful completion of an investigation, and to protect the privacy of persons who have not been formally charged with violations of laws.
>
> All determinations with respect to bounties are made at the Commission's discretion and no determinations are made until a civil penalty has been imposed and actually recovered in a Commission enforcement action. Section 21A(e) of the Securities Exchange Act of 1934 [15 U.S.C. 78u-1(e)]. You will be informed of any determination in accordance with our bounty regulations. See 17 C.F.R. 201.61-68.[15]

While we acknowledge that Commission staff cannot release non-public or sensitive information during the course of an investigation, the Commission should examine ways to notify whistleblowers of the status of their bounty

[15] Code of Federal Regulations, Title 17: Commodity and Securities Exchanges, Part 201-Rules of Practice, Subpart C-Procedures Pertaining to the Payment of Bounties Pursuant to Subsection 21A(e) of the Securities Exchange Act of 1934, Sections 201.61-201.68.

requests beyond simply acknowledging receipt of the applications. This is especially needed when a whistleblower's information results in an investigation that may take years to close.

Recommendation 5:

The Division of Enforcement, in consultation with the Office of General Counsel, should examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests, without releasing non-public or confidential information during the course of an investigation or examination.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Finding 5: Better Tracking of the Use of Whistleblower Information is Needed

While we generally found that the SEC conducted an initial cursory review of bounty applications and forwarded them to appropriate senior-level program staff in the headquarters and regional offices for further consideration, we found that the recipient offices handled the applications on an individualized, *ad hoc* basis. Consequently, better tracking of bounty applications and related information is needed to ensure that bounty information is timely reviewed by experienced Commission staff and significant decisions are documented.

Bounty applications received by the Commission are either filed after recovery of an insider trading civil penalty or prior to payment of an insider trading civil penalty, in connection with a tip or complaint about alleged insider trading.

When an insider trading civil penalty has already been recovered and a related bounty application is received by the Office of the Secretary, the application is forwarded to the Office of the Chief Counsel (OCC) in Enforcement. OCC then contacts the appropriate staff in the headquarters or regional office responsible for the case in which the insider trading civil penalty was recovered and forwards them a copy of the bounty application. If the applicant's information pertains to a

case in which there was recovery of an insider trading civil penalty, the office to whom the bounty application was referred may recommend that the Commission grant a bounty up to 10 percent of the amount recovered as an insider trading penalty. In those cases, the responsible headquarters or regional office, in consultation with OCC and OGC, prepares an action memorandum, which is then provided to the Chairman and Commissioners for final approval. Since inception of the bounty program, formal recommendations have only been prepared in response to 10 bounty applications, where there was recovery of an insider trading civil penalty.

When applications are filed prior to the assessment of an insider trading civil penalty, the Office of the Secretary forwards the application to OCC. OCC then performs a search of the Commission's electronic databases (NRSI,[16] CATS 2000,[17] and the HUB[18]) to determine whether the application relates to conduct that is already the subject of an Enforcement investigation or action. If there is an investigation or action related to the conduct described in the application, the application is referred to the staff responsible for the investigation or action. If the database search does not result in the identification of an ongoing investigation or action, OCC staff determines the appropriate staff to whom the application should be directed. If the application alleges misconduct by officers, directors, or employees of a public company, OCC staff will determine the headquarters location of the issuer. The application will be referred to staff in the Commission office with responsibility for that geographic location. If the application alleges misconduct by individuals who are in a location other than the SEC region in which the issuer is headquartered, the application is referred to staff in the Commission office with responsibility for that geographic location. If the application does not contain information sufficient to identify the location of the alleged insider traders, the application is referred to staff in the Commission office with responsibility for the geographical location in which the whistleblower resides.

Referrals of bounty applications to Commission staff are generally accompanied by a memorandum that states as follows:

> Attached is a copy of a bounty application submitted by X. The claim involves alleged insider trading violation by X company through its X office. The application seeks an insider trading bounty under Section 21A(e) of the Exchange

[16] Name Relationship Search Index (NRSI) provides an index to names contained in various internal and external automated SEC information systems, including filings with the Division of Corporation Finance, and Division of Enforcement inquiries and investigations.
[17] Case Activity Tracking System (CATS 2000) provides case tracking and workflow management for Division of Enforcement offices nationwide.
[18] HUB interfaces with CATS 2000 and provides case management and tracking for Division of Enforcement offices nationwide including the ability to produce various reports.

> Act. I have sent a letter acknowledging receipt of the application. A copy of my letter is attached.
>
> I am referring this matter to your office for such further action as you may consider appropriate.

The whistleblower is also sent an acknowledgement letter, as discussed previously.

During our review, we interviewed responsible Commission staff in Enforcement at headquarters, as well as Enforcement staff from three regional offices to gain an understanding of how offices tracked and utilized bounty application information. We also examined nine out of approximately 30 bounty applications (30 percent) submitted to the Commission between January 1, 2005 and January 1, 2010 (that were neither formally approved or denied by the Commission), to determine if sufficient documentation existed to support timely and appropriate handling of the bounty applications. Further, we reviewed supporting documentation pertaining to five bounty applications that were formally denied by the Commission to determine if adequate documentation was maintained by the Commission to support the denial of the applications.

We found that adequate documentation existed to support the disposition of the five bounty applications that were formally denied by the Commission. However, documentation was not readily available from OCC to show the disposition for the nine bounty applications that were forwarded to Enforcement staff in headquarters and the regional offices for further consideration, but were not formally approved or denied.

We found that once a bounty application is referred by OCC to the appropriate senior-level official in headquarters or a regional office, it is up to that official to take whatever action he or she deems necessary and to document the results of any decisions that are made, according to that office's procedures. Based on our review of available documentation from Enforcement staff in headquarters and three regional offices pertaining to the nine sampled bounty applications, it appears that the bounty applications were generally reviewed timely. However, we found that one application had been referred to a regional office on November 18, 2009, by OCC and was still awaiting review as of January 6, 2009. We also found that Enforcement staff conducted preliminary reviews of the information contained in the bounty applications they received, but did not routinely go back to bounty applicants to clarify information or ask for additional supporting documentation. Rather, general or vague bounty applications were typically dismissed. In addition, for two of the nine bounty applications, we were unable to obtain specific information pertaining to the handling of the applications. We did find that based on information provided by one whistleblower, the responsible

regional office filed both criminal and civil actions and also provided assistance to the whistleblower in the preparation of his bounty application. The whistleblower, however, was not awarded a bounty because no insider trading penalty was recovered. Lastly, we found that Enforcement staff documented the results of their reviews of bounty applications and decisions made using different methods, including personal notes and files and/or use of the Commission's electronic complaint handling system (CTR 2009), as well as the HUB case tracking system.

The SEC has recently taken steps to improve its ability to handle and track all tips and complaints. In February 2009, the SEC retained The MITRE Corporation: Center for Enterprise Modernization[19] to complete a comprehensive review of internal procedures for evaluating tips, complaints, and referrals. The OIG has learned that the project is intended to be significant in scope. On August 5, 2009, Enforcement announced the creation of the Office of Market Intelligence (OMI). OMI is Enforcement's liaison to the Agency's Tip, Complaint, and Referral (TCR) process and system, which is responsible for the collection, analysis, risk-weighing, triage, referral and monitoring of the hundreds of thousands of tips, complaints and referrals that the Commission receives each year. By analyzing each tip according to internally-developed risk criteria and making connections between and among tips from different sources, Enforcement hopes to be able to better focus its resources on the tips that have the greatest potential for uncovering wrongdoing. OMI will also utilize the expertise of the SEC's other divisions and offices as well as the newly-created specialized units within Enforcement, to help analyze tips and identify securities law violations.

We believe that the Commission should incorporate necessary management controls in its new TCR process and information technology system to include complaints and tips from whistleblower's who seek a bounty, in addition to other types of tips and complaints. This will help ensure that bounty applications are appropriately and timely evaluated by experienced Commission staff and bounty application information can be linked with other related complaints and tips.

Recommendation 6:

The Division of Enforcement should develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of its tip, complaints and referral processes and systems for other tips and complaints. These controls should provide for the collection of necessary information and require processes that will help

[19] The MITRE Corporation: Center for Enterprise Modernization (www.mitre.org) is a not-for-profit organization that provides systems engineering, research and development, and information technology support to the government.

ensure that bounty applications are reviewed by experienced Commission staff, decisions whether to pursue whistleblower information are timely made, and whistleblowers that provide significant information leading to a successful action for violation of the securities laws.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Finding 6: Bounty Files Did Not Always Contain Complete Information

Some bounty files maintained by OCC were missing key documents.

We obtained and reviewed the hard-copy bounty files maintained by OCC (OCC's primary recordkeeping method for the bounty program) for the nine sampled bounty applications. We found that generally the bounty files maintained by OCC contained a copy of the bounty application, an acknowledgement memorandum that was sent to the bounty applicant to acknowledge receipt of their application, and a copy of a memorandum showing to which senior-level official within the Commission the bounty application was forwarded for consideration. However, for the nine bounty applications the OIG reviewed, we found in some instances that not all these documents were maintained.

Specifically, we found:

- For one of nine bounty files, the actual bounty application was missing.
- For three of nine bounty files, a copy of the acknowledgement memorandum that was sent to the whistleblower was missing. However, there was mention in other documentation in the file that an acknowledgement memorandum was sent.
- For two of nine bounty files, the memorandum showing to which headquarters or regional office that OCC referred the bounty application for further consideration was missing.

We believe that, at a minimum, OCC should maintain copies of pertinent data pertaining to bounty applications, including the application itself, a copy of any correspondence with the whistleblower, and documentation showing the Commission office(s) to which the information was referred for action.

Recommendation 7:

The Division of Enforcement should require that a bounty file (hard copy or electronic) be created for each bounty application. The file should contain at a minimum the bounty application, any correspondence with the whistleblower, documentation of how the whistleblower's information was utilized, and documentation regarding significant decisions made with regard to the whistleblower's complaint.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Finding 7: SEC Bounty Program Should Incorporate Best Practices from other Agencies with Whistleblower Programs

The IRS and the DOJ are two large government agencies that use whistleblower programs to identify cases that would otherwise go undetected. There is some evidence that DOJ's whistleblower program has played a role in the increase of civil recoveries obtained by DOJ over a 10-year period. The IRS also has a system in place under which it provides bounties to individuals who present the IRS with information leading to the collection of federal taxes.

We reviewed documentation related to these whistleblower programs and identified several best practices that the Commission should adopt in developing a successful SEC bounty program. In order to protect the confidentiality of privileged information we obtained during our review, the best practices are summarized and not specifically identified with a particular agency. We identified best practices related to tracking and handling whistleblower-type complaints as follows:

- Establishment of a separate "Whistleblower Office" staffed with experienced officials that handles intake of whistleblower complaints and

referral of complaints to other offices as appropriate, while maintaining authority to make award determinations.

- Continual tracking and documentation of the handling of whistleblower complaints through a case tracking system, including information pertaining to the identification of the whistleblower and any representatives, actions taken to assign whistleblower claims to applicable offices and individuals, and the status of significant decisions made and still needed with regard to outstanding whistleblower claims (e.g., whether a claim will be paid and in what amount).

- Use of standardized forms for the intake of whistleblower information as well as recording significant decisions made by operating divisions while processing a whistleblower claim (i.e. operating division assessments on how a whistleblower's information aided in collection of funds pertaining to an examination).

- Initial analysis of whistleblower information by the Whistleblower Office and then by Operating Division subject matters experts to evaluate the information and determine whether it may materially contribute to a case or examination. Additionally, subject matter experts meet with whistleblowers to clarify the whistleblowers' submissions as necessary, gather information about the credibility of the whistleblowers, obtain information regarding legal issues that can affect the use of documents, and obtain possible leads to other sources of information.

- Requirement that routine feedback in the form of status reports be provided to the Whistleblower Office by Operating Divisions regarding the status of cases and examinations that pertain to whistleblower complaints.

- Establishment of a whistleblower award file (created in addition to a regular case file) that is sent by Operating Divisions at the conclusion of an examination to the Whistleblower Office that contains pertinent forms and data to enable the Whistleblower Office to make an award determination.

- Establishment of a requirement that whistleblower complaints be reviewed and pursued, if applicable, within a specified time frame.

- Continual assessment of whistleblower programs through feedback sought from Operating Divisions and others involved in processing whistleblower claims.

Through discussions with Commission officials responsible for drafting the recent proposed legislation to expand the SEC's authority to reward whistleblowers, we learned that the Commission met extensively with representatives from both DOJ and the IRS to identify best practices for revamping the SEC's current bounty program. Commission officials stated they plan to incorporate many of these best practices into implementing regulations and policies and procedures, as appropriate, upon passage of the proposed legislation. Until such time as this legislation may be passed, the Commission should begin to incorporate best practices we identified from DOJ and the IRS.

Recommendation 8:

We recommend that the Division of Enforcement incorporate best practices from the Department of Justice and the Internal Revenue Service into the Securities and Exchange Commission bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Recommendation 9:

We recommend that the Division of Enforcement set a timeframe to finalize new policies and procedures for the Securities and Exchange Commission bounty program that incorporate the best practices from Department of Justice and the Internal Revenue Service, as well as any legislative changes to the program.

Management Comments. Concur. See Appendix V for management's full comments.

OIG Analysis. We are pleased that Enforcement concurred with this recommendation.

Acronyms and Abbreviations

DOJ	Department of Justice
Enforcement	Division of Enforcement
Exchange Act	Securities Exchange Act of 1934
IRS	Internal Revenue Service
ITSEA	Insider Trading and Securities Fraud Enforcement Act of 1988
OCC	Office of Chief Counsel, Division of Enforcement
OIG	Office of Inspector General
OMI	Office of Market Intelligence
SEC or Commission	U.S. Securities and Exchange Commission
TCR	Tip Complaint and Referral Process

Scope and Methodology

This review was not conducted in accordance with the government auditing standards.

Scope. We examined Enforcement program activities related to the SEC bounty program since its inception in 1989, and assessed whether necessary management controls have been established and operate effectively to ensure bounty applications are routed to appropriate personnel and are properly processed and tracked. We also determined whether other government agencies with similar programs have best practices that could be incorporated into the SEC bounty program. Fieldwork was performed during December 2009 and January 2010.

Methodology. In order to accomplish our audit objectives, we reviewed applicable Commission policies and procedures pertaining to the SEC bounty program; interviewed personnel from the Office of the Chairman, Enforcement and three regional offices to understand how bounty applications are processed; reviewed documentation to support all ten bounty applications that were formally approved or denied; and selected a sample of bounty applications that were not formally approved or denied to determine if sufficient documentation existed to support timely and appropriate handling of bounty applications. We also gathered information regarding the IRS and DOJ whistleblower programs to identify best practices.

Judgmental Sampling. We judgmentally selected a sample of nine out of approximately 30 bounty applications that were received by the Commission, but were not formally approved or denied. We then reviewed applicable files and documentation maintained by Enforcement as well as three of the 11 regional offices to determine whether the bounty applications were tracked, reviewed by experienced Commission staff and appeared to be appropriately handled.

Prior OIG Coverage. This review was conducted as a result of an issue that we identified during OIG's investigation into the SEC examination and investigations of Bernard L. Madoff and related entities, OIG's Report of Investigation, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme,* Report No. 509, August 31, 2009.

Criteria

Section 21A(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-1(e), as added by the Insider Trading and Securities Fraud Enforcement Act of 1988, Public Law 111-72 (enacted on October 13, 2009). Authorizes the SEC to award a bounty to a person who provides information leading to the recovery of a civil penalty from an insider trader, from a person who tipped information to an insider trader, or from a person who directly or indirectly controlled an insider trader. All bounty determinations, including whether, to whom, or in what amount to make payments, are within the sole discretion of the SEC, however, the total bounty may not currently exceed 10 percent of the amount recovered from a civil penalty pursuant to a court order.

17 C.F.R., Part 201, Subpart C- Procedures Pertaining to the Payment of Bounties Pursuant to subsection 21A(e) of the Securities Exchange Act of 1934. Sets forth procedures regarding applications for the award of bounties pursuant to Subsection 21A(e) of the Securities and Exchange Act of 1934.

List of Recommendations

Recommendation 1:

The Division of Enforcement should develop a communication plan to address outreach to both the public and the Securities and Exchange Commission (SEC) personnel regarding the SEC bounty program. The plan should include efforts to make information available on the SEC's intranet, enhance information available on the SEC's public website, and provide training to employees who are most likely to deal with whistleblower cases.

Recommendation 2:

The Division of Enforcement should develop and post to its public website an application form that asks the whistleblower to provide information, including, for example (1) the facts pertinent to the alleged securities law violation and an explanation as to why the subject(s) violated the securities laws; (2) a list of related supporting documentation available in the whistleblower's possession and available from other sources; (3) a description of how the whistleblower learned about or obtained the information that supports the claim including the whistleblower's relationship to the subject(s); (4) the amount of any monetary rewards obtained by the subject violator(s) (if known) as a result of the securities law violation and how the amount was calculated; and (5) a certification that the application is true, correct, and complete to the best of the whistleblower's knowledge.

Recommendation 3:

The Division of Enforcement should establish policies on when to follow-up with whistleblowers who submit applications to clarify information in the bounty applications and obtain readily available supporting documentation prior to making a decision as to whether a whistleblower's complaint should be further investigated.

Recommendation 4:

The Division of Enforcement should develop specific criteria for recommending the award of bounties, including a provision that where a whistleblower relies partially upon public information, such reliance will not preclude the individual from receiving a bounty.

Recommendation 5:

The Division of Enforcement, in consultation with the Office of General Counsel, should examine ways in which the Commission can increase communications with whistleblowers by notifying them of the status of their bounty requests without releasing non-public or confidential information during the course of an investigation or examination.

Recommendation 6:

The Division of Enforcement should develop a plan to incorporate controls for tracking tips and complaints from whistleblowers seeking bounties into the development of its tip, complaints and referral processes and systems for other tips and complaints. These controls should provide for the collection of necessary information and require processes that will help ensure that bounty applications are reviewed by experienced Commission staff, decisions whether to pursue whistleblower information are timely made, and whistleblowers that provide significant information leading to a successful action for violation of the securities laws.

Recommendation 7:

The Division of Enforcement should require that a bounty file (hard copy or electronic) be created for each bounty application. The file should contain at a minimum the bounty application, any correspondence with the whistleblower, documentation of how the whistleblower's information was utilized, and documentation regarding significant decisions made with regard to the whistleblower's complaint.

Recommendation 8:

We recommend that the Division of Enforcement incorporate best practices from the Department of Justice and the Internal Revenue Service into the Securities and Exchange Commission bounty program with respect to bounty applications, analysis of whistleblower information, tracking of whistleblower complaints, recordkeeping practices, and continual assessment of the whistleblower program.

Recommendation 9:

We recommend that the Division of Enforcement set a timeframe to finalize new policies and procedures for the Securities and Exchange Commission bounty program that incorporate the best practices from Department of Justice and the Internal Revenue Service, as well as any legislative changes to the program.

Management Comments

MEMORANDUM

TO: H. David Kotz, Inspector General, Office of Inspector General

FROM: Robert Khuzami, Director, Division of Enforcement

RE: Enforcement's Response to the Office of Inspector General's Report, Assessment of SEC Bounty Program, Report No. 474

DATE: March 24, 2010

This memorandum is in response to the Office of Inspector General's Draft Report No. 474, entitled *Assessment of SEC Bounty Program*. Thank you for the opportunity to review and respond to this report. We concur in the report's recommendations.

Early last year, Chairman Schapiro directed staff to begin working to establish a world-class whistleblower program. To that end, we conducted an extensive review of whistleblower programs at other governmental agencies and the Financial Industry Regulatory Authority (FINRA) to identify best practices for administering a successful program at the SEC. Our effort resulted in legislation currently under consideration by Congress that would create a new, more-comprehensive whistleblower program related to all securities violations.

As a result of our review, and as noted in your report, Division leadership was aware, prior to the audit, of the issues with the insider trading bounty program raised in your report. The Division's independent findings, and its plans for developing a new whistleblower program, are consistent with those set forth in the report.

In addition, it is not surprising that only a small percentage of insider trading cases have been initiated as a result of tips submitted through the insider trading bounty program. The vast majority of insider trading cases arise from routine surveillance performed by the SEC staff and the Self-Regulatory Organizations (SROs), such as FINRA and the stock exchanges, and not from tips submitted by members of the public. For example, of the 37 insider trading actions brought by the Commission in FY 2009, 31 were the result of surveillance by the SROs or the Division itself. We believe the principal reason that the current bounty program has not yielded more rewards derives more from its relatively narrow scope and the confidential nature of insider trading violations than from the procedural shortcomings we recognize exist. Notwithstanding the program's limitations, the Commission has an excellent track record of paying eligible claimants, as each award has been for the maximum amount allowed by the bounty statute

The proposed whistleblower legislation was drafted principally to broaden the nature of wrongdoing for which whistleblowers could receive a bounty. In our efforts to craft this new program, however, great care was taken to address and avoid problems identified with the insider trading bounty program, including our desire to establish a formal program with dedicated staff and state-of-the-art policies and procedures. If the proposed legislation is enacted, the new

whistleblower program would not be an extension of the current insider trading bounty program. Instead, it would subsume the existing program and, thereby, constitute an entirely new program based on the structure and best practices of other successful whistleblower programs.

We also have taken other steps that we believe will address some of the recommendations. As indicated in the Draft Strategic Plan for 2010-2015, the Commission is centralizing the process for receiving, reviewing, and acting upon tips, complaints and referrals (TCRs) so they can be handled consistently and appropriately, including through examinations or enforcement investigations. In connection with this effort, the Commission hired the MITRE Corporation to assist in revamping our intake, triage and analysis of TCRs, and has adopted a new agency-wide policy for handling TCRs, embodied in *Tips, Complaints, and Referrals Intake Policy*, Securities Exchange Commission Regulation 3-2, March 10, 2010 (SECR 3-2). The Division has adopted supplemental guidance to implement this policy. Division of Enforcement, *Interim Policies and Procedures for Handling Tips, Complaints and Referrals (TCRs)* (March 24, 2010).

The Division's new Office of Market Intelligence (OMI) will consolidate the Division's handling of TCRs in accordance with SECR 3-2 and our supplemental guidance. The principal functions of OMI will include coordination, consolidation and management of the Division's processes with respect to TCRs that come to the Division's attention from any internal or external source. Tips received through the insider trading bounty program will be covered by the Commission's new TCR policy, as will the tips and complaints covered by the proposed new whistleblower legislation. We have considered OIG's report in light of these developments.

While we concur with the recommendations, it is our hope that pending legislation before the Congress, as noted above, will create a new program wholly replacing the current one. In such a case, we believe it would be appropriate to address many of the recommendations below through enactment of policies and procedures involving the agency's new authority as opposed to embarking upon modifications of the current insider trading bounty program, which we hope will soon be superseded.

Recommendation 1 relates to communicating information about the bounty program, both externally and internally. We concur and will develop a plan consistent with this recommendation.

Recommendation 2 relates to the development of a form for requesting information from whistleblowers. We concur with this recommendation. In connection with the revamped TCR system, the electronic form in which information is collected will be updated, and we expect to have a form directed specifically to whistleblowers.

Recommendation 3 relates to policies for follow-up with whistleblowers to obtain any additional information they may have. We concur with this recommendation. The Division will be developing processes and procedures for follow up with whistleblowers.

Recommendation 4 relates to the criteria for recommending the award of bounties. We concur with this recommendation. The Division will develop criteria consistent with this recommendation.

Recommendation 5 relates to the examination of ways to provide notice to whistleblowers as to the status of their bounty requests. We concur with this recommendation. The Division will work with the Office of General Counsel to address this recommendation.

Recommendation 6 relates to controls for tracking tips and complaints from whistleblowers. We concur with this recommendation. The Commission's TCR project has already focused on particular capabilities necessary to track whistleblower tips and complaints, and the system currently in development will incorporate controls to ensure that tips are reviewed and track whether timely decisions are made whether to pursue tips.

Recommendation 7 relates to maintenance of whistleblower complaint files. We concur with this recommendation. The Division will adopt procedures for creation and retention of information relevant to a whistleblower complaint.

Recommendation 8 relates to incorporation of best practices from the Department of Justice and the Internal Revenue Service with respect to bounty applications. We concur with this recommendation. As the report notes, the Division has already met with these agencies to identify best practices. The Division will adopt best practices for the existing insider trading bounty program or will incorporate such practices into any new program should the proposed legislation be enacted.

Recommendation 9 relates to formulation of a timeline for policies and procedures for the existing bounty program. We concur with this recommendation. The Division will develop an appropriate timeline.

Office of Inspector General Response to Management's Comments

We are pleased that Enforcement fully concurred with all nine of the report's recommendations and are encouraged that the SEC has begun to take steps to correct the identified deficiencies.

Enforcement noted in its response that it believes the principal reason that the current bounty program has not yielded more rewards derives more from its relatively narrow scope and the confidential nature of insider trading violations than from procedural shortcomings that it recognizes exists. Enforcement further stated that the newly proposed whistleblower legislation was drafted principally to broaden the nature of wrongdoing for which whistleblowers could receive a bounty.

As we discussed in our report, although we noted the limitations in scope, we also found that the minimal use of the SEC bounty program can be attributed to the fact that the program has not been widely publicized and that information on the SEC's public website was misleading and may have deterred prospective whistleblowers from applying. We also found that more frequent communication with whistleblowers would encourage applications.

We believe it is critical for the SEC to implement the report's recommendations to ensure that it has a fully functioning and successful bounty program in place as its authority is potentially expanded.

Audit Requests and Ideas

The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at:

U.S. Securities and Exchange Commission
Office of Inspector General
Attn: Assistant Inspector General, Audits (Audit Requests/Ideas)
100 F Street, N.E.
Washington D.C. 20549-2736

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3238 P STREET. N.W. WASHINGTON, DC 20007 | 202-342-1902 (tel) 202-342-1904 (fax) | WWW.WHISTLEBLOWERS.ORG

February 10, 2011

Commissioners
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: SEC Rule Making Proceeding -File Number S7-33-10
Whistleblower Regulations – Dodd-Frank Act
Foreign Corrupt Practices Act

Dear Commissioners:

We are writing to raise a concern over a specific proposed rule set forth in the pending Dodd-Frank whistleblower enforcement regulations. The provision at issue is section 21F-8(c)(2). This provision directly impacts the ability of the United States to enforce the requirements of the Foreign Corrupt Practices Act ("FCPA").

The Dodd-Frank Act contains specific exclusions exempting certain classifications of persons from filing whistleblower claims under § 21F of the Securities Exchange Act. These exclusions do not include any exemption for employees working for foreign governments. However proposed rule 21F-8(c)(2) includes such an exemption.

If foreign government workers (which would also include employees of state-owned companies) are excluded from coverage under § 21F by a broad blanket exemption, the ability of the United States to properly detect violations of the Foreign Corrupt Practices Act will be crippled. The FCPA prohibits corporations from paying or *offering* bribes to foreign government officials. As worded, honest civil servants from countries around the world will be exempted from the protections afforded under Dodd-Frank if they were to expose attempts by covered industries to pay bribes. As worded, the proposed exclusion would also include barring employees of state industries from blowing the whistle on bribery.

The impact on this exclusion is potentially radical. It would exempt not only civil servants who may be the target of bribery attempts, but also employees who work for state-owned industries. It would be troublesome to place international private companies at a severe competitive disadvantage to international state-owned industries by exempting employees of government-owned companies from Dodd-Frank, while at the same time accepting that private sector employees are covered. For example, in the People's Republic of China, which is now a major player in the world economy, many employees working for state-owned companies would now be exempted Dodd-Frank provisions.

Moreover, the proposed rule is in conflict with over ten years of case law developed in the United States concerning foreign government whistleblowers. The United States is a signatory of international anti-corruption treaties that pledge to provide support for

employees who blow the whistle on corruption.[1] Stripping all foreign state employees of protection would strike a major blow against the Department of State and Department of Justice's ongoing campaigns to stop corruption in foreign markets, and indirectly undercut the obligation of the United States under international law. It would be inconsistent with the current international policy of the United States.

The United States courts and government recognize that civil servants employed by foreign countries need whistleblower protection, and in fact the United States regularly grants political asylum to foreign civil servants who expose corruption by their governments. For example, since 2000 the United State Courts of Appeal have recognized the legitimacy of political asylum applications from foreign government civil servants who exposed corruption in Albania, Armenia, China, Guatemala, Italy, Philippines, Russia, and Ukraine.[2]

We recommend a modification of the proposed rule that is consistent with the actual statutory mandates of the law and the fundamental purposes of the Dodd-Frank Act. The single most important goal of the Dodd-Frank whistleblower reward provisions is to use the significant deterrence powers contained in *qui tam* to strengthen the ability of the United States Government to detect fraud, obtain witnesses that will help in the successful prosecution of fraud cases and to encourage/protect insiders, with critical information, to step forward and risk their jobs, careers and even their lives, to stop corruption.

In the context of the Foreign Corrupt Practices Act, where many of the witnesses to bribes will be foreign nationals employed by their respective governments, either as state employees working in government owned businesses or civil servants. The ability of these foreign nationals to report bribery committed outside of the geographical jurisdiction of the United States, often by other foreign nationals who work for companies subject to the broad jurisdictional reach of the FCPA, is absolutely essential for the enforcement of that law, and in order for the United States to best fulfill its obligations under international anti-corruption conventions, none of which recognize an exemption for foreign civil servants.

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[1] Article III, 8 Inter-American Convention Against Corruption of 29th March 1996 and Article 33 United Nations Convention against Corruption of 31st October 2003, *UN Treaty Series*, vol. 2349, p. 41.

[2] Aleksanyan v. Gonzales, 246 Fed. Appx. 471 (9th Cir. 2007), Aroyan v. Gonzales, 183 Fed. Appx. 634 (9th Cir. 2006), Bu v. Gonzales, 490 F.3d 424 (6th Cir. 2007), Cao v. AG of the United States, 407 F.3d 146 (3d Cir. 2005), Ghazaryan v. Gonzales, 215 Fed. Appx. 585 (9th Cir. 2006), Glistin v. Mukasey, 284 Fed. Appx. 429 (9th Cir. 2008), Grava v. INS, 205 F.3d 1177 (9th Cir. 2000), Hayrapetyan v. Holder, unpublished (9th Cir. 2010), Harutyunyan v. Ashcroft, 104 Fed. Appx. 86 (9th Cir. 2004), Haxhiu v. Mukasey, 519 F.3d 685 (7th Cir. 2008), Mamouzian v. Ashcroft, 390 F.3d 1129 (9th Cir. 2004), Massetti v. Gonzales, 151 Fed. Appx. 519 (9th Cir. 2005), Pashalyan v. Gonzales, 185 Fed. Appx. 603 (9th Cir. 2006), Rodas Castro v. Holder, 597 F.3d 93 (2d Cir. 2010), Sagaydak v. Gonzales, 405 F.3d 1035 (9th Cir. 2005), Wang v. Mukasey, 259 Fed. Appx. 763 (6th Cir. 2008), Zhu v. Mukasey, 537 F.3d 1034 (9th Cir. 2008).

Thank you in advance for your kind attention to these most important matters. We look forward to an opportunity to discuss these concerns with you.

Respectfully submitted,

Stephen M. Kohn
Executive Director

PROPOSED REVISION TO SEC RULE 21F-8(c)(2)

In order to ensure that SEC Rule 21F-8(c)(2) does not violate the express statutory requirements and/or the Congressional intent behind the Dodd-Frank Act, the exclusion for employees of foreign governments should be modified in the following manner, and limited to persons who: "*are, or were at the time [they] acquired original information, a member, officer or employee of a division of a foreign government which performs the functions of the United States Department of Justice, the Securities Exchange Commission, or the Commodity Exchange Commission. However, any exclusion of a foreign national shall not be undertaken without the consultation of the U.S. Department of State. Where the State Department determines that the employee's disclosures were necessary for the detection of the violations, and protecting or rewarding that employee would be consistent with United States foreign policy and international anti-corruption and/or international human rights conventions, the Department of State shall inform the SEC and/or the CFTC that the foreign government employee should obtain protection and/or a reward, and the exclusion set forth in this provision shall not apply. The United States Department of State shall also be consulted in all cases in which an employee of a foreign government (but not an employee of a state-owned company) applies for a reward under this regulation. For exceptional good cause shown, the SEC or CFTC may deny a reward based on information provided by the Department of State. Exceptional good cause includes documentation that a reward would have a negative impact on U.S. foreign relations, interfere with foreign government cooperation with the United States under existing treaties or otherwise encourage corruption. There shall be no limitation on the right of an employee of a state-owned industry, company or concern to file claims or obtain protections as afforded under the Dodd-Frank Act.*"