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Can the SEC Guard Against 'Unintended Consequences' of Whistleblower Rules?

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On August 12, the SEC's final whistleblower rules went into effect pursuant to which the SEC is authorized to provide whistleblower who provide "original information" 10 to 30 percent of monetary penalties where those penalties exceed \$1 million; other known as the bounty program. The SEC whistleblower rules have not been without controversy.

Among other things, the corporate community has expressed its concern that the rules undercut internal compliance programs that have been developed at high expense and, in turn, generate additional litigation and costs. The industry has also expressed concern that the program allows a whistleblower to go directly to the SEC without first reporting a violation to the company, even though there are incentives for informants to internally report first. The ability to avoid internal reporting, it is argued, defeats the very purpose of internal compliance programs. In other words, what is the point of having an internal reporting compliance program where a whistleblower can circumvent that process altogether.

Yin Wilczek, of the BNA Securities Regulation & Law Report, recently reported on comments by Sean McKessy, Chief of the SEC's Office of the Whistleblower, made contemporaneously with the implementation of the SEC whistleblower rules. These comments were meant to quash some of the concerns that the industry has raised. Unfortunately, his comments only lead to further concern that informants may abuse the program with the implicit endorsement of the SEC.

According to Wilczek, McKessy represented that the SEC will carefully monitor the program for "unintended consequences" and will ultimately implement "improvements" and "tweaks" where necessary. Although the SEC is committed to monitor and improve this program, McKessy also stated that he did not "have any preconceived notions about how that may play out". As such,

McKessy has left a large door open as to what he meant by monitoring the program for unintended consequences.

McKessy's further comments, however, should raise grave questions regarding the "monitoring," "improvements" and "tweaks" that the SEC may contemplate. McKessy stated that, "If even one fraud is stopped before it gets to the Madoff situation, the effort would have been worth it." This statement can be seen as simply as a perverse twisting of the old criminal maxim paraphrased as: better a guilty man go free than an innocent man go to jail. The SEC's version, however, should state, better a company be improperly charged with securities violations so that the SEC will no longer be faced with the embarrassment it sustained when it failed to act on the tips of whistleblowers regarding the Madoff Ponzi scheme.

Taking McKessy's comments to heart, the corporate community should be concerned how the SEC will monitor and improve a program where it appears as though the SEC's primary concern is avoiding future embarrassment. In the end, the unfortunate consequence of an overly aggressive program will be unnecessary costs for the corporate community in dealing with bounty hunters instead of true whistleblowers. The only way to protect yourself is to make sure your corporate governance policies and procedures are kept current and enforced so that you can address issues as they arise so that you can avoid becoming the next trophy on the SEC's mantle.