

## Whistleblowers

### Seven Steps Companies Can Take to Incentivize Internal Reporting of FCPA Violations

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When real or potentially unlawful conduct is occurring at a public company or regulated entity, learning of it in real time and addressing it quickly is critical to that entity's ability to respond and manage reputational and financial fallout. The Securities and Exchange Commission's Whistleblower Rules (promulgated under Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act), which award whistleblowers a percentage of the penalty paid by the company to the SEC as a result of the information from the whistleblower, contain certain key provisions. These provisions can be leveraged by entities to incentivize whistleblowers to report information internally, thereby providing the company with additional time to properly understand, contain, remediate and, in certain instances, self-report potential violations of the federal securities laws, including the FCPA. See "When and How Should Companies Self-Report FCPA Violations? (Part Two of Two)," *The FCPA Report*, Vol. 1, No. 2 (Jun. 20, 2012).

The risk associated with not taking action to steer information internally could result in employees sending damaging and sometimes inaccurate information directly to the SEC in an effort to win a piece of the \$450 million whistleblower fund. Such a scenario could jeopardize a company's ability to quickly and effectively stop ongoing improper conduct and could prevent a company from receiving self-reporting credit from the SEC.

At present, the SEC's Whistleblower Office is receiving about eight whistleblower tips per day, and that number is likely to increase after the first whistleblower award is paid. That award is expected shortly. If companies take steps now to enhance their internal reporting policies and procedures, they could prevent a dreaded surprise phone call from the SEC sometime soon.

#### *The SEC's Rulemaking Process*

The corporate community lobbied extensively for the Whistleblower Rules to contain a provision that required whistleblowers to report through internal compliance infrastructure in order to be eligible for the SEC's whistleblower program. They argued that to do otherwise would eviscerate internal compliance programs that they had built up after Sarbanes Oxley.

The whistleblower community lobbied hard on the other side of the issue, fighting against a requirement of reporting internally before going to the government, pointing to scenarios like the Madoff case where doing so would have been fruitless.

Ultimately, the rule writing team and three members of the Commission viewed the incentivization of internal reporting, and the inclusion of the three provisions, discussed below, as the appropriate balance. (Two members of the Commission voted against the rules.) At the time, SEC Enforcement

Division head Robert Khuzami said that an absolute requirement to report internally would place an undue burden on the whistleblower. These rules, however, make it much more attractive for employees to report internally first while keeping compliance programs intact.

### *The Three Key “Internal Report” Principles in the Whistleblower Rules*

How does a company begin to encourage internal reporting when monetary awards of 10 to 30 percent are available to whistleblowers who report potential violations to the SEC? The whistleblower rules contain the following three provisions that can be integrated into a company’s existing compliance infrastructure to encourage internal reporting:

1. **120-day rule:** Whistleblowers who report internally are deemed to have reported the same information to the SEC as of the date of the internal report so long as the whistleblower, or the company on the whistleblower’s behalf, provides the same information to the SEC within 120 days. (This was changed from the original 90-day proposal; both sides of the aisle were content with this, though it was in the Enforcement Division’s interest to keep this period short.)
2. **Tacking:** If an entity conducts an internal investigation based on a whistleblower’s internal report, and thereafter provides that information to the SEC, for purposes of determining whether an award is due and how much, the whistleblower will receive credit for the submission of the same information.
3. **Bump Up:** Making use of a company’s internal compliance and reporting system to report wrongful conduct is a positive factor that will potentially increase the amount of a whistleblower award.

### *Seven Steps Companies Can Take to Maximize the Benefit of These Provisions*

To integrate the new rules in their own programs, and gain the most from the new rules, companies should consider revising internal reporting policies and procedures to include the following principles:

1. Create an “Internal Report Certificate Program” to memorialize the date on which the internal report occurred so that whistleblowers can be confident that the SEC will recognize their place in line;
2. Provide whistleblowers with periodic updates throughout the 120-day period on the status of ensuing internal investigations so the whistleblower is aware of progress and can remain confident that his/her concerns are being addressed and that time still remains to report if needed;
3. Create a system and culture that protects whistleblowers and removes perceived threats from efforts to communicate with the SEC, if desired or needed;
4. Train managers to be supportive of employees who report wrongdoing internally;
5. Consider establishing an internal award program that recognizes employees who exceed expectations in reporting wrongdoing internally;
6. Enhance internal reporting hotlines and consider hiring a Whistleblower Ombudsman, a person independent of the company to whom the concerned employee can report; and
7. Publicize efforts taken in this regard so that employees are aware of the enhancements that have been made to the internal reporting program.

When the SEC wrote the Whistleblower Rules, the evidence showed that employees generally want to report observations of improper conduct internally and honor

their employee codes of conduct – they don't want to ruin the company's reputation and they want the company to operate appropriately. Employees also don't want to ruin their own reputations, which may happen if the company is able to determine the identity of the whistleblower based on an ensuing SEC inquiry. By virtue of the way in which the SEC rule writing team drafted the rules, employees are now formally incentivized to report internally first. Developing, implementing and, importantly, publicizing the above measures can help a company keep employee observations of wrongdoing inside the company until such time as the company can understand the nature and extent of any actual problems and formulate an appropriate response plan.

*Mr. Sporkin is a partner in the Washington D.C. office of BuckleySandler LLP. He is the former Chief of the SEC's Office of Market Intelligence. In the aftermath of the Madoff fraud, Mr. Sporkin was selected to lead the SEC's efforts to design, build and manage the Office of Market Intelligence, a new office established to detect ongoing unlawful conduct spanning all SEC program areas. In 2010 and 2011, he led a similar effort to launch the SEC's Whistleblower Office called for by the Dodd-Frank Wall Street Reform and Consumer Protection Act. During his nearly 20 year career at the SEC, he has led investigations involving the Foreign Corrupt Practices Act, financial fraud, insider trading and market manipulation.*