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BEFORE THE

U.S. HOUSE REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

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Good afternoon Chairman Garrett, Ranking Member Waters and members of the Subcommittee. Thank you for the opportunity to submit this statement in connection with today's hearings on the whistleblowing provisions of Section 21F of the Securities Exchange Act, as enacted by the Dodd-Frank Act.

The American Association of Bank Directors represents directors of banks, savings institutions, and their holding companies. Section 21F strikes at the heart of the diligent efforts of bank directors and directors of other companies to oversee their internal reporting and compliance systems to identify and resolve potential improprieties and violations of law and regulations. These systems count on the loyalty of employees and other insiders to advise boards of directors and their committees of information they need to address any concerns.

This hearing is a welcome sign of the willingness of members of Congress to examine more carefully a provision in Dodd-Frank that was added without full evaluation of its implications. It fundamentally conflicts with Section 301 of the Sarbanes-Oxley Act and undermines the very important public policy of encouraging public companies to make significant efforts to establish and implement an internal reporting system under which whistleblowers may report anonymously any purported improprieties or violation..

A key element of any robust internal reporting system is reliance on employees, officers and directors who suspect or discover improper behavior to report it, by name or anonymously, to the Audit Committee or other reporting body within the company so that prompt review and necessary corrective action is taken on a timely basis. Section 21F entices insiders to circumvent that corporate compliance process by offering them significant personal bounties.

Section 301 of the Sarbanes-Oxley Act empowered directors by requiring audit committees of publicly reporting companies to adopt procedures for the receipt of complaints regarding accounting, internal accounting controls, or auditing matters, and the confidential anonymous submission by employees of the issuer of concerns regarding

questionable accounting or auditing matters. Section 806 protects employees who file such complaints from retaliation. . Also see Section 406 of the Sarbanes-Oxley Act, U.S. Sentencing Guidelines Section 8B2.1 and Principles of Federal Prosecution of Business Organizations, Section 28.800. Section 21F significantly undermines Section 301 and other federal government initiatives encouraging corporate self-policing, and the effectiveness of the authority of the Audit Committee and other board committees assigned the task of establishing and monitoring the company's compliance systems.

The regulations proposed by the SEC on November 3, 2010 inadequately reconcile the contradictory public policies expressed in Sarbanes-Oxley and Dodd-Frank. Changes should be made that will insure the preservation of the authority that the Board of Directors and its committees have over the compliance systems in their companies. These include barring any insider from being potentially being considered a whistleblower unless the insider first reports all of the information that the insider will report to the SEC to the appropriate parties at the company in accordance with the company's internal reporting system or, if the company (a nonpublic company) does not have a written internal reporting system, to the Chairman and/or President of the company, or if both the Chairman and President are subjects of the alleged violation, to an independent director. If the insider nevertheless circumvents the company and submits the information only to the SEC, the SEC would be required to provide the information to the company within ten days of receipt, and disqualify the person as a whistleblower.

Requiring insiders to report information to companies prior to submitting the information to the SEC will provide companies with an opportunity to provide its own information to the SEC. It will also take a considerable burden off the SEC to review incomplete information. The SEC has limited resources, and like other federal agencies, is facing possible limits on expenditures to reduce the deficit. We understand that the SEC has been deluged with "whistleblower" complaints, often from activist counsel soliciting such persons on the internet and through other media. It is difficult to imagine how the SEC will be able to handle all of these filings, whether or not meritorious, without enlisting the good faith efforts of the companies in question. In any event, complying with the requirements of an SEC investigation will likely impose significant additional financial burdens on companies least prepared to bear them, smaller reporting companies.

Congressman Grimm's draft legislation is a huge step in the right direction. Comment letters from advocates for whistleblowers suggest that the SEC has little or no discretion to exclude employees from being considered whistleblowers. Legislation clarifying the conditions under which insiders will be disqualified is essential.

There is also no assurance that the SEC will adopt final regulations that will contain provisions that are in Congressman Grimm's draft legislation. Advocates for whistleblowers and their counsel have sought to play a significant role in the refashioning of the proposed rule. Three months after the comment period for the proposed rule expired,, Stephen M. Kohn, Executive Director of the National Whistleblowers Center

wrote to Chairman Schapiro reporting on a meeting he had with SEC Commissioners and Chairman Schapiro's staff to discuss the proposed rules, and stating that SEC representatives solicited his comments on specific provisions in the proposed regulations, including a request to "provide review of the proposed rules and make specific recommendations regarding those portions of the proposed rules that should be changed." The 32 page letter details a line by line review of key provisions and specific changes to those provisions.

Congressman Grimm's legislation should go further to protect the interests of public companies and their Boards of Directors in implementing their internal reporting systems. Among other changes, we note the following. The proposed legislation would only cover "employees." The coverage should be broader, to encompass any insider (or former insiders for some period following their resignation or termination of service) and others who may come into possession of information in the course of providing services toa company, and who are not otherwise excluded by the existing provisions of 21F and the proposed regulations. Additionally, the legislation should bar any insider from being potentially being considered a whistleblower unless the insider first reports all of the information that the insider will report to the SEC to the appropriate parties at the company in accordance with the company's internal reporting system or, if the company (a nonpublic company) does not have a written internal reporting system, to the Chairman and/or President of the company, or if both the Chairman and President are subjects of the alleged violation, to an independent director. If the insider nevertheless circumvents the company and submits the information only to the SEC, the SEC would be required to provide the information to the company within ten days of receipt, and disqualify the person as a whistleblower.

Congressman Grimm's proposal, by allowing an employee to become a whistleblower without first reporting internally where the "highest levels of management are involved," inadvertently weakens the internal reporting process established by Sarbanes Oxley, by ignoring the existence and capacity for investigation of the Board of Directors and the Audit Committee. Absent evidence of knowing involvement by the Audit Committee members, there should be no direct report to the SEC. We are also concerned about the SEC's ability to quickly determine the bad faith of management being a basis for avoiding internal reporting. Apart from the SEC's workload, the SEC would invariably be basing its determination on one side of the story, from a financially interested party. We appreciate the efforts the proposed legislation and proposed regulations under Section 21F have taken to attempt to insure that those having pre-existing legal or fiduciary obligations to the company not be able to be paid whistleblowers based on information learned in such capacities, but we feel that the group reflected in the legislation should be broader, including at a minimum all directors and executive officers, as well as those with specific complaint or violation investigation related positions.

The best solution is an outright repeal of Section 21F. The Congress has created a dual loyalty for every insider of every company in the U.S. Section 21F applies to both public and nonpublic companies. Insiders have a legal duty to serve the best interests of

the company that employs or retains them and the company's shareholders. Section 21F deputizes them and promises them huge riches to bypass their companies and report to the government. This mistake needs to be corrected as soon as possible.