



December 16, 2010

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

Re: File Number S7-33-10, Dodd-Frank Wall Street Reform and Consumer Protection Act – Securities Whistleblower Incentives and Protection Program

Dear Ms. Murphy:

This letter is submitted in response to the request for public comments by the U.S. Securities and Exchange Commission (the “Commission”) on its Proposed Rules for Implementing the Whistleblower Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), which offers rewards to eligible whistleblowers who voluntarily provide the Commission with original information about violations that results in monetary sanctions exceeding \$1 million.¹

The Business Roundtable Institute for Corporate Ethics (the “Institute”) is an independent entity established in partnership with Business Roundtable—an association of chief executive officers of leading U.S. companies with nearly \$6 trillion in annual revenues and more than 12 million employees—and leading academics from America’s business schools. The Institute, which is housed at the University of Virginia’s Darden School of Business, brings together leaders from business and academia to fulfill its mission to renew and enhance the link between ethical behavior and business practice through executive education programs, practitioner-focused research, and outreach.

While the Institute commends the Commission’s objective to implement the Proposed Rules in a manner “that encourages strong company compliance programs” along with its acknowledgment that “many employers have compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances

¹ U.S. Securities and Exchange Commission News Release, “SEC Proposes New Whistleblower Program Under Dodd-Frank,” Release No. 2010-213. November 3, 2010. Available at www.sec.gov/news/press/2010/2010-213.htm.

of confidentiality,”² we are concerned the Proposed Rules may lead to unintended consequences. Our greatest concern is that these rules might undermine the ethics and compliance cultures and programs in existence at many leading companies, which we believe should be widely supported and emulated.

Perspective of the Business Roundtable Institute for Corporate Ethics

The Institute’s unique nexus of leaders from business and academia promotes thought leadership that is both grounded in academic excellence and relevant to the contemporary, day-to-day challenges facing organizations and their leaders. As such, the Institute is widely-recognized for producing leading-edge research and programs that promote the development and sharing of best practices in company ethics and compliance programs.

Among recent Institute publications contributing to the development of stronger ethical cultures in organizations are: “*The Dynamics of Public Trust in Business: A Call to Action to Overcome the Present Crisis of Trust in Business*” (2009)—a joint publication with the Arthur W. Page Society, “*Shaping Tomorrow’s Business Leaders: Principles and Practices for a Model Business Ethics Program*,” (2007) and “*Breaking the Short-Term Cycle: Discussion and Recommendations on How Corporate Leaders, Asset Managers, Investors, and Analysts Can Refocus on Long-Term Value*” (2006)—a joint publication with the CFA Institute.³ The Institute also led efforts in the publication of “*Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer*” (2007), the first-of-its-kind cooperative report, involving five leading business ethics organizations, to define the role and responsibility of Chief Ethics and Compliance officers.

The Institute strongly supports efforts to strengthen organizational ethics and compliance cultures, programs, and systems. We know from Institute programs that building strong ethics and compliance programs continues to be of the highest importance to corporate leaders. As reflected in the Institute’s *Mapping the Terrain* survey of Chief Executive Officers, “[w]ith regard to the top corporate ethics priority for business, the majority of CEOs cited establishing a framework for business decision making that integrates ethics as the top priority followed by encouraging pushback and a culture for proactively addressing potential bad news early.”

Through our experience and research, we find that the majority of U.S. companies have long-standing, robust ethics and compliance programs that pre-date the most recent wave of crises and responses. The majority has been further expanded in the current decade due to additional requirements promulgated from legislation such as the Sarbanes-

² U.S. Securities and Exchange Commission. “Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934,” Release No. 34-63237. November 3, 2010. p. 34-35. Available at www.sec.gov/rules/proposed/2010/34-63237.pdf

³ All Business Roundtable Institute for Corporate Ethics reports are available at www.corporate-ethics.org

Oxley Act of 2002 (“Sarbanes-Oxley”) and the 2004 Amendments to the Federal Sentencing Guidelines (“FSG”). Thus, this growing majority of corporate compliance and ethics programs provides a rich foundation of lessons and best practices that we should collectively leverage.

While the Commission intends the Proposed Rules not *discourage* whistleblowers from initially reporting misconduct using mechanisms within their companies, the Proposed Rules should proactively *encourage* employees and other potential whistleblowers to first utilize the well-developed internal compliance elements of leading companies—including codes of ethics, anonymous reporting hotlines, and most importantly, those mechanisms of encouraging employees to “speak-up” when encountering potential violations—which both academic and practical research demonstrates is most effective at strengthening the ethical culture of organizations.

In this regard, we believe that the current Proposed Rules for implementing whistleblower provisions could more effectively leverage existing corporate ethics and compliance programs and practices by adopting a framework similar to that of the FSG, which is designed to deter corporate malfeasance through incentives that mitigate penalties for misconduct in companies that have “effective compliance and ethics programs”, prompt reporting to authorities, and non-involvement of high-level personnel in the actual offense.⁴

The FSG approach has already spawned complementary efforts “by a number of regulatory and law enforcement authorities [for] developing model compliance programs, programs for self-reporting, and programs for amnesty.”⁵ Additionally, influenced by FSG, industry and professional organizations meet regularly to share innovative ideas and best practices for ethics and compliance processes.

In order to (1) reward and incent companies to continue the development of their compliance and ethics programs, and (2) to encourage the usage of such company compliance and ethics programs that have been robustly designed through both corporate leadership and adherence to previous legislative actions and have been shown to be more effective in deterring misconduct, the Proposed Rules should:

- Require whistleblowers, who are employed at companies with “effective compliance and ethics programs” (which would include companies with

⁴ According to the U.S. Sentencing Commission, “An Overview of the Organizational Guidelines,” (at www.usc.gov): The seven criteria for establishing an effective compliance program include: (1) Oversight by high-level personnel, (2) Due care in delegating substantial discretionary authority, (3) Effective communication to all levels of employees, (4) Reasonable steps to achieve compliance, which include systems for monitoring, auditing, and reporting suspected wrongdoing without fear of reprisal, (6) Consistent enforcement of compliance standards including disciplinary mechanisms, and (7) Reasonable steps to respond to and prevent further similar offenses upon detection of a violation.

⁵ U.S. Sentencing Commission, “An Overview of the Organizational Guidelines,” at www.usc.gov/Guidelines/Organizational_Guidelines/ORGOVERVIEW.pdf

Sarbanes-Oxley-compliant processes), to report violations internally prior to reporting to the Commission;

- An exception to the internal reporting mandate may be made in the extreme instance in which a whistleblower has good reason to believe that the internal ethics and compliance program is sufficiently corrupt or dysfunctional with respect to the issue at hand as to prevent effective reporting. Allowing such exception may also encourage more companies to proactively design ethics and compliance programs to have more direct access to the board of directors.
- Provide for a more appropriate “grace period” for whistleblowers to report potential violations to the Commission after they have first reported such violations through internal reporting systems. Such a grace period shall protect the whistleblowers’ interests and allow the company sufficient time to thoroughly investigate reports (e.g., 180 days); and
- Exclude whistleblowers who may also bear culpability in the reported violation from any eligibility for financial rewards.

The Institute is aware of many individual companies and organizations providing comments to the Commission expressing further suggestions on the above as well as other recommendations to the Proposed Rules. Our remarks are intended to provide additional commentary, based on rigorous academic research, to ultimately support the Commission’s and all of our efforts to ensure that companies continue to maintain and strengthen their existing compliance and ethics programs.

Research on the Effectiveness of Ethics and Compliance Programs

Leading scholars, including many of the Institute’s Academic Advisors, have conducted extensive research on the effectiveness of ethics and compliance programs, systems, and cultures. In a notable *Harvard Business Review* article that we use as a teaching tool in our ethics seminars, Professor Lynn Sharp Paine provides a useful distinction between organizations that manage ethical behavior either through (1) compliance-based programs, for organizations which focus activity and resources on threats, deterrence, and punishment for legal and ethical breaches, or (2) integrity-based programs, in which companies promote internally-developed values and self-governance to drive ethical decision making and behavior.⁶ The article asserts that companies with integrity-based programs are most effective at discouraging misconduct, a conclusion that is also confirmed by further academic research.⁷

⁶ Lynn Sharp Paine, “Managing for Organizational Integrity,” *Harvard Business Review* 106 (March-April 1994): 110–11.

⁷ L.K. Treviño, G. Weaver, D. Gibson, & B. Toffler, “Managing Ethics and Legal Compliance: What Works and What Hurts,” *California Management Review* 41, no. 2 (1999): 131–151.

Of course, the most successful company integrity-based programs include many essential compliance elements such as robust codes of ethics, broadly delivered training and education programs, and anonymous reporting mechanisms for employees; significantly, all of which are prominently used in many of today's leading corporate compliance and ethics programs. Thus, compliance and integrity-based programs are not mutually exclusive. In a scholarly article analyzing Sarbanes-Oxley and the FSG, the author concludes that "there is strong evidence to believe that properly implemented compliance programs can improve ethical behavior in organizations and reduce the high levels of fraud that currently exist."⁸

The Sarbanes-Oxley Act of 2002 marked an important legislative milestone in furthering efforts at restoring trust in business to the marketplace by requiring certain essential compliance elements in companies' overall organization ethics systems, including specific provisions for codes of ethics and the establishment of whistleblowing mechanisms for employees to utilize without fear of retaliation.⁹

Subsequently, the 2004 Amendments to the Federal Sentencing Guidelines redefined an effective company compliance program as one designed, implemented, and enforced to "prevent and detect criminal conduct [and to] promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."¹⁰ The specific instructions in the FSG are that the organization's "compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent and detect criminal conduct."¹¹

Corporate compliance and ethics programs which have been developed through the encouragement and mandate of the FSG reflect closely the integrity-based programs promoted by Paine and other academic scholars. According to research from KPMG, the presence of such compliance and ethics programs continues to have favorable impact on employee behaviors, and particularly supports potential whistleblowers in strengthening their motivation for reporting.¹²

National Business Ethics Survey Analysis of Reporting of Misconduct

Among the most extensive research on ethics and compliance activity within companies is the Ethics Resource Center's National Business Ethics Survey ("NBES"), a

⁸ David Hess, "A Business Ethics Perspective on Sarbanes-Oxley and the Organizational Sentencing Guidelines," *Michigan Law Review* 105, no. 8 (June 2007): 1804.

⁹ Sarbanes-Oxley Act of 2002, Section 406(a) (Requiring codes of ethics for senior financial officers) and Section 301(4) (Requiring procedures for employees to submit concerns about financial practices).

¹⁰ U.S. Sentencing Commission, *U.S. Sentencing Guidelines Manual*, Section 8B2.1(a). 2010.

¹¹ U.S. Sentencing Commission, *U.S. Sentencing Guidelines Manual*, Section 8B2.1(b)(6). 2010.

¹² KPMG Forensic, *Integrity Survey 2008-2009*. Available at www.kpmginstitutes.com/aci/insights/2009/pdf/integrity-survey-08-09.pdf

longitudinal analysis “based on a framework provided by the Federal Sentencing Guidelines for Organizations [and] the Sarbanes-Oxley Act of 2002...in defining elements of formal programs, ethical culture, risk, and outcomes.”¹³ Among the notable findings in the 2009 NBES is the increase in corporate whistleblowing, with 63% of employees reporting misconduct they observe; an increase from 58% in 2007.¹⁴

However, hotline usage is among the lowest utilized reporting sources for such whistleblowing (3% in 2009 and 2007). Rather, for the overwhelming majority of employees who report misconduct, they do so by talking to their supervisor or management (75% in 2009; 77% in 2007). Furthermore, when one adds the 15% of employees who report observed misconduct to another responsible person in the company, the conclusion is that 9 out of 10 employees who report misconduct do so through their supervisor or other persons inside the company.¹⁵

This 2009 NBES data shows that the overwhelming majority of misconduct reporting occurs through communication with supervisors and management, which is also consistent with previous NBES reports and other scholarly research. These conclusions suggest that it would be more advantageous for corporate leaders and regulators to focus greater efforts on increasing mechanisms that encourage employees to “speak-up” rather than additional third-party reporting channels.

Unintended Consequences Regarding Corporate Compliance and Ethics Programs

The Proposed Rules currently pose two prominent risks to overall compliance and ethics efforts. Both risks are related to the unintended consequence of not encouraging potential whistleblowers to first avail themselves of internal reporting mechanisms prior to reporting to the Commission. The first risk is in potentially undermining existing, effective internal reporting mechanisms. The second risk is the lost company benefit of the proactive learning and continuous improvement that occurs when information is reported, an essential element of best practice ethics programs. As the Commission correctly recognizes, “internal compliance and reporting systems are essential sources of information for companies about misconduct.”¹⁶

For those employees who observe misconduct, the NBES describes the approximately 2/3 of employees (63%) who report it through supervisors, management, other employees, or hotlines. What happens, however, to the remaining 1/3 of employees who may observe misconduct and do nothing? The answer to this question is important for implementation of the Proposed Rules.

¹³ Ethics Resource Center, *2009 National Business Ethics Survey*, (2009) 7, Available at www.ethics.org.

¹⁴ *2009 National Business Ethics Survey*, 35.

¹⁵ *2009 National Business Ethics Survey*, 35.

¹⁶ Proposed Rules, p. 34

Based on the extensive experience of Institute Academic Advisors and other faculty instructing thousands of students and managers who may face ethical dilemmas in the workplace, we can surmise that the remaining 1/3 of employees most likely are simply afraid to speak up. One of the most important, yet difficult to implement compliance and ethics program mechanisms is giving voice to such employees. Companies, however, are doing so more successfully through ethics information campaigns led by Chief Ethics and Compliance Officers. The NBES and KPMG data are consistent in identifying “tone at the top” as the primary reason why employees choose to speak-up in reporting misconduct. According to NBES, strong top management culture (e.g., “tone at the top”) was related to the largest increase in employee reporting (with a 33% higher rate of reporting in strong versus weak cultures).¹⁷

Academic research is becoming increasingly clear in indicating that “speaking-up” results in both proactive avoidance and remedy of potential misconduct and improved processes and productivity.¹⁸ In the article “Speaking Up to Higher-Ups,” the authors conclude that “if leaders truly want to know about *all* employees’ concerns and improvement ideas, they must proactively and consciously create opportunities for direct, informal, interaction with employees at multiple levels.”¹⁹ This is an increasingly valuable element of corporate compliance and ethics programs, and one that may unintentionally be impaired due to the competing financial interests of employees choosing to utilize the Commission’s whistleblower provisions.

The Institute believes companies’ internal ethics and compliance programs that result in employees constructively “speaking-up” and “pushing-back” should be supported. Such programs are better able to address issues and solve problems early, before they often become larger problems necessitating outside alternatives.

Conclusion

Indisputably, one lesson learned from the current financial crises, as well as from prior ethics crises, is that ensuring an ethical company culture is in everyone’s best interest; not just investors, but also employees, customers, suppliers, and public citizens. Efforts that reflect and enable this mutuality of interest are more likely to have a notable impact that builds trust and value for all stakeholder groups.

Based on research about the causes and remedies of corporate misconduct, the Institute encourages the Commission to formulate the Proposed Rules so that they motivate companies to establish precisely the sorts of internal practices and policies that

¹⁷ Ethics Resource Center, “Reporting: Who’s Telling You What You Need to Know, Who Isn’t, and What You Can Do About It,” (2010). Available at www.ethics.org.

¹⁸ Julia Adler-Milstein, Sara J. Singer, and Michael W. Toffel, “Speaking Up Constructively: Managerial Practices that Elicit Solutions from Front-line Employees,” *Harvard Business School Working Paper*, #11-005, 2010.

¹⁹ James R. Detert and Linda K. Trevino. “Speaking Up to Higher-Ups: How Supervisors and Skip-Level Leaders Influence Employee Voice,” *Organizational Science* 21, no. 1 (Jan-Feb 2010): 249–270.

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discourage misconduct, enable and reward employees for raising concerns with their supervisors, and establish mechanisms within a company for addressing misconduct. The Institute suggests that the FSG provides such a model for implementing the new rule.

Our comments address the Commission's request for recommendations that "strike the right balance between the Commission's need for a strong and effective whistleblower awards program, and the importance of preserving robust corporate structures for self-policing and self-reporting."²⁰

Policy makers, investors, and other stakeholders can encourage companies to operate with the highest integrity and compliance within the law by:

- Encouraging strong corporate cultures and principles. Regulations and laws are important, and provide a foundation for compliance, but ethical conduct that restores trust in business also requires strong cultures and an appropriate level of risk-taking.
- Continuing to support mechanisms and data collection to further improvement on compliance issues within companies and best practice sharing among companies;
- Providing reporting mechanisms through the Commission—after exhausting existing, robust company compliance and ethics programs—that both afford whistleblower protection and allow for appropriate yet thorough internal investigation activities.

We thank you for considering the Institute's comments. If you would like to discuss further any content of this letter, please contact Dean Krehmeyer, Executive Director of Business Roundtable Institute for Corporate Ethics, at 434-924-6060 or KrehmeyerD@darden.virginia.edu.

Sincerely,



Dean Krehmeyer
Executive Director

²⁰ Proposed Rules, p. 35.