

**Re: File Number S7-16-18 (Proposed Amendments to Whistleblower Rules)**

Dear Commissioners:

As most of us recall, the global financial crisis and the Bernie Madoff (“Madoff”) scandal were direct catalysts for the enactment of the SEC whistleblower program. I was called to testify before the House of Representatives concerning my efforts to expose Madoff. I arrived armed with the 2008 Association of Certified Fraud Examiner’s biennial report on white-collar fraud. Therein were statistics showing that whistleblowers were the number one method of detecting fraud – more than twenty times as effective as law enforcement alone. I testified on the need for a whistleblower program, and Congress agreed with me. At that time, our nation’s banking and securities laws and enforcement procedures were ill-equipped to detect large, complex financial fraud schemes that were led from the C-suite. The SEC Whistleblower Program was meant to act as a pendulum swing.

Today, the SEC Whistleblower Program receives thousands of tips from investors and finance professionals from around the globe. Thanks to the hard work of the Commission’s Office of the Whistleblower (“OWB”) and whistleblowers themselves, exam teams can be sent out on highly focused exams and know what to inspect to find fraud – all because an insider or outside analyst came in and laid bare the fraud scheme. The Commission is doing the largest cases in its history, relying on whistleblowers who have been incentivized to report wrongdoing. The FBI and the U.S. Department of Justice (“DOJ”) are also beneficiaries of the SEC’s program, receiving a steady stream of solid criminal referrals leading to convictions that put securities fraudsters behind bars where they belong.

With those positive developments as a backdrop, I am happy to have an opportunity to comment on the proposed amendments to certain whistleblower rules. I hope that whatever rule changes are ultimately enacted serve to enhance the program and allow the Commission to continue to prosecute even more creative and larger-scale frauds that are taking place all too frequently in this country.

Below are my views on some of the proposed rules:

a. False Filers – Proposed Amendment to Rule 21F-8 with new paragraph (e).

My impression is that there are far too many false filers – those who file Whistleblower Applications for Reward (“WB-APPs”), or related appeals, on cases for which they have no basis to expect an reward. Those false filers appear to have a “you have to be in it, to win it” mentality, as though the SEC whistleblower program were a state lottery. Such a mentality, however, greatly undermines the efforts of legitimate whistleblowers by hindering the WB-APP evaluation process and increasing government skepticism of whistleblower tips.

My advice is to be ruthless with false filers, especially those who haven’t filed a TCR and haven’t provided actionable information to the Commission. I believe it should be “one and done” for false filers, not “three strikes and you’re out.” It also seems that attorneys are filing some of the frivolous claims. Barring offending attorneys from practicing before the Commission and publicizing their punishment should prove a good deterrent for others that are similarly inclined to file for an award without legitimate grounds. This program is too important for the smooth functioning of our capital markets to let these false filers diminish its efficacy.

That said, Proposed Amendment to Rule 21F-8 (along with Proposed Rule 21F-18 establishing a summary disposition procedure) is a good start, and I endorse any effort to bring the false filing problem under control. The “three strikes” policy under the Proposed Rule is more leeway than I would afford false filers, but it is a necessary and practical first step. I also support the use of formal adjudicatory proceedings to deal with false statements by purported whistleblowers, as this serves the public function of shining light on the wrongdoing and showing would-be false-filers that it is not something worth attempting. *See Proposed Rules*, at 79, n. 189.

b. Clarifying Payments for Cases in Federal Bankruptcy

The Proposed Amendment to Exchange Act Rule 21F-4(e) defining “monetary sanctions” is unclear, and seemingly fails to address a critical gap in cases that settle and/or go into federal bankruptcy court instead of receivership. The Commission needs to treat recoveries by a Commission-forced bankruptcy trustee as qualifying for an award under the whistleblower program in the same manner as it would recoveries by a Commission-forced receiver.

While Ponzi cases often go into receivership, public company accounting frauds, *e.g.*, Enron, often end up in federal bankruptcy court. It is important for corporate whistleblowers to know they will be rewarded for turning in their company even if exposing the fraud ends up bankrupting the company. Accounting fraud is a scourge that raises the cost of capital for every honest company that keeps an accurate set of books. The Commission needs to make clear that the whistleblower program rewards accountants who come in and expose cooked books. A real-world example is WorldCom, where the company’s Chief Audit Executive, Cynthia Cooper, turned whistleblower, sending WorldCom spiraling into bankruptcy. Another real-world example is the whistleblower who turned in the Life Partners Holdings Inc. (“LPHI”) case, sending that company into bankruptcy court, which has resulted in more than **\$1 billion** being repaid to investors. Brave, honest people like that need to be rewarded.

Perhaps the Commission is already addressing this issue. I noted with interest in the proposed amendments to the “monetary sanctions” definition that the Commission appears to view receivers and bankruptcies trustees as alternative procedural mechanisms to accomplish the goal of returning funds to investors. As the Commission noted elsewhere in the proposed rule, “our view [is] that Congress did not intend for meritorious whistleblowers to be denied awards simply because of the procedural vehicle that the Commission (or the other authority) has selected to pursue an enforcement matter.” To me that suggests that the Commission would not see any substantive difference between a receiver and trustee in bankruptcy when it comes to evaluating the pool of funds with respect to which a whistleblower qualifies for an award. If so, that is a positive development, but to remove any confusion it should be clarified or codified in any final rule. Otherwise, whistleblowers such as the one in LPHI will be discouraged for fear that a bankruptcy might ruin their chance at a much-deserved award. Remember, it is the largest, most widespread frauds that bankrupt companies and the Commission does not want to be in a position of discouraging whistleblowers from bringing cases that may result in such a proceeding, which undoubtedly would benefit the company’s shareholders.

c. “Independent Analysis” – Proposed Interpretative Guidance

The Commission’s proposed interpretive guidance on “independent analysis” references my team’s work on the Madoff case, so I have four comments that speak to some of the widespread fear

among my whistleblower colleagues that this proposed provision has invoked. *See Proposed Interpretive Guidance*, at pp. 103-105.

First, in 1943 the False Claims Act (“FCA”) whistleblower program was rendered largely useless for four decades because of the public knowledge bar enacted by Congress: Any information in the government’s possession was off limits to whistleblowers, ensuring that there were no successful whistleblowers until 1986 when President Reagan signed a revamped version of the FCA into law. The Commission’s proposed rules could bring the program down that same path that the FCA was forced in 1943. I hope that is not the case, as it would truly undermine the public-private partnership that is being established between the Commission and its whistleblowers.

Second, we all know that many securities frauds are hiding in plain sight and can be solved using publicly available information. There is certainly more to it than compiling negative press reports and claiming credit for identifying a fraud, so I agree with the Commission’s logic to the extent that merely reading the newspaper and filing a TCR shouldn’t qualify for an award. But having the capability to assemble disparate information from multiple sources and build a cohesive set of fraud theories is no easy task. Indeed, there is often a need to choose the right math or accounting rules and apply them correctly to prove that a fraud theory holds merit. There is also the question of what can be deemed “publicly available,” as many cases can be identified using information that, while technically in the public domain, is largely inaccessible to all but the most experienced researcher. The fact is that a thorough presentation of publicly available information resulting from exhaustive research into obscure public sources can triangulate fraudulent conduct in ways that inside information – which can often be compartmentalized – cannot. I have seen it done on numerous occasions.

So, a balance must be struck.

I enjoyed reading that my team’s work to uncover the Madoff fraud would have made the cut under the Commission’s current standards. Under the Proposed Interpretive Guidance, however, even my team could not have been certain of recovering a whistleblower award because of the “20/20 Hindsight” nature of the guidance. Indeed, I am not sure that I would re-submit that same level of work product going forward if the “independent analysis” rule is amended as proposed. The primary problem is that it does not provide for an objective standard protecting whistleblowers who submit independent analysis. Under the proposed rule, it would be far too easy for the Commission, in hindsight, to claim that it could have or would have learned of a fraud on its own. Instituting a sensible objective standard would both protect the SEC Whistleblower Program from paying out unearned awards, while also protecting the whistleblower from having a misguided SEC employee say, “we would have caught that on our next exam anyway, so why pay the whistleblower?”

Every securities fraud is obvious when looking in the rear-view mirror. In real-time, however, the schemes are always opaque and seem plausible on the surface. So, in my view, it would be unjust and against the spirit of the whistleblower program to adopt language allowing the Commission to deny a whistleblower award, in essence, because it “could have” used publicly available information to identify a fraud when it did not and the whistleblower did. Therefore, if any changes are made to this provision – and I question whether they truly are necessary – then the Commission instead should take caution only to limit whistleblower eligibility in those circumstances where there is a concrete indication that the government did not need the whistleblower’s tip to identify and dismantle a fraud. For example, any Proposed Rule allowing the Commission discretion to reject a whistleblower’s application for an award should require the following test showing that, prior to the filing of the

whistleblower's TCR, the Commission had already commenced an investigation or exam for the issues raised in that TCR. Otherwise, credit must be given to the whistleblower.

Finally, there is a gray area where a TCR is filed and it successfully leads the Commission to file an enforcement action or discuss settlement with the investigation target(s). Defendants in that position sometimes refuse to settle on the more serious issues raised by the whistleblower but do agree to settle for less serious infractions not included in the TCR. Given that the TCR in my hypothetical scenario essentially launched the enforcement action, acting as a catalyst to a successful settlement, I would hope that the Commission would include language allowing the whistleblower to receive proper credit and be paid for those efforts.

d. Proposed Discretionary Cap on Large Awards in Proposed Amendment to Rule 21F-6.

I strongly disagree with the proposed discretionary cap on awards exceeding \$100 million. Although well-intentioned, this provision would be a gift to the major investment banks and other large public companies, as it would deter high-ranking officers at those entities from turning whistleblower.

It was my hope all along – a hope shared with many at the Commission who designed the program – that the potential rewards from blowing the whistle would be lucrative enough to draw in high-ranking industry professionals. The thinking behind this was “*what if, in 2004, the deputy head of capital markets for a major bank had come in and disclosed that the MBS deals, the CDOs, and the CDO squared and cubed, were all backed by falsified, worthless liar loans? Could we have prevented the 2007-2009 Global Financial Crises if a program had been in place?*” But so far that hasn't happened. To my knowledge, no one from the C-Suite or anywhere near the top of the corporate pyramid has filed a TCR disclosing securities fraud. The folks running these major financial institutions usually earn millions of dollars annually and have eight figures more in company stock that has yet to vest. Capping awards would all but ensure that the elephant never walks through the Commission's doors – only rabbits and the occasional zebra. Imagine if a direct report to the C-Suite became a whistleblower, disclosed a multi-billion-dollar fraud scheme, and volunteered to wear a wire for the FBI that results in C-Level prison terms. That should be the goal. This program should always aim high, not low or average. That was how it was designed and it is how it should remain.

There is currently no legislative limit on the amount of money an investment bank, Ponzi operator, or public company cooking its books can steal from investors. Nor is there any cap on the amount of fines levied against large financial institutions caught engaging in securities fraud. Indeed, if there were caps on fines, think of the blow to morale that would strike within the Commission's exam and enforcement ranks. Well, that's exactly how whistleblowers are going to react if the Commission unilaterally imposes any kind of a cap – even a discretionary one – on large awards.

And then there is the human toll. Many whistleblowers who have been fired and then industry black-listed suffer from depression. Depression often leads to poor health, divorce, along with other stressors. How can emotional well-being be quantified in dollars? I'm not sure, but it's clear that merely replacing lost wages is not enough of a reward for the emotional hell that whistleblowers often face. Capping an award – even on a discretionary basis – when the whistleblower exposes a massive fraud and deals with the likely emotional onslaught that follows disincentivizes integrity.

Another issue that must be considered is that individual whistleblowers do not receive the *gross* whistleblower award granted by the Commission. There are always taxes and attorneys' fees to pay – both of which can combine to reduce the gross award significantly. In addition, awards are often shared among multiple whistleblowers or a whistleblower team. Consequently, a \$100 million gross award, for example – after 40% attorneys' fees, 37% federal income tax, and 10% state and local taxes – quickly turns into less than a \$32 million award, nearly 68% lower than the original award. If the case involved a whistleblower team – and many large cases do – each whistleblower's recovery could be a fraction of that amount. Therefore, I worry that if the Commission imposes any kind of cap on award that high-level executives and/or highly qualified industry professionals will not come forward with large cases because it won't make economic sense for them to do so – especially when it takes 6 to 8 years to get paid after filing a case, the SEC's investigation, the settlement process, issuing a notice of covered action, filing a whistleblower application for reward, *etc.* On a risk/reward and time value of money basis, netting only 32% of the gross award (or a fraction thereof) is already unattractive to many whistleblowers.

Finally, enacting a cap would be extremely unfair to individuals who disclose industry-wide frauds. If a whistleblower's case transforms an industry, likely resulting in tens of billions saved by investors, what kind of message does capping an award send to those who made that level of impact and, in all likelihood, can no longer work in their chosen field?

The bottom line is that a minimum allowable award should be paid only when there are compelling negative factors involved in the whistleblower's submission. Perhaps the whistleblower waited until he/she was fired or laid off before filing the TCR or was one of the key people involved in the scheme, or both. The Commission needs to send a message that TCR submissions that involve poor ethical behavior by the whistleblower will be punished come award time. But capping awards only punishes whistleblowers who did everything right by taking numerous risks to assist the Commission in dismantling the largest of frauds.

e. Adjusting Upward Awards Potentially Below \$2 Million

Yes, adopting Rule 21F-6 ( c ) to extend the program to smaller cases is good public policy. Stopping securities frauds when they're small and below the \$2 million threshold is much better than stopping them when they're big and harming more investors. Otherwise there's a perverse incentive for whistleblowers to let small frauds get bigger (which always happens) and ensnare more victims before turning them in. The Commission should eliminate incentives for waiting to turn in fraud.

f. Rewarding Successful Cases Involving Non-Prosecution Agreements and Deferred Prosecution Agreements

Yes, thank you for looking to extend the program and incentivizing integrity while at the same time encouraging whistleblower cooperation with DOJ and State Attorneys General. Extending the program will result in increased detection and punishment of securities fraud, thereby lowering the cost of capital for honest businesses.

g. Allowing Alternative Mechanisms for Submitting TCRs when the Commission's Website Goes Down

Yes, by all means allow submission of a TCR via e-mail, registered mail, or any other means deemed suitable delivery by the Commission.

Here's some inside history that never fails to bring a smile to anyone hearing it from me. During the program's first week, in order to help it get started, I filed a *pro bono* case involving a very tiny Ponzi scheme that was less than eight months old and had yet to take in a lot of money, although one of the victims was a famous celebrity. Unfortunately, we made our filing on a Sunday night and the Commission's brand-new whistleblower website consistently crashed five lines into the online TCR submission. I called the applicable Regional Director at home (we knew each other quite well as he was also on the Commission's whistleblower committee) and told him about the case and the website's problems. The Regional Director had me email him the case on Sunday night and had his exam and enforcement teams read it the next morning and participate on a conference call with my whistleblower team on Monday afternoon. First thing Monday morning I called the Director of the OWB who said words to the sanitized effect of, "Oh no, I wonder how many cases we missed this past weekend!" He then had me input my TCR line by line to each failure point while he had his programmer fix each broken section of code. If memory serves we finally got stumped on page two or three and it took several days of reprogramming to get the website up and running properly. So, yes, allowing an alternate means of case submission is a wonderful idea because with hackers, normal IT glitches, power blackouts, hurricanes, *etc.*, it always pays to have a backup means of communication on which whistleblowers and the Commission can rely.

h. Additional Considerations in Making Award Determinations

The Commission has asked for comments on additional considerations that should be assessed in making award determinations and I have a few suggestions.

**First**, cases that have higher favorable economic impact on the capital markets need to be more widely advertised by the Commission to Congress and the public. The Commission's successful enforcement actions are saving investors billions of dollars going forward, yet the investing public wouldn't know it because the Commission doesn't quantify and publicize the agency's true value added to the capital markets with its enforcement actions. Right now, the Commission is vastly understating its successes because it's not conducting economic analysis of successful cases and publicizing the results. Those success stories should be presented in the statistics that the Commission submits to Congress and makes available to the public. The Commission has a very good story to tell, but it needs to find a better, more modern way to tell it in the most compelling way possible.

**Second**, as a corollary to the foregoing point, add a plus factor to each award if the whistleblower(s) agrees to waive anonymity at the end of the process and allow the Commission to use his/her name to assist in promoting the program. The current method of issuing a press release and, possibly, hosting a press conference is insufficient in the modern media era. Allowing the Commission to promote the stories of successful whistleblowers plants a seed that will germinate into better quality cases going forward, while also serving as a deterrent to anyone considering becoming a securities fraudster.

**Third**, consider the expenses that whistleblowers commit to large, complex transnational securities fraud cases run by the biggest financial services firms. Often those cases require the expenditure of many thousands of hours of investigative and legal work. Not only are the cases labor-intensive, they usually also require the purchase of expensive financial data sets and/or the hiring of consultants to assist in analyzing that data to prove that fraud is occurring and/or come up with a means to quantify actual monetary damages. Thus, in my view, cases like that deserve a plus factor in the award determination.

**Fourth**, in my experience, there is somewhat of a disconnect between enforcement attorneys and the OWB. That can create inefficiencies because enforcement staff does not always have a fulsome understanding of the process that awaits a whistleblower after a successful enforcement action. I, myself, have had an enforcement attorney react in surprise that I had not yet received an award on a successful case on which I had worked with that attorney years earlier. As a means of increasing efficiency in resolving award applications and educating enforcement staffers on the critical role they play in the process, the Commission should require enforcement attorneys, *prior to resolving any case in which they considered whistleblower information*, to provide OWB with a written summary of all of the assistance that the whistleblower(s) and the TCR provided during the case. I understand that enforcement attorneys ultimately provide OWB with a declaration describing their interactions with a whistleblower, but often those documents are prepared years after working with the whistleblower. Instead, they should be completing detailed questionnaires/checklists/rating charts about the whistleblower's assistance when it is fresh in their memories, so that the OWB staff can more easily and quickly make the proper preliminary determination of an award. In other words, don't let any whistleblower cases settle until the OWB's paperwork is completed. That should significantly improve the speed and accuracy of the process.

**Fifth**, currently there is no safe way to file a whistleblower case concerning a securities fraud case led by organized crime figures. I've had several conversations with FBI officials regarding this point and they agree. The key gap is that the Commission is simply not set up to handle organized crime cases that protect whistleblowers like the FBI, Drug Enforcement Administration and U.S. Postal Inspectors, and other law enforcement agencies do. An anonymous TCR is simply not enough protection for whistleblowers and their attorneys in a case where the perpetrators have a propensity toward violence. If the Commission cannot enact a whistleblower protection program comparable to federal confidential source protection programs, there needs to be a protocol in place whereby the attorney and whistleblowers can go to a criminal law enforcement agency with an organized crime led securities fraud and have that agency file a TCR for them, assigning confidential informant numbers in place of names. Such cases then need to be kept segregated within the Commission and available only to a select few on a "need to know" basis. It is the least the Commission can do for whistleblowers brave enough to take those life-threatening risks.

Once again, I appreciate this opportunity to comment on the proposed rule changes and interpretive guidance and wish the Commission only continued success on this vital government program.

Sincerely,  
/s/ Harry Markopolos  
Harry Markopolos  
Markopolos Research LLC