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Emily Pasquinelli, Office of the Whistleblower, Division of Enforcement
Brian A. Ochs, Office of the General Counsel
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Via email: rule-comments@sec.gov

Re: File Number S7-16-18; Whistleblower Program Rules

Dear Ms. Pasquinelli and Mr. Ochs,

On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following comments on the Securities and Exchange Commission (SEC)’s proposed rule “Whistleblower Program Rules” [File Number S7-16-18], (“proposal”) to amend the SEC’s implementation of its whistleblower rules.¹ We are concerned with a number of elements in this proposal. With this comment, we specifically oppose the proposed arbitrary cap on whistleblower awards in cases over \$30 million. However, we do support the portion of the proposal that would authorize the SEC to adjust the award percentage upward for small awards.² These comments are supplemental to group comments submitted by the National Employment Law Project, the Government Accountability Project, and Public Citizen on additional portions of the proposal.

Since 1971, Public Citizen has advocated for stronger health, safety, consumer, whistleblower protection and other rules, as well as for a robust regulatory system that curtails corporate wrongdoing and advances the public interest. Whistleblowers are integral to our mission to

¹ Whistleblower Program Rules, 83 Fed. Reg. 34702 (Jul. 20, 2018) (to be codified at 17 C.F.R. 240, 17 C.F.R. 249) <https://bit.ly/2Mzd9MV>.

² Whistleblower Program Rules, 83 Fed. Reg. 34702 (Jul. 20, 2018) (to be codified at 17 C.F.R. 240, 17 C.F.R. 249) <https://bit.ly/2Mzd9MV>.

protect the public interest since they serve as eyes and ears to rooting out government and corporate misconduct. We thank you for the opportunity to comment on this proposal.

Background

This year marks the 10th year since the economic collapse, where massive fraud led to the inflation of a housing bubble whose rupture caused widespread hardship. This month also marks the 10th year since the bankruptcy of Lehman Brothers. This major global investment bank figured at the center of the mortgage fraud that precipitated the crash. In the months leading up to Lehman's demise, Matthew Lee, a senior-vice president in Lehman Brothers' finance division, made internal disclosures about accounting problems within the bank. In a memorandum to senior management, he identified six allegations of unethical accounting.³ His whistleblowing prompted an investigation by Lehman's outside auditor, Ernst & Young, but that major accounting firm allegedly did not disclose to Lehman's independent directors what it learned in that inquiry about Lehman's risky activities⁴. About a month after Lee's disclosures, he was terminated by Lehman in what the firm claimed was a layoff.⁵ In 2010, then-New York Attorney General Andrew Coumo asserted in a lawsuit Ernst & Young that Lehman had engaged in a "massive accounting fraud" with Ernst & Young's assistance "in order to create a false impression of Lehman's liquidity, thereby defrauding the investing public."⁶

Unfortunately, Lee's story is just one of countless of Wall Street whistleblowers who risked their careers in an effort to prevent the financial crisis a decade ago. The story of Lee is true of most whistleblowers, especially those near the center of exposing major frauds. Whistleblowers not only face possible demotion and termination for speaking truth to power, but often end up facing a lifetime blacklisted from their industry. Some face retaliatory criminal investigation and prosecution. They can suffer in their family life and emotional well-being.⁷ If management and regulators heeded the warnings of whistleblowers, and if more whistleblowers had come forward, we may have been able to avert the greatest financial crisis of recent history.

The lessons learned from the Great Recession, including the mistreatment of financial industry whistleblowers, led to passage of the Dodd Frank Financial Reform and Consumer Protection Act of 2010 (Dodd Frank). Dodd Frank was intended to institutionalize greater accountability by the financial industry, and to encourage and protect whistleblowing within the financial industry.

³ Andrew Clark, *Lehman Whistleblower Lost his Job Weeks After Raising Alarm*, THE GUARDIAN (Mar. 16, 2010), <https://bit.ly/2OsaJBm>.

⁴ UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK, REPORT OF ANTON R. VALUKAS, EXAMINER 956 – 960 (2010) <https://goo.gl/Zmqmdt>.

⁵ *Id.*

⁶ Kevin Reed, *E&Y Sued Over Lehman's Audit*, ACCOUNTANCY AGE (Dec. 21, 2010), <https://bit.ly/2xfFuTA>; Karen Friefeld, *Ernst & Young Settles With N.Y. for \$10 million over Lehman Auditing*, REUTERS (Apr. 15, 2015) <https://goo.gl/H3WpVS>.

⁷ TOM DEVINE AND TAREK MAASSARANI, THE CORPORATE WHISTLEBLOWER'S SURVIVAL GUIDE (Berret-Koehler, 1st ed. 2011).

Among other reforms, it allows whistleblowers to report wrongdoing directly to the SEC, rather than requiring employees to approach their employer directly.⁸ Further, Congress authorized the SEC to provide substantial financial awards to whistleblowers “when they provide the SEC with original timely and credible information” that leads to an SEC enforcement action with over \$1 million in sanctions. The award ranges between 10 percent and 30 percent of the money recovered.⁹

The SEC has awarded more than \$320 million to 57 whistleblowers since 2012 when it issued its first award. The payments are made from an investor protection fund (IPF) that is financed through monetary sanctions paid to the SEC by other securities law violators. According to the SEC, “[n]o money has been taken or withheld from harmed investors to pay whistleblower awards.”¹⁰ In September 2018 the SEC announced its second highest whistleblower award under Dodd Frank, at more than \$39 million for one individual – which exceeded the previous high of \$33 million in March 2018, and \$30 million four years earlier. While awards this large are rare, the recoveries against wrongdoers that are significantly substantial often result from whistleblower disclosures.

In response to the March award, Jane Norberg, Chief of the SEC Office of the Whistleblower commented on the public policy significance: “These awards demonstrate that whistleblowers can provide the SEC with incredibly significant information that enables us to pursue and remedy serious violations that might otherwise go unnoticed.” She concluded, “We hope that these awards encourage others with specific, high quality information regarding securities laws violations to step forward and report it to the SEC.”¹¹

The SEC’s Office of the Whistleblower, established under Dodd Frank, states, “Assistance and information from a whistleblower who knows of possible securities law violations can be among the most powerful weapons in the law enforcement arsenal of the Securities and Exchange Commission.”¹² Based on their unique knowledge, these employees of conscience are in a position to help the SEC “identify fraud and other violations much earlier than might otherwise have been possible.” Their role provides significant benefits to the SEC, including reducing harm to investors, better preserving the integrity of the U.S. capital markets, and holding wrongdoers

⁸ *Dodd Frank Whistleblower Protections*, GOVERNMENT ACCOUNTABILITY PROJECT (viewed on Sept. 14, 2018), <https://bit.ly/2NiS7Hq>.

⁹ *Office of the Whistleblower*, U.S. SECURITIES AND EXCHANGE COMMISSION (viewed on Sept. 14, 2018), <https://bit.ly/1L3dXUO>.

¹⁰ Press Release, U.S. Securities and Exchange Commission, *SEC Awards More Than \$54 Million to Two Whistleblowers* (Sept. 6, 2018), <https://bit.ly/2oYYnFE>.

¹¹ Press Release, U.S. Securities and Exchange Commission, *SEC Announces Its Largest Ever Whistleblower Awards* (Mar. 19, 2018), <https://bit.ly/2OnNrMZ>.

¹² *Office of the Whistleblower*, U.S. SECURITIES AND EXCHANGE COMMISSION (viewed on Sept. 14, 2018), <https://bit.ly/1L3dXUO>.

accountable more quickly.¹³ The SEC whistleblower awards program models earlier proven incentive programs.

Whistleblower rewards programs have a long and fruitful history in other venues as well. Under the False Claims Act (FCA), individuals and entities with evidence of fraud against the federal government can sue the wrongdoer on behalf of the government and receive 15 percent to 25 percent of the recoveries. It is considered the most effective tool is combating fraud against the federal government. From 1987 to 2017, the federal government has recovered more than \$56 billion through the False Claims Act (FCA), and more than 70 percent of recoveries resulted from whistleblower disclosures. Senate Judiciary Chairman Charles Grassley (R-IA), the author of the FCA modern whistleblower protections, spoke in support of awards programs during this year's National Whistleblower Appreciation Day, "Tens of billions of dollars once lost to fraud has been returned to the federal treasury, all because of whistleblowers."¹⁴ Notably, the FCA does not have a 10 percent cap on awards.

Proposed Cap on Awards

We disagree with the proposal to establish a 10 percent rate cap rule in cases over \$30 million. As part of its justification for the cap, the proposal claims:

[T]he Commission may find itself faced with the possibility of paying out significantly large awards that are in excess of the amounts appropriate to advance the goals of the whistleblower program. These awards could substantially diminish the IPF [Investor Protection Fund], requiring the Commission to direct more funds to replenish the IPF rather than making that money available to the United States Treasury, where they could be used for other important purposes.¹⁵

The SEC's rationale fails to acknowledge that the IPF is funded by the monetary sanctions the SEC collects from wrongdoers – a fund that is largely dependent on whistleblower disclosures. Placing an arbitrary cap on awards could discourage some of the highest stakes whistleblowing and subsequently shrink the size of the IPF. In addition to lacking sound justification, it is also callous to the individuals who put their careers on the line to blow the whistle, and SEC is not in a position to quantify the lifetime hardships that whistleblowers face, compared to their income if they had remained silent observers.

¹³ *Id.*

¹⁴ Press Release, Chuck Grassley, United States Senator for Iowa, *Grassley: Whistleblowers Deserve Our Profound Gratitude* (Jul 30, 2018), <https://bit.ly/2OtsOzb>.

¹⁵ Whistleblower Program Rules, 83 Fed. Reg. 34702 (Jul. 20, 2018) (to be codified at 17 C.F.R. 240, 17 C.F.R. 249) <https://bit.ly/2Mzd9MV>.

Senate Judiciary Chairman Charles Grassley (R-IA), in his remarks during the 2018 National Whistleblower Appreciation Day, discussed the value of whistleblower rewards programs:

The whistleblower reward provisions don't just provide an incentive for them to step forward. In many cases the rewards are there to make them whole for the retaliation they suffer. It just makes sense—the government would never know all the ways it was getting ripped off without these whistleblowers. So whatever the government recovers because of their information, whistleblowers ought to receive a share of that.¹⁶

Sen. Grassley emphasized that “It is vitally important” that whistleblowers in important cases are “awarded what Congress has determined they are entitled to.” He said that the SEC must not “arbitrarily decide what it thinks is ‘appropriate.’” He noted: “There would be no recoveries in these cases if there were no whistleblowers. That’s just how it works.”¹⁷ We support Sen. Grassley’s estimation of the critical role the reward program plays to enable the Commission to receive quality intelligence about wrongdoing in the financial industry.

In the financial sector, compensation can be extraordinary. In 2007, 50 individuals at Lehman Brothers who were not senior executives received a collective \$700 million in compensation. The best paid individual received more than \$50 million, in one year, and more than \$100 million over the three years leading up to the crash.¹⁸ Some of these individuals may have been part of the reckless practices and fraud that led to Lehman’s bankruptcy. Others, undoubtedly, conducted themselves honestly. If the SEC caps awards, it may be less likely that those who stand to earn sums in these proportions would step forward and risk the inevitable recriminations and loss of future income to report fraud. Again, the threat to whistleblowers is substantial. Recently, the *New York Times* described a Goldman Sachs senior banker who alerted management to what he considered misconduct. He expected an investigation. “Then he was gone,” the newspaper reported.¹⁹ Such high profile, well publicized narratives serve as a chilling reminder to the potential fate of the whistleblower. To counter this, the SEC must not cap its current whistleblower award.

Conclusion

¹⁶ Press Release, Chuck Grassley, United States Senator for Iowa, *Grassley: Whistleblowers Deserve Our Profound Gratitude* (Jul 30, 2018), <https://bit.ly/2OtsOzb>.

¹⁷ *Id.*

¹⁸ *Lehman Compensation Documents*, LOS ANGELES TIMES (viewed on Sept. 17, 2018) <http://documents.latimes.com/lehman-report/>

¹⁹ Emily Fitter, Kate Kelly, and David Enrich, *A Top Goldman Banker Raised Concerns. Then He Was Gone* NEW YORK TIMES (Sept. 11, 2018) <https://www.nytimes.com/2018/09/11/business/goldman-sachs-whistleblower.html>

The SEC whistleblower awards program was established to incentivize whistleblowers, including within in some of the highest stakes financial industry cases. Placing an arbitrary cap of 10 percent on some awards sends a message to potential whistleblowers that their information is less valued, undermining the potential for the SEC whistleblower program. We urge you to rescind this portion of the proposal and instead focus on ensuring better implementation of SEC's anti-retaliation protections for whistleblowers.

For questions, please contact Shanna Devine at [REDACTED], or Bartlett Naylor, at [REDACTED].

Sincerely,

Public Citizen