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**URGENT MATTER**

Jay Clayton  
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[chairmanoffice@sec.gov](mailto:chairmanoffice@sec.gov)

Vanessa Countryman  
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**Re: TENTH SUPPLEMENTAL COMMENT: RULE 21F-6(D)  
File Number S7-16-18**

**Update: Reduction of Rewards in Large Cases (Deterrent Effect)**

Dear Chairman Clayton and Secretary Countryman:

We are writing to further comment on the U.S. Securities and Exchange Commission's ("SEC" or "Commission") proposed amendments to the whistleblower program.<sup>1</sup> We are filing this comment in order provide additional feedback on the proposed regulatory changes to Rule 21F-6 that would permit the Commission to reduce an award percentage in large cases.

As you are aware, Congress required the SEC to consider the deterrent effect of paying awards whenever the agency exercises its discretion in setting the percentage for an award. When discussing proposed rule 21F-6 in the *Federal Register*, the Commission did not elaborate on how the proposed new authority could impact the deterrent effect of paying large awards. Congress required that the Commission consider this deterrent effect whenever it exercised its discretion increase or decrease an award. 15 U.S.C. § 78u-6(c)(1)(B)(III). Thus, prior to approving any change in the current criteria for reducing rewards the Commission must also consider the impact of any new rule on the deterrent effect triggered by paying rewards.

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<sup>1</sup> See Whistleblower Program Rules, 83 Fed. Reg. 34,702 (2018), Rel. No. 34-83557; File No. S7-16-18.

Should the Commission decide to amend the rules to grant itself the discretion to reduce rewards in large cases, any such change must be carefully crafted in order to take into consideration the deterrent effect of paying large rewards, as well as the requirements set by Congress while enacting the Dodd Frank Act (“DFA”). By explicitly incorporating an analysis of the deterrent effect of paying large awards, the Commission has an opportunity to improve its current program and explicitly address how it can use its authority to set award percentages that prevent corporate fraud and positively change market behavior.

## SUMMARY RECOMMENDATION

The Commission must take the deterrent effect of paying large rewards into consideration when evaluating the amount of any award, regardless of the percentage range. 15 U.S.C. § 78u-6(c)(1)(B)(III). If the Commission were to amend its current rules to authorize reducing rewards in large cases, no reductions should be permitted in cases that would undermine the deterrent effect triggered by large rewards. Furthermore, no reduction should be authorized in cases in which a whistleblower engaged in the positive behaviors identified by Congress and identified under current [SEC rules](#). 15 U.S.C. § 78u-6(c)(1)(B)(I) and (II); 17 C.F.R. § 240.21F-6(a). Given the deterrent effect of paying rewards, the benefits of paying large rewards far outweighs the costs of those awards. Thus, the Commission must give clear instructions to its staff that no reductions should be approved if those reductions undermine the overarching goal of incentivizing whistleblowers to report securities fraud or deter other frauds on Wall Street.

## DISCUSSION

### **I. Statutory Mandates on How the Commission Must Calculate a Whistleblower Award and the Requirement to Consider the Deterrent Effect of Paying Rewards**

The text of the [Dodd-Frank Act](#) provides the best guidance as to how Congress intended the Commission to utilize its authority to set an award in the 10-30% range. Congress wanted the Commission to use its authority to set award amounts that promote positive behavior by employees who witness wrongdoing and create a deterrent effect within the market through large award payments. Congress explained the criteria it expected the Commission to utilize when setting award amounts:

*In determining the amount of an award . . . the Commission—*

*(i) shall take into consideration—*

*(I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action;*

*(II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action;*

- (III) *the programmatic interest of the Commission in **detering violations** of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws; and*
  - (IV) *such additional relevant factors as the Commission may establish by rule or regulation; and*
- (ii) *shall **not take into consideration the balance of the Fund.***

15 U.S.C. § 78u-6(c)(1)(B) (emphasis added).

When setting the amount of a whistleblower award, Congress *required* the Commission to focus both on incentivizing certain whistleblower behaviors (including disclosure of “significan[t] . . . information” and provision of “assistance” to the Commission), and on the potential deterrent effect paying awards would have on wrongdoing in the marketplace. Congress understood that the reward program could be effectively used as a tool for “[detering violations of the securities laws,](#)” recognizing that “making awards to whistleblowers” would send a very loud message to the market far beyond simply rewarding a valuable informant for providing excellent information in a timely manner. The larger the reward, the greater the deterrent effect. The higher the reward, the more likely wrongdoers would perceive that other employees, or their co-conspirators, would be seduced to report an economic crime. This was the precise rationale given by Congress in 1863 when the original False Claims Act was introduced in Congress. Senator Jacob Howard explained that he wanted to hold out a “**strong temptation**” to get co-conspirators to turn on each other. *See [Congressional Globe](#), pp. 955-56 (Feb./ 14, 1863)(emphasis added).*<sup>2</sup>

The Congressional intent to use the DFA’s reward provisions to increase the deterrent effect on committing economic crimes reflected not only in the statutory language itself, but also explicitly in the Dodd-Frank-Act [Senate Report](#). In discussing its focus on using the new whistleblower program as a deterrent, Congress explained that it “intend[ed] for this program to be used actively with **ample rewards** to promote the [integrity of the financial markets.](#)” (emphasis added).

However, nowhere in the proposed rule does the Commission attempt to explain how reducing awards, simply based on the size of the violation and the resulting award amounts, would promote these goals. In fact, the Commission did not once discuss the *deterrent* effect on wrongdoing triggered by paying large awards.

**A. Background to the Requirement that the Commission Consider the Deterrent Effect when Setting the Percentage for an Award**

The DFA created a statutory requirement that both the Commodity Futures Trading Commission (“CFTC”) and the SEC consider the deterrent effect of all payments to whistleblowers when

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<sup>2</sup> Senator Howard explained that the entire rationale behind the False Claims Act was to “hold out to a confederate a strong temptation to betray his co-conspirators.”

weighing whether to set an award at the 10% level, the 30% level or somewhere in between. The origin of this requirement is spelled out in the legislative history of the False Claims Act (“FCA”).

Unlike the DFA, the FCA did not create a mandatory requirement that the courts weigh the deterrent effect paying a large reward would have on market behavior. However, the legislative history of the FCA clearly indicates that Congress wanted to use the 1986 amendments to the FCA as a tool for deterring behaviors. Further, in 2008 Congress understood that paying whistleblowers in fact triggered a very positive deterrent effect on market behavior, and Congress clearly wanted to reinforce this deterrent effect. Thus, it is not surprising that two years later Congress made weighing the deterrent effect mandatory on the SEC and the CFTC when those two agencies exercised their discretion to set the award percentage.

On April 1, 1985 Senator Charles Grassley introduced amendments to the False Claims Act on the Senate floor. Part of his driving force for resurrecting the full potential of the FCA was to “**strengthen deterrence.**” [131 Cong. Rec. 22,322-23 \(1985\)](#) (emphasis added). This intent was reflected in the [1986 Senate Report](#) recommending the adaptation of the FCA amendments. As explained in that report: “Fraud is perhaps so pervasive and, therefore, costly to the Government due to a **lack of deterrence.** GAO concluded in its 1981 study that **most fraud goes undetected** due to the failure of Governmental agencies to effectively ensure accountability on the part of program recipients and Government contractors.” Congress then quoted to the GAO study: “For those who are caught committing fraud, the chances of being prosecuted and eventually going to jail are slim. . . The sad truth is that crime against the Government often *does* pay.”

The Senate Report also cited to findings from the Economic Crime Council of the Department of Justice, which concluded that in major “economic crime areas” the government “needed” “stronger enforcement and **deterrence.**” (emphasis added). Congress cited to witness testimony presented by the Center for Law in the Public Interest, which directly pointed to the False Claims Act’s potential for deterring economic frauds:

All of these witnesses expressed strong support for amendments to the False Claims Act. Mr. John Phillips, testifying on behalf of the Center for Law in the Public Interest, focused his remarks on the necessity for enhancing the *qui tam* provisions under the False Claims Act, saying that an effective vehicle for private individuals to disclose fraud is **necessary both for meaningful fraud deterrence** and for breaking the current “conspiracy of silence” among Government contractor employees.

[S. Rep. No. 99-345](#) (emphasis added).

Based on these reports and testimony, the Senate concluded that the FCA needed to be amended, and the whistleblower reward *qui tam* provisions needed to be significantly enhanced. Among their primary justifications for these amendments was to transform the FCA into a “much more powerful tool in **deterring fraud.**” (emphasis added).

In 2008, Congress reviewed the impact of the 1986 False Claims Act. Department of Justice officials with direct knowledge of the law’s progress over time testified on the positive impact the

whistleblower reward *qui tam* provisions had on deterring economic frauds. The theory expressed in the 1986 Senate Report, that strengthening the FCA would help deter crime, not just punish it, was clearly vindicated. According to Michael Hertz, Deputy Assistant Attorney General, Civil Division:

In the wake of **well-publicized recoveries** attributable to the *qui tam* cases, those who might otherwise submit false claims to the Federal Government are more aware than ever of the “watchdog” effect of the *qui tam* statute. We have no doubt that the Act has had the salutary effect of deterring fraudulent conduct.

S. Rep. No. 110-507 (emphasis added).

The Senate Judiciary Committee unanimously agreed with Mr. Hertz’ assessment, finding that “the presence of effective *qui tam* provisions in the FCA has a deterrent effect on those who seek to defraud the Government.”

In 2010, as part of the DFA, Congress passed two new whistleblower reward and *qui tam* provisions covering the Commodity Exchange Act and the Securities Exchange Act. Each of these laws permitted the SEC and CFTC to set the percentage for an award between 10% and 30%, but also set forth mandatory criteria the Commissions has to apply when setting these awards. Among those conditions is the deterrent effect of paying an award. 15 U.S.C. § 78u-6(c)(1)(B)(III) (the Commission “**shall** take into consideration . . . the programmatic interest of the Commission in **detering violations**”) (emphasis added).

Congress enacted the Dodd-Frank Act’s whistleblower reward provisions not only to incentivize whistleblowers to come forward, but also to act as a deterrent on future crimes and ultimately change market behavior. As explained in the Senate Report accompanying the DFA, the whistleblower provisions were “intend[ed]” “to be used actively with **ample rewards** to promote the [integrity of the financial markets](#).” In Congress’ view, large rewards would create a deterrent effect on misconduct by increasing the fear that economic crimes would be detected.

## **B. The Deterrent Effect of Paying Significant Rewards**

In a 2014 article in the [Villanova Law Review](#), University of California-Davis professor of law and Chairman of the IRS Advisory Council Dr. Dennis J. Ventry explained that whistleblower disclosures have a major deterrent effect on corporate crime. Professor Ventry outlined the deterrent effect of whistleblowing:

Whistleblowers can do more than just uncover and report knowing violations of the law. They can also prevent noncompliance from happening in the first place. An effective whistleblower program (run either through a state’s FCA or as a standalone statute) would add significant risk to noncompliance by increasing the probability of detection and the likelihood of potential penalties, the two most important variables in traditional tax deterrence models. In turn, **increased aversion to noncompliance—due to increased fear of detection**

and palpable penalties as well as additional variables such as moral, ethical and reputational inputs—would result in increased revenue collection.

Dennis J. Ventry, *Not Just Whistling Dixie: The Case for Tax Whistleblowers in the States*, 59 VILL. L. REV. 425 (Aug. 2015).

To further document the powerful deterrent effect of whistleblowing, Professor Ventry surveyed the literature on crime deterrence and noted that objective, scholarly, and empirical studies had long documented the fact that the “degree of deterrence” of crimes can be “calculated as product of probability of detection.” Or, as first explained by the Nobel Prize winning economist [Gary S. Becker](#), “for the individual to elect to engage in crime, the gain relative to its loss must exceed the odds of capture.”

Professor Ventry, citing to well-documented examples, explained the importance of paying large rewards to increase to public perception that whistleblowers increase the “odds of capture.” His conclusion on this matter was clear: “[K]eep whistleblower *awards* sufficiently high,” as “sufficiently high awards” can be used to “induce external reporting of otherwise meritorious claims and provide incentives for whistleblowers to incur the risks and costs associated” with blowing the whistle.

Numerous studies fully support Professor Ventry’s conclusions. These include: Niels Johannesen and Tim Stolper, [The Deterrence Effect of Whistleblowing: Evidence from Offshore Banking](#) (2017); Christine I. Wiedman and Chunmei Zhu, [Do the SEC Whistleblower Provisions of Dodd-Frank Deter Aggressive Financial Reporting?](#) (2017); Jaron H. Wilde, [The Deterrent Effect of Employee Whistleblowing on Firms’ Financial Misreporting and Tax Aggressiveness](#) (2017); Philip Berger and Heemin Lee, [Do Corporate Whistleblower Laws Deter Accounting Fraud?](#) (2019); Jetson Leder-Luis, [Whistleblowers, The False Claims Act, and the Behavior of Healthcare Providers](#) (2019).

The Wiedman and Zhu article looked directly at the SEC’s whistleblower program, and concluded that empirical evidence supported a finding that paying awards enhanced detection:

These findings provide evidence of significant benefits of the SEC WB Program and underscore the role that whistleblowers can play in the detection and deterrence of fraud. While companies argue that regulations are costly and onerous, this research reinforces the argument that these regulations help the SEC leverage limited resources and encourage companies to improve their financial reporting and strengthen internal controls.

A paper published by the Stockholm School of Economics surveyed academic studies supported by empirical evidence to fully confirm the deterrent effect of paying whistleblower rewards. See Theo Nyreröd and Giancarlo Spagnolo, [SITE Working Paper, No. 44: Myths and Numbers on Whistleblower Rewards](#), STOCKHOLM INST. OF TRANSITION ECON., STOCKHOLM SCH. OF ECON. (2018). Their findings are clear:

As for empirical evidence on deterrence, Johannesen and Stolper (2017) found that whistleblowing had deterrence effects in the off-shore banking sector.

\* \* \*

Wilde (2017) also provide evidence that whistleblowing deters financial misreporting and tax aggressiveness.

\* \* \*

Bigoni *et al.* (2012) conducted laboratory experiments on leniency policies and rewards as tools to fight cartel formation. They found that rewards financed by the fines imposed on the other cartel participants had a strong effect on average price (returning it to a competitive level). In the model setting, this implies that rewards have a deterring and desisting effect on cartel formation. The authors also take it that the results are significant for real world scenarios. They also found that cartel formation was significantly lower in a reward environment than in a leniency environment alone.

The study conducted by Berger and Lee, professors at the University of Chicago Booth School of Business and the Zicklin School of Business at the City University of New York, exemplifies the conclusions of all of the major studies conducted on the deterrent value of whistleblowers, specifically concluding that there is “a high direct deterrence value of whistleblower cases.” Like Ventry, Berger and Lee recognized the benefits of paying large rewards, finding that the “opportunity for a large payout creates incentives for a whistleblower to come forward with their private information about fraud or misconduct, which can alleviate personal and professional costs arising from whistleblowing on one’s employer” and “creates a profit motive for rooting out impropriety.”

These objective studies demonstrate that the benefits of deterring corporate misconduct through paying large rewards far exceeds the costs to the government of such payments. Furthermore, the funds for the rewards are generated from the very cases the whistleblowers report and are not paid from taxpayer monies. Thus, the actual monetary costs of paying large rewards is miniscule in comparison to the deterrence value of such payments. These benefits far exceed the direct monetary benefits derived from the specific whistleblower-generated sanction. This deterrence value generates long-range and high-value benefits to investors, taxpayers, and the markets.

### **C. Case Studies: The Deterrent Effect of Paying Significant Rewards**

Objective academic studies have verified that paying whistleblower rewards has a major impact on the deterring economic crimes. For example, Jetson Leder-Luis careful study, [\*Whistleblowers, The False Claims Act, and the Behavior of Healthcare Providers\*](#) (2019), documented that the deterrent value of whistleblower cases is over six-times as great as the immediate enforcement value. Leder-Luis looked at four major health care enforcement actions filed under the *qui tam* provisions of the False Claims Act. The cases directly resulted in a total of \$1.9 billion in

government recoveries. However, the deterrent value of these cases over the next five years was calculated to be \$18.9 billion. As reported:

These 4 whistleblower case studies recovered around \$1.9 billion for the federal government, but exhibit even greater benefit in deterrence effects, totaling around \$18.9 billion. The average deterrence effect for these cases is around 6.7 times the settlement value over 5 years.

\* \* \*

Overall, these results indicate that the direct deterrence benefits of whistleblowing cases often exceed the settlement values many times over, and greatly exceed the retrospective damages used to compute those settlement values. This indicates a large savings to the Medicare program as a result of these whistleblowing cases, exceeding both the direct recoveries to the government from the settlement as well as the whistleblower compensation.

\* \* \*

In addition to the fiscal effects described in the previous section, whistleblowing under the FCA creates incentives for providers to change the way they conduct healthcare.

In another objective economic study Philip Berger and Heemin Lee, in their article "[\*Do Corporate Whistleblower Laws Deter Accounting Fraud?\*](#)" (2019), reviewed data related to accounting frauds. They concluded that the "exposure" to "False Claims Act" liability "reduces the likelihood of accounting fraud by 5% to 9%." Based on this they concluded: "Collectively, our results are consistent with the notion that the enhanced whistleblower regulation with a bounty model effectively motivates managers to prevent and avoid fraud, and we provide reasonable causal quantification of this effect on the population of affected firms."

Professor Ventry looked directly at the impact paying large rewards. He looked at the fall-out from Mr. Bradley Birkenfeld's disclosures documenting illegal offshore banking in the Swiss bank UBS. This review is significant as Mr. Birkenfeld's award was the largest public award paid, to date, to an individual whistleblower. Professor Ventry described the long-term "collateral impact" and "effect" of Birkenfeld's whistleblowing:

The "treasure trove of inside information" that Birkenfeld provided U.S. officials formed "the foundation for the UBS debacle and everything that followed." Indeed, thanks to one of "the biggest whistleblowers of all time," the U.S. government (take a deep breath) received: \$780 million and the names of 250 high-dollar Americans with secret accounts as part of a deferred prosecution agreement (DPA) with UBS; another 4,450 names and accounts of U.S. citizens provided as part of a joint settlement between the U.S. and Swiss governments; more than 120 criminal indictments of U.S. taxpayers and tax advisors; additional indictments against foreign bankers, advisors, and lawyers;



still more foreign nationals pleading guilty to conspiring to assist U.S. taxpayers to file false returns and evade U.S. taxes; the closure of prominent Swiss banks—including the oldest private bank—based on their participation in helping U.S. clients evade tax liability; more than \$5.5 billion collected from the IRS Offshore Voluntary Disclosure Program (OVDP), with untold tens of billions of dollars still payable due to only a quarter of the 39,000 OVDP cases being closed; program participants ratting out banks as a requirement of their participation; banks themselves disclosing the names and accounts of clients who refuse to participate in the program to avoid their own monetary penalties and to defer or avoid criminal prosecution; and the IRS aggressively going after taxpayers who tried to “stay under the radar” by failing to participate in the program and then “quietly” filing amended returns on foreign bank accounts for prior years. All because one person blew the tax whistle.

As explained by Mr. Ventry, the deterrent effect of Mr. Birkenfeld’s massive award achieved [unprecedented reforms concerning illegal offshore banking](#), money laundering, and tax evasion. The Internal Revenue Service (“IRS”) was able to leverage that payment to achieve remarkable enforcement successes resulting in billions of dollars recovered and tens of thousands of illegal accounts closed. In 2009, capitalizing on the fear of detection triggered by Mr. Birkenfeld’s disclosures, the IRS launched an “Offshore Voluntary Disclosure Program,” allowing taxpayers with undisclosed offshore accounts to self-report their crimes, reduce their penalties, and possibly avoid criminal prosecution. As of 2018, more than [56,000 delinquent taxpayers had come forward and the IRS had collected \\$11.1 billion in back taxes](#), while numerous individuals were [successfully prosecuted](#).

After Birkenfeld’s award was announced, other Swiss bankers were motivated by Birkenfeld’s historic whistleblower payment and started to blow the whistle on their banks. As of 2014, nearly every Swiss bank had executed a settlement or plead guilty to tax crimes, often on the basis of whistleblower disclosures. In addition to the \$11.1 billion collected from individual tax cheats, the United States collected an additional \$5.09 billion from numerous Swiss banks. Thus, triggered by one whistleblower, the [largest fraud prosecutions](#) in U.S. history were [successfully completed](#), and the U.S. taxpayers have, as of 2018, recovered \$16.19 billion.

The Swiss banking industry quickly realized the impact paying a whistleblower a \$104 million award would have on other employees working in that industry. Days after the Birkenfeld award was announced, bankers and their consultants held a major industry meeting in Geneva, Switzerland. At this meeting, the attendees “seethed” at Birkenfeld and attacked his “total lack of morality” for blowing the whistle on them. According to a reporter from *Agence France-Presse* who attended the meeting, Birkenfeld had “driven the nail into the heart of the once seemingly invincible Swiss bank secrecy” system. A respected banking consultant reportedly declared that their U.S. client offshore banking program was “over.”<sup>3</sup>

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<sup>3</sup> The *Agence France-Presse* article is reprinted at:  
<https://dailystar.com.lb/ArticlePrint.aspx?id=188088&mode=print>.

The day after the Birkenfeld award was announced, the publication [SwissInfo](#),<sup>4</sup> reported on the reaction to the award in the Swiss newspapers, and published the following summaries of multiple Swiss press stories:

*The [Blick](#) tabloid newspaper said . . . it proves how ruthlessly US officials are pursuing tax evaders and how determined they are to dry up tax havens.*

*Zurich's [Tages-Anzeiger](#) went further describing it as a "seductive offer for bankers." "This enormous reward show how the US are raising the stakes in their tax fight with Switzerland . . . in promising such high compensation the IRS are hoping that more incriminating material is handed over."*

*The French-speaking daily [Le Temps](#) agreed that Birkenfeld's huge reward could encourage other bank employees to follow his example.*

These Swiss banking officials explained why large rewards have a massive deterrent effect. Large rewards highlight the risk of detection. As explained by Ben Johnson, in this study published by the *Minnesota House Research Department*, "When people believe they will be caught and punished, they are less likely to commit crimes." Mr. Johnson discussed the Nobel Prize winning economist Gary Becker's economic theory that "an increase in the likelihood of apprehension" has a "greater impact on the number of offences than an increase in punishment." See *Minnesota House Research Department, Do Criminal Laws Deter Crime? Deterrence Theory in Criminal Justice Policy: A Primer*, 4.<sup>5</sup>

## **II. The Commission Did Not Evaluate the Impact on the Deterrent Effect of Paying Whistleblower Reward in its Rulemaking Proposal**

The primary justification for approving this new authority was to "help ensure that the Investor Protection Fund (IPF) that Congress has established to pay meritorious whistleblowers is used in a manner that effectively and appropriately leverages the IPF to further the Commission's law-enforcement objectives." This justification was troublesome, due in part due to Congress' explicit directive that the amount of money in the IPF was not permitted to be criteria for determining the amount of an award. Congress anticipated that the Commission may attempt to reduce awards based on the amount of funds in the IPF (i.e. the pool of money collected from sanctions that was earmarked to pay rewards from), and prohibited any such cost-benefit approach: "In determining the amount of an award made under subsection (b), the Commission . . . shall not take into consideration the balance of the Fund." [15 U.S.C. § 78u-6\(c\)](#) (emphasis added).

In the [commentary to the proposed rules](#) the Commission staff also reasoned that reducing the amount of an award could promote the whistleblower program and incentivize reporting. The Commission staff explained this apparently contradictory approach as follows: "[A]djust[ing] an award downward so that the dollar amount of the payout is more in line with the program's goals of rewarding whistleblowers and incentivizing future whistleblowers from a cost-benefit

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<sup>4</sup> Available online at [https://www.swissinfo.ch/eng/whistleblower-payoff\\_birkenfeld-reward-may-tempt-other-bankers/33500198](https://www.swissinfo.ch/eng/whistleblower-payoff_birkenfeld-reward-may-tempt-other-bankers/33500198).

<sup>5</sup> Available at <https://www.house.leg.state.mn.us/hrd/pubs/deterrence.pdf>.

perspective.” How “adjusting an award downward” could be consistent with the “programs goals of rewarding whistleblowers and incentivizing future whistleblowers” was not adequately explained.

Neither justification discussed, directly or indirectly, the impact reducing awards in the largest cases could have on the deterrent effect of the DFA’s reward program. Given Congress’ explicit requirement that the deterrent effect of paying awards be weighed every time the Commission makes a decision setting the percentage range for an award, it is incumbent upon the Commission to carefully consider these matters during the rulemaking adjudication.

### **III. Legal Requirements for Increasing or Decreasing Whistleblower Rewards**

Congress intended the Commission to leverage the size of its award to accomplish two goals: (1) encourage positive reporting behaviors by potential whistleblowers; and (2) create a deterrent effect on wrongdoing in the market. The factors that Congress (and the Commission) intended to trigger a large reward at or close to the 30% level were:

- “Significance of the information provided by the whistleblower”;
- The “assistance” the whistleblower “provided” to the Commission;
- The impact an award may have on the Commission’s “interest in deterring violations of the securities laws by making awards to whistleblowers”;

Paying rewards at the highest levels achieves these purposes. Reducing awards, based on their size alone, could completely contradict these goals. Reduction in a whistleblower reward based on the overall size of a reward would have a highly detrimental effect on the deterrent effect of the law, undermine the language in the statute, and negate the clear intent of Congress.

On the other hand, Congress also understood that the Commission could utilize its ability to reduce the amount of an award to discourage negative conduct within the market. In 2011, when the Commission issued its first set of rules governing the whistleblower program, it [identified factors to decrease an award](#). Among these factors are:

- “Culpability,” i.e. “the whistleblower's role in the securities violations”;
- “Whether the whistleblower financially benefitted from the violations”;
- “Whether the whistleblower knowingly interfered with the Commission's investigation of the violations”;
- “Whether the whistleblower unreasonably delayed reporting the securities violations”;
- Whether the whistleblower “interfered with an entity's established legal, compliance, or audit procedures to prevent or delay detection of the reported securities violation”;
- Whether the whistleblower “made any materially false, fictitious, or fraudulent statements.”

These criteria are all valid reasons for reducing a whistleblower reward.

Regardless of the specific justifications for increasing or decreasing an award, the empirical evidence and academic literature demonstrate that paying large rewards will have a deterrent effect

on wrongdoers. It is common sense that corporate wrongdoers would have an increased fear of detection if they understood that corporate employees or executives could obtain extremely large rewards for reporting securities frauds. The trust necessary for a large, sophisticated economic criminal conspiracies to be successful is undermined by the payment of large rewards. It will increase the fear of detection that is a critical element in preventing crimes.

## CONCLUSION

### **Factors that Need to be Considered when Evaluating Rules that Would Permit the SEC to Reduce Rewards in Large Cases**

The Commission already possesses the authority to reduce awards. But these reductions must be consistent with the primary goals Congress set forth in the Dodd-Frank Act itself.

Rewards should be paid at the maximum levels if the underlying facts are consistent with the criteria set forth by Congress for increasing the size of a reward. The ability of the Commission to reduce rewards in such cases, based solely on the size of a sanction or a potential reward, should be strictly prohibited. Paying a 30% reward is a small price to pay for obtaining the benefits Congress set forth in the Dodd-Frank Act.

On the other hand, paying large rewards to persons who engage in the negative behaviors outlined by the SEC in its current rules does not similarly serve the public interest. The Commission clearly has the authority to take the amount of an overall reward into consideration when lowering the percentage of an award where whistleblowers engaged in the bad behaviors identified by the Commission, such as interfering in Commission investigations or providing false or misleading information to the SEC. In such cases, the Commission can use its authority to approve the amount of a reward to serve the public interest and discourage bad behavior.

Thus, should a rule be approved that permits the Commission to take the overall amount of a potential payment into consideration when adjusting the percentages permitted under law, the following three criteria must be applied:

1. No reduction in cases that could negatively impact the deterrent effect of paying a large reward;
2. No reduction in cases in which whistleblowers engage in the positive behaviors outlined by Congress (and approved by the Commission in the 2011 rulemaking) in order to encourage those behaviors in future whistleblowers, and reward those behaviors in the cases under consideration;
3. Reductions based on the overall amount of a potential reward could be permitted in cases in which the whistleblower engaged in the negative behaviors for which the Commission legitimately wants to discourage in the market, as identified in its current regulations.

If the Commission were to amend its current rules to authorize reducing rewards in large cases, no reductions should be permitted in cases that would undermine the deterrent effect triggered by large rewards. Furthermore, no reduction should be authorized in cases in which a whistleblower engaged in the positive behaviors identified by Congress and identified under current [SEC rules](#). The Commission must give clear instructions to its staff that no reductions should be approved if those reductions undermine the overarching goal of incentivizing whistleblowers to report securities fraud or deter other frauds on Wall Street.

This letter is submitted on behalf of the undersigned law firm and on behalf of the National Whistleblower Center.

Thank you for your careful attention to these matters. We would welcome the opportunity to more fully explain this proposal.

Respectfully submitted,

/s/Stephen M. Kohn

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