December 17, 2010

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-33-10, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934

Dear Ms. Murphy:

Ethics and compliance rank highly among the characteristics needed in today's corporations, and a proper system for internal whistleblowing is vital to those causes. Since 1977, the National Association of Corporate Directors (NACD), a nonprofit educational organization, has provided corporate directors with resources to help them maintain the most ethical tone at the top, as well as effective compliance systems. We convene, educate, and inform 10,000+ members on many issues, including ethics and compliance.

NACD is grateful for this opportunity to comment on the SEC's Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934. These whistleblower provisions provide an incentive for persons having "independent knowledge" of possible corporate wrongdoing to report directly to the SEC. In NACD's opinion, the legislators who enacted the original provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) did not weigh the consequences the provisions could have on the ethical and compliance-based cultures of corporations. A strong corporate culture is one of the best tools a company has for combating fraud. We are writing this letter in order to bring about a more workable regulatory solution.

NACD is primarily concerned with the chilling effect that these proposed rules may have on current internal compliance systems already in place, thanks in part to existing regulatory and professional requirements. Attorney conduct rules in Section 307 of the Sarbanes-Oxley Act (Sarbanes-Oxley), as well as current ethics rules of the American Bar Association (Model Rule 1.13(b)), require attorneys to report suspected legal violations "up the ladder." Furthermore, additional rules under Sarbanes-Oxley (Sections 301 and 406) require that public companies have hotlines for reporting accounting concerns as well as codes of ethics supported by "prompt internal reporting to an appropriate person or persons identified in the code of violations of the code." The new whistleblowing rules should build on these requirements for internal reporting. The rules should include a requirement for all employees to report to immediate supervisors prior to submitting complaints to the SEC. At a minimum, a requirement for reporting up the

ladder would ensure that attorneys adhere to their Section 307 rules and professional ethics by informing corporate supervisors. More broadly, early reporting up the ladder will have the effect of useful pre-screening of complaints. Whistleblowing systems often elicit complaints about management matters best addressed by internal human resources professionals. Such matters are not appropriate for SEC investigations conducted at taxpayer expense.

We recognize that the SEC's proposed rules attempt to promote the use of internal systems by granting higher monetary rewards to whistleblowers who first report their complaints to the company, and by giving companies some time to address problems internally, before the SEC investigation begins. We also acknowledge that the rules set forth seven exceptions to the "independent knowledge" definition intended to promote the use of internal systems. These exceptions, however, do not go far enough to ensure the full use of internal systems. With certain restrictions, any individual should be able to report suspected legal violations through an internal whistleblower system that includes the ability to report to the SEC. Therefore, the rules should require individuals to make use of corporate compliance systems prior to submitting any allegations to the SEC.

We also have strong reservations about the incentive system for whistleblowers. The proposed rule establishes a large "bounty" for information that leads to enforcement actions by the SEC. This bounty may incentivize individuals to avoid internal compliance systems and deal directly with the SEC. We understand the SEC's need to learn of violations that are not being detected and addressed within the company; however, the rules as currently proposed may bypass the company's ability to address these internally as they arise. In this letter, we hope to help the SEC reshape the rule to maintain robust compliance systems while still pursuing the intent of the Dodd-Frank mandate. We ask the SEC to consider the following commentary responding to specific questions asked in the proposal.

NACD Commentary

Request for Comment #6:
Should the rule [in defining "independent knowledge"] preclude submissions from all government employees?

NACD strongly believes that the proposed definition of "independent knowledge" should exclude government employees. The government and its agencies, as regulatory bodies, are already charged with discovering fraud and other damaging activities. Awarding bounties for government responsibilities undermines the very purpose of the government and its laws, including the Dodd-Frank Act. Rather, the rule should be aimed at stopping potential fraud before government agencies are required to act.

Request for Comment #9
Is it appropriate to exclude from the definition of "independent knowledge" or "independent analysis" information that is obtained through a communication that is protected by the attorney-client privilege?

NACD believes the proposed rule should exclude from the definition of "independent knowledge" all communications with attorneys, even in cases where the privilege has

been waived for any reason. The proposed whistleblower rule excludes from the definition of "independent knowledge" a communication that is "subject to the attorney-client privilege." However, the concept of "privilege" has never been well defined. The rule should define some types of communication that under all circumstances and without exception should be included in the definition of privilege.

Request for Comment #11

Should the exclusion for "independent knowledge" or "independent analysis" go beyond attorneys and auditors, and include other professionals who may obtain information about potential securities violations in the course of their work for clients?

The "independent knowledge" definition should also exclude professionals hired by the board of directors, such as consultants or attorneys. The responsibilities of public company boards have expanded in recent years as the challenges of the business environment and the burden of regulations have grown. In response, NACD and others have recommended that boards of directors hire outside consultants for independent advice on areas such as compensation, audit, strategy, crisis, and risk. In the course of their work, these outside consultants are given access to company information that may be sensitive or reveal potential wrongdoing by the corporation. For the benefit of candid advice and consultation, boards and outside consultants must establish trust. This trust would be undermined when outside consultants could be awarded a bounty with the submission of damaging information about the corporation. Therefore, individuals hired by the board for the purpose of advice and consultation should not be deemed to have "independent knowledge" for the purpose of receiving bounties and protection.

Request for Comment #13

Do the proposed exclusions for information obtained by a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity … strike the proper balance? Should a "reasonable time" be defined in the rule?

It must also be made clear that individuals in an internal audit function, or those individuals working in the capacity of internal audit, are not deemed to have "independent knowledge." The rule should make it clear that anyone performing or supporting an internal audit function must be specifically excluded. Additionally, this exclusion must be extended to those individuals who may perform the functions of internal audit but whose job titles and responsibilities may differ. Oftentimes, an individual in a different department of an organization may have temporary duties that aid the internal auditors. Such individuals must also be excluded from the rule because they are given access to information that may lead to a whistleblower submission.

Exclusions should apply to all employees who provide information at the request of internal or external auditors. Currently, none of the exclusions specifically apply to company employees who interact with independent public accountants. As a result, company accountants providing information at the request of external auditors will still be considered to have "independent knowledge" and "independent analysis." It cannot be considered independent analysis if an auditor's request calls attention to a matter that should be reviewed. In this event, the company accountant would be incentivized to ignore other internal compliance processes and proceed directly to the SEC as a whistleblower.

Accountants serve as indispensible elements of the audit process; their knowledge and information contribute significantly to the integrity of the internal compliance function. Those individuals who compile information for auditors as part of the internal compliance function should be excluded so as to maintain strong internal compliance systems.

As for the "reasonable period of time," this could be three to six months—no less than 90 days and no more than 180 days. Only after this period would the SEC be permitted to take any enforcement actions. The period may be shortened to prevent material harm that is evident and immediate, or lengthened in some circumstances. In this manner, costly enforcement actions can be avoided if the company takes steps to resolve any wrongdoing first.

Request for Comment #16

Does the provision regarding the providing of information to a company's legal, compliance, or audit personnel appropriately accommodate the internal compliance process?

NACD believes that all individuals deemed to have "independent knowledge" must report allegations or violations to the internal compliance system prior to submitting them to the SEC. The proposed rule allows employees not covered under an "independent knowledge" exclusion to bypass the internal compliance functions. While the rule includes incentives for using the internal compliance function, such as a higher reward, the proposed rule incentivizes employees to be whistleblowers first and loyal employees second. We understand and agree that after a certain amount of time or inaction by the company in response to an allegation of wrongdoing, an employee should be able to approach the SEC with a whistleblower submission. However, there is little motivation or reason for a company to build an effective internal compliance system if the corporate employees are not expected to use it and can bypass it at anytime.

The proposed rule should require and encourage employees to use the internal compliance function prior to approaching the SEC. NACD recommends amending the rule to require an individual to first submit an allegation to internal compliance. After the initial report, the individual may submit the allegation to the SEC. The SEC would then contact the general counsel (GC) or chairman of the audit committee, and advise the GC or chairman to solve any issues or violations and report back within a reasonable period of time (see Request for Comment #13).

Request for Comment #17

Is the 90-day deadline for [reporting] to the Commission (after initially providing information about violations or potential violations to another authority or the employer's legal, compliance, or audit personnel) the appropriate timeframe?

Again, as described in the response to Request for Comment #13, NACD believes that the period for reporting should be between three and six months (90 to 180 days).

Request for Comment #42

Should the anti-retaliation protections …be applied broadly to any person who provides information to the Commission concerning a potential violation of the securities laws?

NACD believes that employers should have the ability to use existing disciplinary measures to respond to employees who circumvent the compliance systems or make false allegations against a company. As the propose rule is currently written, it seems as if potential whistleblowers can enjoy retaliation protections whether or not they satisfy the conditions for an award. This opens the door for employees to submit fake allegations that may cause reputational harm to the company and/or unfairly embarrass corporate employees and leadership.

Conclusion

The SEC's goal of helping to enhance effective whistleblowing is to be commended. However, the problems with the Dodd-Frank whistleblowing provisions are so great that even the most enlightened rulemaking may not be able to correct them. The changes we have recommended above can help to foster more effective and workable whistleblower programs for the good of companies, shareholders, and all stakeholders.

Sincerely,

Barbara Hackman Franklin
Chairman
NACD

Kenneth Daly
President and CEO
NACD