December 17, 2010

VIA E-MAIL RULE-COMMENTS@SEC.GOV

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

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

Dear Ms Murphy:

The National Society of Compliance Professionals ("NSCP") appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or the "Commission") proposed rules (the "Proposed Rules") for implementing the whistleblower provisions of Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act") as set forth in Release No. 34-63237 (November 3, 2010) (the "Proposing Release").

NSCP is the largest organization of securities industry professionals devoted exclusively to compliance issues, effective supervision, and oversight. The principal purpose of NSCP is to enhance compliance in the securities industry, including firms' compliance efforts and programs and to further the education and professionalism of the individuals implementing those efforts. An important mission of the NSCP is to instill in its members the importance of developing and implementing sound compliance programs across-the-board.

Since its founding in 1987, NSCP has grown to over 1,800 members. NSCP's membership is drawn principally from broker-dealers, investment advisers, bank and insurance affiliated firms, as well as the law firms, accounting firms, and consultants that serve them. NSCP membership is unique in that the vast majority of its members are compliance and legal personnel from financial services firms that span a wide spectrum, including employees from the largest brokerage and investment management organizations to operations with only a handful of employees.

The Proposed Rules would implement the whistleblower provisions of Section 21F by prescribing the regulations under which the Commission would pay awards to eligible

whistleblowers who voluntarily provide the Commission with original information about a violation of the federal securities laws resulting in a successful enforcement action in which the Commission obtains monetary sanctions exceeding $1,000,000. The offering of potentially lucrative rewards to whistleblowers is meant to encourage individuals with knowledge of significant unlawful activities to report such matters to the SEC with the goal of enhancing the efficiency and effectiveness of the Commission's enforcement program. Balanced against this intended and clearly laudable consequence is the possibility, as noted in the Proposing Release at 4, that these monetary incentives may negatively impact the effectiveness of existing compliance and other processes that companies have implemented for the purpose of investigating and responding to potential violations of the federal securities laws.

The possibility of this unintended, deleterious consequence is of great concern to NSCP, whose central mission is to enhance compliance efforts. Such possibility is of equal concern to NSCP's members, the vast majority of whom are involved in day-to-day activities integral to compliance and related processes. While NSCP and its members embrace the benefits in law enforcement that a well-functioning whistleblower program can offer to the Commission, the investing public and the financial services industry, we also feel strongly that it is vital that any whistleblower program be designed and implemented in a manner that is aligned with, and does not serve to undermine, existing compliance and related programs of the firms that we serve.

NSCP Supports the Commission's Goals

Before setting forth its views on the Proposed Rules, NSCP would like to reiterate that it strongly supports the overall goal of Section 21F and the Commission's Proposed Rules in identifying and rectifying violations of the securities laws. As noted above, NSCP also believes that a carefully drawn whistleblower program can offer significant assistance towards this goal.

Nevertheless, NSCP believes that, as currently drafted, the Proposed Rules fall short of the standard set forth above because their design and implementation is not aligned with, and, in fact, serves to undermine, existing compliance and related programs of the firms that our members serve. Significantly, the potential monetary award provided under the Proposed Rules acts as a strong disincentive to employee use of internal reporting mechanisms, which mechanisms lie at the heart of firms' internal compliance programs. For this reason, NSCP believes that it is not enough that the Proposed Rules merely do not discourage internal reporting by employees; NSCP believes they must encourage internal reporting by employees, which is something that the Proposed Rules, as drafted, do not accomplish. As a result, NSCP believes that the Proposed Rules are likely to undermine firms' existing compliance and related

programs and result in more harm than good, at considerable cost to the Commission, the industry, and the public.

NSCP's views in this regard are discussed in detail beginning in the immediately following section of this letter. NSCP is also recommending certain additional changes to the Proposed Rules, which recommendations are set forth below under the heading "NSCP's Response to Specific Questions."

The Need to Move Beyond "Not Discouraging" to Actual Encouragement

As noted above, while NSCP believes that a whistleblower program can offer significant assistance towards the Commission's goal of identifying and rectifying violations of the securities laws, it also cautions that a program that fails to encourage internal reporting by employees will inevitably have a negative impact on internal compliance processes. To be clear on this point, NSCP believes strongly that the inclusion of provisions in the Proposed Rules that, in the words of the Proposing Release, are merely "intended to not discourage" internal reporting is not sufficient to avoid this negative impact.[1] NSCP believes that because the Proposed Rules do not actively encourage internal reporting, they are likely to move the Commission further, rather than closer, to its ultimate goal of identifying and rectifying violations of the securities laws.

NSCP notes with approval the similar views expressed by the Commission's Chairman in her opening statement at the SEC open meeting at which the Proposing Release was approved. Specifically, Chairman Schapiro characterized the Proposed Rules as "seek[ing] to reduce the chance that employees unnecessarily bypass internal compliance programs that their own companies may have established."[2] The Chairman further emphasized the importance of this issue noting that the Commission's "goal is not to, in any way, reduce the effectiveness of a company's existing compliance, legal, audit and similar internal processes for investigating and responding to potential violations of the securities laws."[3]

Similarly, Commissioner Walter in her opening statement also highlighted "the importance of ensuring that the robust whistleblower program we are committed to establishing does not

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[1] The Proposing Release at 4 (emphasis added).

[2] Speech by SEC Commissioner: Opening Statement at the SEC Open Meeting: Item 3 – Whistleblower Program, available at www.sec.gov/news/speech/2010/spch110310mls-whistleblowers.htm (emphasis added).

[3] *Id.* (emphasis added).

undercut existing and effective company compliance and other internal processes for responding to violations of the federal securities laws. I believe that these processes are important, and to protect investors it is critical that they also remain robust."[4] Commissioner Walter also noted the focus of the staff and Commissioner Casey on this issue.[5]

NSCP is in complete accord with Chairman Schapiro and Commissioner Walter that the whistleblower rules must not undercut existing firm compliance programs or in any way contain incentives to bypass these programs. Based on our members' collective experience operating those internal firm compliance programs, however, NSCP simply cannot agree that the Rule Proposals, as currently drafted, will achieve those shared objectives. Indeed, NSCP believes that the Proposed Rules not only would fail to reduce the likelihood employees would bypass their employers' internal compliance programs, but actually contain disincentives to the use of internal compliance programs. By discouraging internal reporting, the Proposed Rules would lead directly to the result that Chairman Schapiro and Commissioner Walter have stated must be avoided.

NSCP's views in this regard follow from the fact that timely and complete reporting of possibly unlawful activity to internal compliance, legal, supervisory or other management personnel provides a firm an opportunity to halt the violation at the earliest possible opportunity, address any deficiencies in procedures or systems, make restitution to customers or counterparties, bring such matter to the Commission's attention and otherwise cooperate with any Commission action resulting therefrom. Each of these are positive results that should be encouraged. Such prompt ameliorative actions, however, could well have the effect of reducing any monetary sanction that the Commission ultimately obtains and thereby reducing or even eliminating any resultant whistleblower award.

Specifically, prompt internal reporting would give the subject entity an opportunity to identify, analyze and correct the identified violation, which should serve to limit the scope of the problem and, therefore, the likely size of any Commission sanction. Internal reporting also gives the subject entity a chance to report the problem to the Commission, take remedial action, cooperate with the SEC's own investigation and otherwise take the type of actions that the SEC has identified as likely to lead to "credit . . . in deciding whether and how to take

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[4] Speech by SEC Commissioner: Implementation of 21F of the Exchange Act, "Whistleblowers Incentive and Protection" (proposed rules and forms) – Whistleblower Program, available at www.sec.gov/news/speech/2010/spch110310ebw-whistleblowers.htm (emphasis added).

[5] *Id.*

enforcement action. . . ."[6] Accordingly, it is clear that internal reporting is not in the whistleblower's self-interest and, therefore, that the monetary award provided under the Proposed Rules acts as a strong disincentive to the use by whistleblowers of internal reporting mechanisms.

The only offset to the whistleblower's self-interest not to report internally is the inclusion in the Proposed Rules of a provision stating that internal reporting by a whistleblower is a factor that the Commission may discretionally consider in determining the percentage of the monetary sanction (in the range between 10% to 30%) that the whistleblower will receive.[7] While this possibility of an increased percentage recovery may serve to partially offset the disincentive to report internally, NSCP believes that this possibility will not materially outweigh the rational self-interest of the whistleblower to let violative activity fester and to bring it to the Commission's attention without affording the firm the opportunity to fix the problem and mitigate the consequences.

Moreover, any impact that this consideration may have on the whistleblower's self-interest not to report internally is undercut by the Commission's express willingness to ignore this consideration entirely based upon the whistleblower's "fear of retaliation. . . ."[8] This is likely to be especially true to the extent the Commission allows the whistleblower's determination to be based upon his or her own subjective viewpoint. As a result, absent the provision by the Commission of clear and objective standards, NSCP believes that that the Commission's ability to consider whether the whistleblower reported internally as part of its award determination is unlikely to offer a meaningful incentive to the use of internal reporting systems by whistleblowers.

To be clear the whistleblower program is not intended to appeal to the many conscientious, compliance-oriented "good Samaritans" in the industry. They are presumably already reporting matters to their firms or the Commission. Rather, the whistleblower program is based on a calculus that providing a financial windfall to persons who would otherwise keep silent despite their knowledge of wrongdoing will increase detection of such wrongdoing. It is unrealistic to base development of whistleblower rules on a belief that, having established the program, whistleblowers will internally report because it is the "right thing to do."

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[6] The Seaboard Report, SEC Release No. 34-44969 (Oct. 23, 2001), available at http://www.sec.gov/litigation/investreport/34-44969.htm#framework; *see also*, the SEC's "Enforcement Cooperation Initiative" available at http://www.sec.gov./spotlight/enfcoopinitiative.shtml.

[7] *See* the Proposing Release at 51.

[8] *Id.*

In light of this inherent disincentive, NSCP does not believe that it is enough that the Proposed Rules merely not discourage internal reporting. For the Proposed Rules to achieve the Commission's goal as stated by Chairman Schapiro that the rules not "in any way, reduce the effectiveness of a company's existing compliance, legal, audit and similar internal processes," it is absolutely necessary that the Proposed Rules actively encourage internal reporting by employees.[9]

The Benefits of Internal Reporting

Absent a means of encouraging internal reporting, NSCP believes that it would be reasonable to view the Proposed Rules as a means of "outsourcing" internal compliance functions to the SEC by encouraging information flows to by-pass established internal processes so that they can instead be reviewed by the SEC. Substituting the SEC in the performance of these reviews in place of the subject entity also means substituting the SEC's lack of knowledge and familiarity with the subject entity's business, systems, personnel, structure and the like in place of the depth of experience and knowledge typically found within financial service firms. As a result, substituting the SEC in place of the subject entity can be expected to result in a review that is not only less thorough but also less timely. In light of these obvious inefficiencies, "outsourcing" these reviews to the SEC by encouraging information flows to by-pass established internal processes seems ill advised.

Moreover, as an organization that seeks to enhance compliance within the securities industry, NSCP is concerned that, in light of the SEC's already strained resources, especially when measured against the Commission's rapidly expanding responsibilities, these "outsourced" responsibilities will strain if not entirely displace other, perhaps more critical functions, currently performed by the SEC.[10]

The foregoing concerns would still be true even were the SEC to limit its role to one of merely asking the subject entity to review the whistleblower's report and report back to the SEC. In this case, the SEC's responsibilities start with the receipt of a report, which must be logged in, assigned to the subject company, and tracked. Moreover, in order to preserve the confidentiality of the whistleblower, effort will be required to redact or rewrite the report

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[9] Speech by SEC Commissioner: Opening Statement at the SEC Open Meeting: Item 3 – Whistleblower Program, available at www.sec.gov/news/speech/2010/spch110310mls-whistleblowers.htm (emphasis added).

[10] *See* "Regulator is Slowed by Budget Impasse," WALL ST. J., Dec. 15, 2010, at C1 (discussing impact of recent budge concerns on the pace of the SEC's investigations and routine inspections).

before it is passed along to the subject company. On the back end, the subject entity's response must be reviewed and, if it is not clear to the SEC or otherwise satisfactory, there is likely to be further follow up and discussion between the SEC and the subject entity. As a result, even where the SEC passes a report back to the subject entity, it seems likely that the SEC will be required to devote significant effort to this task, which effort must be weighed, of course, against other uses of such resources by the SEC.

Avoidance of internal reporting mechanisms and, instead, reporting to the SEC will also create inefficiencies for the subject entity. This would be true even if the SEC investigates the matter, as it is likely in such a case that the subject entity will be asked to respond to document and informational requests from the SEC. For a variety of reasons, however, not least, the SEC's lack of familiarity with the details of the subject company's operations, these requests are likely to be much more time consuming than would be the case if the subject entity itself were reviewing the matter. Moreover, even where the SEC forwards such reports to the subject entity, the confidential nature of the report means that it is likely to lack the richness and details necessary to allow the subject entity to focus its review effectively and efficiently.

It must also be considered that employees filing internal reports may be somewhat reluctant to file reports that are entirely or even largely baseless as doing so may reflect a lack of judgment on the employee's part and, therefore, reflects poorly on the employee. No such inhibition is likely to apply, however, with respect to reports made directly to the SEC. Accordingly, it can be expected that employees will be far more willing to report to the SEC and, therefore, there will be a need to review and respond to a far greater number of reports than would otherwise be the case. This is, of course, another source of inefficiency.

The result of all of this is greater costs to both the SEC and the companies it regulates. Either these costs must be borne outright or offset by the allocation of resources away from their current use to meet these new costs. As compliance budgets among SEC regulated companies are not unlimited, this latter outcome is more likely, with the result that the proposed whistleblower program will come at the expense of existing, potentially more deserving, programs.

Moreover, the whistleblower program is likely to negatively impact the culture of compliance that many firms have labored to build. Simply put, the Proposed Rules' encouragement to employees to by-pass the operations of their employers' internal reporting process is likely to have a corrosive effect on how employees view their role. Rather than seeing themselves as integral to their employers' compliance efforts, as their employers' ears and eyes with the responsibility to report red flags and other indications of wrongdoing, employees will now see their interests as separate and apart from the success of their employers' compliance efforts.

This result is particularly disheartening to NSCP's many members that have been involved in the concerted effort of both the financial service industry and of NSCP itself to implement strong and effective compliance programs and to instill a culture of compliance and an understanding and appreciation for ethical behavior in the employees within this industry.

NSCP's Recommendations to Encourage Internal Reporting

Because the potential presence of a monetary award creates a disincentive to report internally, NSCP believes that the only way to truly encourage or incent employees to report internally is to either mandate that employees be required to report internally to be eligible for a whistleblower award, or include concrete, objective incentives in the award calculation criteria that favor and encourage internal reporting by employees. Narrowing the categories of employees who may qualify for whistleblower awards can also serve to ameliorate this problem and is also recommended.

Mandate Internal Reporting

NSCP supports the adoption of a provision requiring internal reporting by all employees as a condition of eligibility for a whistleblower award. Such a requirement could operate in much the same manner as provisions currently included in the Proposed Rule that restrict whistleblower award eligibility for compliance, legal, audit, supervisory and governance personnel unless such persons have previously reported a matter internally and the subject entity has failed to take action on the internal report.

NSCP recognizes the Commission's concerns with respect to the operation of a broad, mandated internal reporting requirement when applied to firms that lack "compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances of confidentiality. . . ."[11] It must be recognized, however, that such concerns are also applicable to a more narrowly drawn mandatory internal reporting requirement, such as that included in the Proposed Rule, that applies only to legal, compliance and related personnel. Accordingly, while NSCP understands these concerns, it also believes that, in light of the disincentives to internal reporting inherent in the Proposed Rules, allowing employees to make this determination entirely from the perspective of their own self-interest, reflects, in effect, a determination by the Commission to assign no "weight" whatsoever to the need to preserve "the effectiveness of . . . existing compliance, legal, audit and similar internal process for investigating and responding to potential violations of the federal securities

[11] The Proposing Release at 34.

laws."[12]

Objective Incentives for Internal Reporting

If the Commission is unable to conclude that an internal reporting requirement should be mandated in order for employees to be eligible for whistleblower rewards, NSCP recommends that consideration be given to an alternative approach in which internal reporting is a heavily weighted criteria in the award calculation. In specifying the calculated award "premium" associated with prior internal reporting, the SEC could reserve the discretion to determine whether, under the particular facts at hand, the employee may objectively and appropriately be excused from internal reporting obligations.

NSCP believes that this approach has several virtues. One, while it still leaves the ultimate determination of whether to report internally to the employee, it forces the employee to make this determination in light of objective criteria pre-established by the Commission's rule rather than upon the employee's mere self-assessment of his or her own self-interest. Second, this approach provides the SEC the flexibility to balance the benefits of internal reporting against competing concerns that may arise naturally under a multiplicity of scenarios. By way of example, such an approach would allow Commission staff to reward a whistleblower notwithstanding the whistleblower's failure to report internally based upon realistic concerns that internal reporting could lead to the destruction of evidence or subject the whistleblower to a significant risk of retaliation. Third, the SEC's determinations from time-to-time as to the factors relevant to internal reporting would provide guidance to employers as to best practices with respect to processes for encouraging internal reporting, thereby enhancing compliance standards and practices.

In addition, and as noted above, narrowing the scope of employees who may qualify for whistleblower awards can also serve to ameliorate the problem of employees being disincented from reporting internally. Accordingly, and as discussed further in NSCP's response to particular questions, NSCP generally recommends that the term "voluntarily" be applied narrowly with respect to employees and that the exclusions from the definition of "independent knowledge" and "independent analysis" that apply to compliance and similar functions be expanded. Doing so will help emphasize, and, importantly, will not undermine, the duty that all employees owe to their employers, including most relevantly the duty to voluntarily bring concerns regarding possible wrongdoings to the attention of relevant supervisory and other personnel and to cooperate fully in the review of any such matter. This will protect the

[12] The Proposing Release at 4 (noting need to weigh "potentially competing demands").

effectiveness of existing compliance processes that are dependent upon employees for identification and reporting with respect to potential problems. In turn, this will permit subject companies to undertake investigations and remedial actions promptly and efficiently and, hopefully, while the matter at hand is still in its early stages.

NSCP's Response to Specific Questions

The remainder of this letter sets forth NSCP's comments to certain of the numbered questions set out in the Proposing Release. Our responses first set forth the original question in italics followed by NSCP's response. For convenience, questions are identified by number corresponding to the original question and presented in numerical order.

Question 2*: Does Proposed Rule 21F-4(a)(1) appropriately define the circumstances when a whistleblower should be considered to have acted "voluntarily" in providing information about securities law violations to the Commission? Are there other circumstances not clearly included that should be in the rule?*

Response: In addition to such matters as are covered by our response to Question 3, NSCP also believes that the defined term "voluntarily" should treat internal reviews similarly to external reviews. That is, "voluntarily" should exclude information provided by an employee after that employee becomes aware of an internal review about a matter to which the employee's subsequent submission is relevant. Under this standard, once a company starts an internal review, information subsequently provided to the SEC by an employee who is aware of the internal review should not be considered to have been provided voluntarily, unless the provided information is clearly outside the scope of the internal review. NSCP believes that any other result would actually have the effect of encouraging employees responding to an internal review to withhold critical information from their employers in order to increase their chances of providing the information to the SEC before their employer or any other employee in the organization does so.

Question 3*: Should the Commission exclude from the definition of "voluntarily" situations where the information was received from a whistleblower after he received a request, inquiry, or demand from a foreign regulatory authority, law enforcement organization or self-regulatory organization? Similarly, should the Commission exclude from the definition of "voluntarily" situations where the individual was under a pre-existing legal duty to report the information to a foreign regulatory authority, law enforcement organization or self-regulatory organization?*

Response: In NSCP's view, the purpose of Section 21F is to encourage the reporting of

information by persons who are not otherwise subject to a reporting obligation with respect to such information. Rules to implement Section 21F should not have as their focus reporting by persons who are already subject to a legal or other obligation to report. Indeed, to the extent practical, such otherwise obligated persons should be excluded from participating in any monetary award as any other result would serve to reward persons for doing what they were already obligated to do.

Accordingly, NSCP believes that the definition of "voluntarily" should treat foreign and domestic regulators, and government regulators and self-regulatory organizations, similarly and not distinguish among them. Indeed, a whistleblower that provides information to a foreign regulator regarding a violation of U.S. securities laws is likely to presume that there is a reasonable probability that the foreign regulator may share the reported information with the SEC. As a result, a person reporting under such circumstances does not seem to NSCP to be acting any more voluntarily than a person who waits, in the words of the Proposing Release, until "official investigators 'come knocking on the door.'"[13] Similarly, NSCP agrees that an individual subject to any legal duty to report information, whether to a foreign or domestic regulatory authority, law enforcement organization or self-regulatory organization should not be considered to be acting voluntarily.

For this same reason, NSCP believes the SEC should treat any obligation that an employee may have under the employer's written procedures to bring red flags and other indications of wrongdoing to supervisory and/or control personnel at the employer as equivalent to a pre-existing legal duty to report information internally and not treat such information as voluntarily provided. To do otherwise would encourage employees to withhold information from their employers, which, as discussed above under the heading "The Benefits of Internal Reporting," is likely to have a decidedly negative impact on the ability of companies to identify and fix potential problems promptly and efficiently. Accordingly, narrowing the scope of employees who may qualify for whistleblower awards also serves to ameliorate the problem of employees being disincented from reporting internally.

Question 4*: Is it appropriate for the proposed rule to consider a request or inquiry directed to an employer to be directed at individual employees who possess the documents or other information that is within the scope of the request? Should the class of persons who are covered by this rule be narrowed or expanded? Will the carve-out that permits such an employee to become a whistleblower if the employer fails to disclose the information the employee provided in a timely manner promote compliance with the law and effective*

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[13] The Proposing Release at 13.

operation of Section 21F?

Response: Consistent with our responses to Questions 2 and 3 above, NSCP strongly agrees that any employee who is aware, in whole or in part, of a request or inquiry directed to the employer or who is contacted by the employer in connection with responding thereto should be considered to have received the request at the same time as the employer. The employee should also be regarded as having received the request at the same time as the employer if there is a reasonable likelihood that, by virtue of the employee's position or responsibilities at the employer, the employee would have been contacted by the employer in responding to the request. As noted above, the purpose of Section 21F is to bring to the Commission's attention information it otherwise would not have received, not to reward persons for bringing to light information the Commission would have received in the ordinary course.

***Question 5**: The standard described in Proposed Rule 21F-4)(a)(1) would credit an individual with acting "voluntarily" in certain circumstances where the individual was aware of fraudulent conduct for an extended period of time, but chose not to come forward as a whistleblower until after he became aware of a governmental investigation or examination (such as by observing document requests being served on his employer or colleagues, but before he received an inquiry, request, or demand himself, assuming that he was not within the scope of an inquiry directed to his employer). Is this an appropriate result, and, if not, how should the proposed rule be modified to account for it?*

Response: Consistent with our response to Questions 2 and 4, to the extent an individual discloses information that is related to a government, self-regulatory or internal investigation, NSCP does not believe that such disclosure should be considered to be provided voluntarily.

***Question 6**: Is the exclusion set forth in Proposed Rule 21F-4(a)(2)(sic) for information provided pursuant to a pre-existing legal or contractual duty to report violations appropriate? Should specific circumstances where there are pre-existing duties to report violations to investigating authorities be set forth in the rule, and if so, what are they? For example, should the rule preclude submissions from all Government employees?*

Response: Consistent with our response to Question 2, NSCP believes that it is appropriate to treat information provided by individuals with a pre-existing legal or contractual duty to report the information as information that has not been provided voluntarily. NSCP encourages the Commission to provide clear guidance, whether in the Proposed Rules, the approving release or elsewhere, as to the scope of any such exclusion.

***Question 7:** Is it appropriate to include knowledge that is not direct, first-hand knowledge, but*

is instead learned from others, as "independent knowledge," subject only to an exclusion for knowledge learned from publicly-available sources?

Response: NSCP believes that whether the information at issue is direct or indirect is less important than whether the information is reliable and specific enough to allow for a meaningful and focused review. Consistent with responses to Questions 2 - 4 above, information that is requested as part of an internal review should not be deemed to be provided voluntarily. In a similar vein, information learned as part of an internal review (and thus obtained indirectly) should not be deemed to be provided voluntarily either.

***Question 9 (first part)**: 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?*

Response: Allowing attorneys or other persons subject to the privilege to breach the privilege, or even allowing others to obtain information through the use of protected information, would have a chilling effect on open communications between clients and attorneys and would, therefore, be a disincentive to firms and their employees to be forthright with their attorneys. Such a result would have an obviously adverse effect in the conduct by firms of internal reviews.

***Question 9 (parts two and three)**: Are there other ways these rules should address privileged communications? For example, should other specific privileges be identified (spousal privilege, physician-patient privilege, clergy-congregant privilege, or others)? Should the exclusion apply broadly to information that is obtained through communications that are subject to any common law evidentiary privileges recognized under the laws of any state?*

Response: NSCP believes that the question of whether other privileges should be recognized should be guided by relevant, applicable federal, state or foreign law and the Commission should not put itself in the position of second guessing existing determinations. This is particularly true as it is likely to be in the interest of Commission staff to deny a privilege as a means of encouraging the provision of more, rather than less, information.

***Question 13:** Do the proposed exclusions for information obtained by a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity under an expectation that the person would cause the entity to take steps to respond to the violation, and for information otherwise obtained from or through an entity's legal, compliance, audit, or similar functions strike the proper balance? Will the carve-out for situations where the entity does not disclose the information within a reasonable time promote effective self-policing*

functions and compliance with the law without undermining the operation of Section 21F? Should a "reasonable time" be defined in the rule and, if so, what period should be specified (e.g., three months, six months, one year)? Does this provide sufficient incentives for people to continue to utilize internal compliance processes? Are there alternative or additional provisions the Commission should consider that would promote effective self-policing and self-reporting while still being consistent with the goals and text of Section 21F?

Response: NSCP has two concerns regarding Proposed Rule 21F-4(b)(4)(iv) as it is currently written. First, NSCP does not understand why it is limited to information that was "communicated with the reasonable expectation that the [recipient] would take steps to cause the entity to respond appropriately to the violation. . . ." Specifically, in recognition of the special responsibilities that are placed on the persons that perform such functions, NSCP believes that Proposed Rule 21F-4(b)(4)(iv) should apply to any information obtained by persons performing such functions. By way of example, a supervisor who is told of a violation has the same duty to report that matter to the company's compliance or legal group regardless of the "reasonable expectation" attendant to the telling of such information. Moreover, such persons should not be put in a position where they have to discern the "reasonable expectations" of the communicant – particularly as it will be in their interest to construe such expectations in a manner designed to exclude the communication from the coverage of this provision.

In addition, NSCP believes that the functions referenced by Rule 21F-4(b)(4)(iv) should also take into account personnel from a variety of other areas, including operations, finance, technology, credit, risk, and the like, who perform control functions, that is, functions that are principally related to compliance with regulatory requirements, including supervision, monitoring or oversight with respect to such functions. Indeed, and especially in smaller firms, it can sometimes be difficult to draw lines between the responsibilities listed in the question above and these other areas.

As to Proposed Rule 21F-4(b)(4)(v), NSCP believes the reference therein to "legal, compliance, audit or other or similar" functions or processes merely serves to create ambiguity and should be deleted such that the provision would simply apply to "functions or processes for identifying, reporting and addressing potential non-compliance with law. . . ." In addition, NSCP believes that the Commission should provide clear guidance that such covered "functions or processes" would include supervisory reviews, which in the brokerage industry at least are more fundamental to a broker-dealer's compliance than even the compliance function itself.

Regarding the definition of "reasonable time," in NSCP's view, this needs to be a flexible

standard given the circumstances of each matter. Accordingly, NSCP is comfortable reposing with the Commission the determination of this standard on a case-by-case basis. For example, an active "pump and dump" scheme involving registered representatives and traders from multiple firms should be dealt with swiftly as any delay is likely to result in additional investors across the market being defrauded. By contrast, a complex trading scheme that is uncovered months after it has been completed lacks similar urgency, and could take weeks or even months to unravel. In short, the standard should be one where, as long as the firm is moving toward appropriate resolution, in light of the totality of the circumstances, a subjective definition of "reasonable time" is appropriate. Under this standard, so long as the firm proceed appropriately and in a "reasonable time," a putative whistleblower would not be eligible for an award regardless of whether they separately reported the matter to the SEC before or after the firm did.

Question 14: *Is the proposed exclusion for information obtained by a violation of federal or state criminal law appropriate? Should the exclusion extend to violations of the criminal laws of foreign countries? What would be the policy reasons for either extending the exclusion to violations of foreign criminal law or not? Are there any other types of criminal violations that should be included? If so, on what basis?*

Response: As an organization whose mission is to enhance compliance efforts within the securities industry, NSCP believes strongly that the Commission should not adopt rules that would have the effect of encouraging or rewarding action taken in violation of applicable law, whether federal or state, or U.S. or foreign law. Even if additional securities law violations might be uncovered by illegal trespass, theft, eavesdropping, or other criminal activities, the consequences in undermining respect for the rule of law would, in NSCP's view, outweigh any transitory benefit in the prosecution of a particular violation exposed by the criminal whistleblower.

Question 16: *Is the provision that would credit individuals with providing original information to the Commission as of the date of their submission to another Government or regulatory authority, or to company legal, compliance or audit personnel appropriate? In particular, does the provision regarding the providing of information to a company's legal, compliance, or audit personnel appropriately accommodate the internal compliance process?*

Response: The fundamental purpose of Section 21F is to support the integrity of the securities industry by fostering the reporting of information for the purpose of facilitating its review and the taking of appropriate remedial action in response thereto. For this reason, NSCP believes that the focus of the Proposed Rules should be on encouraging the provision of critical information regarding non-compliance to the party that is in the best position to act responsibly

on such information. As NSCP believes that such party will often be the subject company, NSCP strongly agrees that individuals should be credited with providing original information upon the provision of information to a company's legal, compliance, or audit personnel. NSCP is not convinced, however, that providing credit with respect to reporting to other government or regulatory authorities should be similarly encouraged. Indeed, NSCP is concerned that the provision of such credit may needlessly complicate the Proposed Rules while making an appropriate and timely use of the information reported to such other government or regulatory authority less likely rather than more.

Question 17: *Is the 90 day deadline for submitting Forms TCR and WB-DEC 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? Should a longer time period apply in instances where the whistleblower believes that the company has or will proceed in bad faith? Would a 90 day deadline for submitting the TCR and WB-DEC also be appropriate in circumstances where the individual provides information to an SEC staff member? Would a shorter time frame be appropriate? Should there be different time frames for disclosures to other authorities and disclosures to an employer's legal, compliance or audit personnel?*

Response: Securities rules and regulations can be complex and compliance scenarios are not always clear and straightforward. As such, a ninety day time frame may not be sufficient time for a firm to assess a complex situation. As the proposed regulation is written with a ninety day deadline, a whistleblower may very well be forced to contact the SEC prematurely before a firm has had a reasonable time to assess the matter at hand. NSCP is concerned that any hard deadline may foster a rush to the SEC on issues that have not been fully vetted by a firm's internal compliance/audit function; NSCP also expects that there will naturally be an increase in non-material issues being reported to the SEC that will ultimately result in the SEC wasting precious resources in assessing and following up on a landslide of non-issues.

Instead, NSCP suggests that a deadline be a minimum of ninety days or such longer time as is "reasonable." Similar to the discussion of "reasonable time" set out in NSCP's response to Question 13, a "reasonable" approach would allow a flexible standard that takes into account the circumstances at hand and would be decided on a case-by-case basis.

Question 18: *Should the Commission consider other ways to promote continued robust corporate compliance processes consistent with the requirements of Section 21F? If so, what alternative requirements should be adopted? Should the Commission consider a rule that, in some fashion, would require whistleblowers to utilize employer-sponsored complaint and reporting procedures? What would be the appropriate contours of such a rule, and how could*

it be implemented without undermining the purposes of Section 21F? Are there other incentives or processes the Commission could adopt that would promote the purpose of Section 21F while still preserving a critical role for corporate self-policing and self-reporting?

Response: Reliance on whistleblowers should properly be viewed as a supplement, and not in any way as a replacement, to robust company internal compliance programs. As set forth above under the heading "NSCP's Recommendations to Encourage Internal Reporting," NSCP believes that, on balance, the Proposed Rules are likely to be harmful to industry efforts to foster compliance, and could actually result in reduced detection and prevention of unlawful activity, unless the rules are devised in a manner that encourages internal reporting. NSCP believes that encouraging internal reporting could be accomplished by requiring that employees utilize employer-sponsored internal complaint and reporting procedures, or alternatively through the adoption of clear, objective award criteria that incentivize employee whistleblowers to report matters internally before reporting to the SEC.

Question 19: *Would the proposed rules frustrate internal compliance structures and systems that many companies have established in response to Section 10A(m) of the Exchange Act, as added by section 301 of the Sarbanes-Oxley act of 2002, and related exchange listing standards? If so, consistent with Section 21F, how can the potential negative impact on compliance programs be minimized?*

Response: As noted earlier in this letter, NSCP believes that the Proposed Rules would frustrate internal compliance structures and systems. In order to minimize this potential negative impact, NSCP recommends that, consistent with NSCP's response to Questions 2 - 4, the Commission narrowly define "voluntarily" as applied to employees and, in accordance with the approach set forth above under the heading "NSCP's Recommendations to Encourage Internal Reporting," the Commission incorporate into the Proposed Rules a requirement that employees use employer-sponsored internal complaint and reporting procedures or, alternatively, adopt objective award criteria that create clear and strong incentives for employees to report matters internally before reporting to the SEC.

Question 23. *The Commission requests comment on the proposed definition of the word "action." Are there other ways to define an "action" that are consistent with the text of Section 21F and that will better effectuate the purposes of the statute?*

Response: NSCP recommends that the definition of the term "action" be revised so that, for SEC enforcement actions that include multiple counts, only those counts in the Commission action that result directly or indirectly from the whistleblower's report are deemed to constitute an "action" for which a whistleblower is eligible for reward, and that the Commission allocate

the overall monetary sanction so that only those counts are included in determining whether the $1,000,000 threshold requirement has been satisfied, and if so, in calculating the size of the award. As currently drafted, the Proposed Rule does not make such an allocation in determining whether the threshold amount has been satisfied, but does incorporate this issue in the calculation process.

In declining to make such an allocation in determining the threshold, the Proposing Release states: "This approach would effectuate the purposes of Section 21F by enhancing the incentives for individuals to come forward and report potential securities law violations to the Commission, and would avoid the challenges associated with attempting to allocate monetary sanctions involving multiple individuals and claims based upon the select individuals and claims reported by the whistleblowers."[14] NSCP disagrees strongly with both of these statements and asserts that the release itself is internally inconsistent with respect to the avoidance of the challenge of having to allocate.

The statute is clear on its face that the purpose of Section 21F is not to encourage whistleblowers to report every violation of law, but only serious violations that result in the imposition of monetary sanctions exceeding $1 million. By refusing to make an allocation for actions involving multiple individuals or claims, the Proposed Rules in fact encourage whistleblowers to report to the Commission any and every conceivable violation, on the chance that the matters on which they report, however innocuous, will be grouped together with serious violations and result in an overall sanction that qualifies them for an award.

To encourage reporting of all violations, however insignificant, has very real consequences. The Commission has estimated in the Proposing Release that it expects that the whistleblower rules could result in as many as 30,000 complaints a year.[15] NSCP would submit that, should the process function such that whistleblower reports for fairly minor violations resulted in awards, especially significant awards, the Commission could be inundated with far more complaints on insignificant matters, clogging a process that is already expected to be cumbersome.

The second rationale for the current proposal is to avoid the "challenges" of allocation. The Proposing Release, however, makes it clear that this challenge has not been avoided. In Section II.F, setting out the criteria for determining the amount of an award, the Proposing Release sets out a series of factors to be considered. The ninth factor is, "whether the

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[14] The Proposing Release at 44 and 45.

[15] The Proposing Release at 96.

information provided by the whistleblower related to only a portion of the successful claims brought in the Commission or related action."[16] The only difference between the assessment required under this provision, and the allocation the Commission has sought to avoid in its definition of "action," is the precision of the calculus. But to state that the Commission is able to avoid such an apportionment is incorrect.

NSCP suspects that part of the basis for the proposal is to avoid second-guessing by whistleblowers or others on the allocation judgments made by the Commission in situations where the allocation results in denial of an award for failure to meet the threshold. NSCP believes such second-guessing is also unavoidable. The vast preponderance of SEC enforcement actions are settled. A firm (or the SEC Enforcement staff, for that matter) intent on denying an award for a whistleblower who had reported on a relatively insignificant violation (one which, standing alone, would not support a monetary sanction exceeding $1 million) could insist that such violation be severed and settled separately. While this would deny the whistleblower an award, it would do so in a manner that increased the legal costs for the defendant(s) and the administrative burdens on the SEC staff. And splitting the cases would in no way spare the SEC second-guessing with respect to the relative sanctions of the respective matters.

Question 27: *Should the Commission identify, by rule, additional criteria that it will consider in determining the amount of an award? Is so, what criteria should be included? Should we include as a criterion the consideration of whether, and the extent to which, a whistleblower reported the potential violation through effective internal whistleblower, legal or compliance procedures before reporting the violation to the Commission? Should we include any of the other considerations described above?*

Response: In accordance with the approach set forth above under the heading "NSCP's Recommendations to Encourage Internal Reporting," NSCP strongly supports the inclusion of award criterion that specifically recognize whether an employee reported a potential violation through internal whistleblower, legal or compliance procedures before reporting the violation to the Commission. Moreover, for the reasons already noted, any recognition of countervailing factors that are meant to excuse compliance with internal reporting systems, *e.g.*, an employee's fear of possible retaliation, should be tightly circumscribed and based upon clear and objective standards and, in no event, upon an employee's subjective viewpoint.

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[16] The Proposing Release at 51.

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NSCP would like to thank the members of the NSCP Ad Hoc Committee, and in particular Glen Barrentine of Cadwalader, Wickersham & Taft LLP, for their effort.

Thank you for your attention to these comments. Questions regarding the foregoing should be directed to the undersigned at 860.672.0843.

Very Truly Yours,

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