THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

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December 17, 2010

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

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

Dear Ms. Murphy:

The Financial Services Roundtable[1] and the American Bankers Association (collectively, the "Associations") appreciate the opportunity to provide comments on the proposal by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") to adopt rules (the "Proposed Rules") to implement the "whistleblower" provisions of Section 21F of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), pursuant to Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").

The Associations commend the Commission for acting expeditiously to develop the Proposed Rules. We are providing these comments in the hope that it will foster the development of final rules that achieve the goals of the Act in a manner that provides the most benefit to all affected parties.

General Comments

On November 3rd, the Commission, as required by the Act, published the Proposed Rules to establish a process for rewarding individuals who provide it with information leading to successful enforcement actions.[2] The Proposed Rules establish an infrastructure and procedures under which "whistleblowers" – persons who provide information to the SEC regarding potential violations of the federal securities laws – can qualify for significant monetary awards.

While the Associations support the Commission's efforts to encourage those with information about possible corporate wrongdoing to make that information known, the Associations are concerned that:

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[1] The Financial Services Roundtable is a trade association for 100 of the nation's largest financial services firms. Our members provide banking, securities, and insurance products and services to millions of consumers and businesses in the U.S. and other countries.

[2] Securities Exchange Act Release No. 63237 (Nov. 3, 2010), 75 Fed. Reg. 70488 (Nov. 17, 2010) (the "Proposing Release").

- the Proposed Rules fail to place sufficient reliance on the effectiveness of the internal compliance procedures that so many companies, including our members, have established, and

- the Proposed Rules will do damage to those efforts as employees and others with knowledge about possible violations of applicable securities laws, rules and regulations (referred to herein as "applicable law") avoid even the most highly effective internal policies in order to preserve and protect the possibility, no matter how remote, of receiving large cash awards.

As a result, we are concerned that the policing of potential securities law violations would be left largely to the SEC alone. Consequently, we fear that the Proposed Rules could lead to less effective policing of securities law violations rather than creating a stronger system.

Specific Comments

The Associations believe that extreme care is needed in crafting the whistleblower program in order to avoid unintended, negative consequences for companies that engage in good faith efforts to discover and deal with improper and illegal conduct at its earliest stages. The Associations provide these comments to highlight what we believe to be the principal concern with the Proposed Rules – that they could cause people with information about possible wrongdoing at a company to bypass even the most comprehensive internal procedures, leaving companies in the dark about possible misconduct or illegal activity by their employees, officers, directors, independent contractors, or agents (sometimes referred to herein as "insiders").

The Associations believe that the Proposed Rules should give companies greater credit for maintaining robust internal compliance procedures, and reduce the incentives for bypassing them. Otherwise, companies that have worked to develop and maintain robust procedures for addressing such matters may find them rendered ineffective, and the good working relationship that most companies have with their employees negatively affected, as the paradigm shifts to reporting violations solely to the SEC. In addition, the Commission would lose the benefit of efficient filtering and attention provided by robust company policies and procedures, leading to the Commission receiving more complaints than it can realistically handle.[3]

I. The Proposed Rules Should Require the Use of Established Internal Procedures for Reporting Possible Wrongdoing By Persons Seeking Whistleblower Awards.

The Proposed Rules are "intended not to discourage whistleblowers who work for companies that have robust compliance programs to first report the violation to appropriate company personnel, while at the same time preserving the whistleblower's status as an original source of the information and eligibility for an award."[4] However, the Proposed Rules do not require whistleblowers to report internally and thus many employees will bypass established internal procedures and take their concerns directly and exclusively to the Commission. This is especially likely because of the opportunity to receive such large monetary rewards. The Proposing Release asks whether the Commission should "consider a rule that, in some fashion, would require whistleblowers to utilize employer-sponsored complaint and reporting

[3] The Commission estimates that it would receive approximately 30,000 complaints each year. *See* Proposing Release at 96, 75 Fed. Reg. at 70512.

[4] *Id.* at 4, 75 Fed. Reg. at 70488.

procedures."[5] Our response is a resounding "yes." Where a company implements a robust program in which employees can report activity that may violate applicable law, whistleblowers generally should be required to use such programs as a condition to being entitled to a whistleblower award.

A. Companies With Internal Procedures For Receiving and Responding to Information About Suspected Misconduct Should Have the Opportunity to Use Them.

Our members have developed strong internal compliance procedures to encourage employees, agents, and other company insiders to report suspected violations of applicable law, and to protect those who make such reports. These robust compliance programs include policies and procedures designed to prevent illegal activity from going undetected by providing a mechanism that encourages insiders to report suspected problems, irregularities, or illegal conduct. Many programs *require* insiders to report such matters or face possible disciplinary action. These companies are serious about rooting out violations of applicable law, as well as violations of company policies. When such matters are reported, the procedures generally require the company to investigate, take action to correct any problems, discipline those who engaged in improper or illegal activities and, where necessary or appropriate, notify the SEC or another relevant regulatory or enforcement authority. These policies include provisions to prevent retaliation against whistleblowers.

There are a number of reasons that companies adopt such procedures. First and foremost, companies recognize the value of establishing procedures to detect and deal with potential violations of applicable law, as well as other internal policies and procedures that govern the conduct of the company and its personnel. These companies understand that it is best to deal quickly with isolated issues, before they grow into widespread, enterprise-threatening problems. Companies recognize that illegal or inappropriate conduct can have a severe impact on the company's profitability; its value to stockholders; the perception of the public, suppliers, counterparties, and competitors; and the morale of its personnel. Smart management recognizes that taking steps to detect misconduct at the earliest possible moment, and to address it quickly, is good corporate citizenship.

Over the past 15-20 years, a growing number of federal and state laws and regulations have encouraged the establishment of robust compliance programs that include both reporting mechanisms and protections for whistleblowers.[6] Companies have responded by investing substantial time, energy and capital in thorough training, new systems, new processes and procedures, new Codes of Employee Conduct, and additional staff intended to promote the right compliance culture throughout their organizations. Where companies have invested significant resources in developing robust policies and procedures for complying with applicable law and responding to possible violations thereof, there should not be incentives for bypassing them. As Commissioner Paredes said at the open meeting announcing the Proposed Rules (the "Open Meeting"), it would be unfortunate if effective programs were thwarted by the whistleblower program.[7] The Proposed Rules should encourage good faith efforts

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[5] *Id.* at 37, 75 Fed. Reg. at 70496.

[6] For example, the Financial Institutions Reform, Recovery, and Enforcement Act of 1999 ("FIRREA"); the Federal Deposit Insurance Corporation Improvement Act ("FDICIA"); the Sarbanes–Oxley Act of 2002 ("Sarbanes-Oxley"); the U.S. False Claims Act, and a number of state statutes either require companies to establish such programs or require their use where they have been adopted voluntarily. The U.S. Department of Justice Prosecution Standards, and the U.S. Federal Sentencing Guidelines for Organizations, also take into account a company's internal whistleblower procedures when determining the severity of charges or penalties.

[7] Statement of Commissioner Troy A. Paredes, SEC Open Meeting (Nov. 3, 2010).

to develop procedures to detect and respond to securities law violations, and encourage their use by whistleblowers.

Having employees with questions or information regarding questionable company practices use internal policies and procedures would promote good corporate governance. It would encourage companies with internal policies and procedures to maintain them at the highest standard, encourage those with weak procedures to invest in and improve them, and incentivize those without such procedures to develop them. We agree with the Commission that "[c]ompliance with the federal securities laws is promoted when companies have effective programs for identifying, correcting, and self-reporting unlawful conduct by company officers or employees" and that "internal compliance and reporting systems are essential sources of information for companies about misconduct."[8] According to the Proposing Release, "the policy interest in fostering robust corporate compliance programs" caused the Commission to consider requiring potential whistleblowers to use in-house procedures. Unfortunately, the Proposed Rules do not take this approach. While we recognize the concern that some companies may not have adequate internal procedures,[9] we believe that where a company has well-documented, thorough, and robust internal procedures, it is appropriate for those procedures to be a part of the process that ultimately could result in a whistleblower receiving a significant financial reward.

Giving credence to the quality and effectiveness of internal control procedures by incentivizing whistleblowers to use them would confirm that effective compliance procedures are a strong first line of defense for detecting and preventing violations of applicable law, and would encourage companies to review and improve their programs continually to ensure that they remain sufficient to justify having whistleblowers use them. It also would encourage employees to remain engaged in the process and feel encouraged to bring information relating to possible wrongdoing to the company's attention, so that it can be dealt with in an appropriate fashion. The Associations recognize the Commission's concern that there may be situations where a whistleblower has a legitimate and supportable concern that using internal procedures will work to her or his detriment. However, we respectfully submit that Congress already addressed this possibility when it adopted the Act, by adding the anti-retaliation provisions to Section 21F(h)(1) of the Exchange Act. The Proposed Rules further strengthen this protection by providing that the Act's anti-retaliation provisions will apply whether or not a whistleblower satisfies the procedures and conditions to qualify for an award.[10]

The significant bounties offered to whistleblowers who bring information to the Commission, coupled with the lack of a requirement for whistleblowers to use internal procedures for detecting, investigating and resolving potential violations of applicable law, will result in even the most dedicated employees bypassing internal complaint programs for fear of losing a potentially significant financial recovery. Consequently, the Proposed Rules may inadvertently weaken, rather than strengthen, the effectiveness of current efforts to deal with corporate wrongdoing. If there are concerns about a standard by which to classify a company's internal procedures as sufficient, the Associations suggest that there are precedents with which the Commission is quite familiar, from which an appropriate standard could be derived. For example, the Commission could look to the standards adopted for evaluating internal controls over financial reporting in accordance with Section 302 of the Sarbanes-Oxley Act, requiring procedures to

[8] Proposing Release at 33-34, 75 Fed. Reg. at 70496.

[9] *See id*. at 34, 75 Fed. Reg. at 70496.

[10] *See* Proposed Rule 21F-2(b). Where a company demonstrates a pattern of ignoring internal whistleblower reports, or a history of retaliation complaints, the Commission could consider whistleblowers who ignore that company's procedures and complain directly to the Commission to be justified in doing so, and reward them accordingly.

be designed by or under the supervision of senior officers (or persons performing similar functions) and effected by a board of directors, management and other personnel, to respond to information provided by an individual (whether or not such person is an insider).[11] The SEC also could consider other indicia of sufficient procedures, such as the use by a company of an independent third party for individuals to report wrongdoing anonymously, or compliance with Section 8B2.1 of the U.S. Sentencing Commission Guidelines Manual ("Effective Compliance and Ethics Program").

Finally, as noted above, many company compliance procedures require employees who become aware of potential legal violations to report them to the company or face disciplinary action. The Proposed Rules therefore raise the question of whether companies would be permitted to discipline employees who violate company policies and procedures by withholding information from the company and taking it straight to the SEC. It would certainly send confusing messages to companies and their personnel if the Proposed Rules were to result in employees being rewarded financially for violating a company's compliance procedures.

B. Requiring the Use of Internal Procedures Would Allow Companies and the Commission to Allocate Resources More Efficiently.

The old truism that "an ounce of prevention equals a pound of cure" is especially applicable here. The longer a problem continues, the more likely it is to fester and grow into one that is far more difficult and costly to address, and potentially more damaging to the company. Allowing companies to deal with problems at the earliest possible stages would enable them to avoid the expense of a more deeply entrenched problem and, in many cases, to attack inappropriate activities before they become widespread. Improper conduct will be contained and companies will realize efficiencies that directly benefit the company, its shareholders, its customers, its personnel, and the public. If a company remains unaware of a problem because a whistleblower has taken information directly to the SEC, the company may be drawn into formal legal or regulatory proceedings that lead to much higher legal expenses, raise the level of publicity (which may impact the company's business), and divert the company's management from its normal duties, even though the problem could have been handled expeditiously and more efficiently if the company had been made aware of it sooner. Allegations of and investigations into possible misdeeds or fraud, even if unfounded or incorrect, can have a strong and serious negative impact on a company, lowering its stock price, raising its internal costs (for example, certain insurance premiums), creating negative consumer perception, and harming employee morale. In extreme cases, such allegations can put a company out of business.

Moreover, as fewer whistleblowers use available internal procedures (if for no other reason than to protect their chance for a bounty), more whistleblower claims will get to the Commission's doorstep. The Commission staff will have to review each one to determine whether it states a valid claim, and any complaint that contains even the barest plausible allegation will have to be investigated. This certainly would not be an efficient use of the Commission's limited resources. Companies are far better equipped

[11] *See, e.g.*, SEC Rules 13a-15; 15d-15. This could include processes that encourage and facilitate the reporting of possible violations of the securities laws by the company or its officers, directors, employees, independent contractors, or other agents; the investigation of such possible violations; the maintenance of records that in reasonable detail accurately and fairly reflect the information, the company's review and investigation of the conduct reflected in that information, the company's conclusions with respect to that information and the company's response to any findings of actual or potential securities law violations; and otherwise provide for the timely detection of and response to violations of securities laws.

to assess complaints in the context of their particular business and to "separate the wheat from the chaff." Some complaints may be about practices having nothing to do with securities laws. Many could be related to human resources matters. Some may be the result of ignorance of the actual facts or mere disagreement with management's legitimate business judgment. Also, as Commissioner Aguilar noted at the Open Meeting, "[m]any people use internal whistleblower hotlines to 'vent' and [the SEC has] received reports that are unfounded even where a reward is not given for making a report."[12] Indeed, if companies are not given the opportunity to address whistleblower claims, the flood of complaints could eventually result in the Commission missing a truly significant matter, simply because it lacks the resources to adequately review each claim. As the Commission stated in its 2001 "Seaboard Report," "[w]hen businesses seek out, self-report and rectify illegal conduct, and otherwise cooperate with Commission staff, large expenditures of government and shareholder resources can be avoided and investors can benefit more promptly." "Self-policing, self-reporting, remediation and cooperation with law enforcement authorities, among other things, are unquestionably important in promoting investors' best interests."[13]

C. Companies Need an Adequate Opportunity to Respond to Claims of Wrongdoing.

1. Companies Should Be Notified About All Whistleblower Complaints.

In addition to not requiring whistleblowers to follow internal policies and procedures, the Proposed Rules do not require the SEC to notify a company when it is the subject of a whistleblower complaint. While the Proposing Release states that the Commission expects, "in appropriate cases," to contact a company upon receiving a complaint, it is not required.

The Associations believe that if the Commission does not require whistleblowers to report information to the company, then the company must be notified by the Commission as soon as possible after receiving a whistleblower complaint. Unless a company is involved at the earliest possible moment when the question of possible misconduct is raised, it will be prevented from addressing problems that it otherwise might quickly investigate and resolve. It is far better to provide companies with an early opportunity to investigate and address legitimate allegations, and to defend against spurious ones. An integral part of the internal procedures that companies have developed is the process for investigating and dealing with evidence of potential wrongdoing by insiders, using either internal resources or, in appropriate cases, outside counsel and other third parties. Keeping information from companies could leave them unaware of problems until much later, such as when the SEC determines to launch a formal inquiry. This could increase exponentially the magnitude of a problem and the cost of responding to it. Again, companies should be given credit for having developed procedures and given the opportunity to put them to work.

Moreover, even if the Commission requires the use of internal procedures as a condition to receiving an award, there nevertheless will be situations where reports come to the SEC directly. In such cases, for

[12] Statement of Commissioner Luis A. Aguilar, SEC Open Meeting (Nov. 3, 2010).

[13] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Securities Exchange Act Release No. 44969 (Oct. 23, 2001). We also note that budget concerns have led the Commission to delay establishing the Office of the Whistleblower, with interim responsibility falling on the Division of Enforcement. This further illustrates the strain that an increase in whistleblower complaints will have on Commission resources. *See* http://www.sec.gov/spotlight/dodd-frank/dates_to_be_determined.shtml.

the reasons stated above, the Commission should notify the company as soon as possible, and give the company a chance to investigate and respond.

2. Companies Should Be Given Sufficient Time to Address Whistleblower Claims.

The Proposed Rules provide that whistleblowers who first report information about potential violations internally will be deemed to have reported the violation to the Commission as of the date that they report it to the company, locking in their "place in line" for a whistleblower award. However, this protection is only effective if the employee reports the matter to the Commission within 90 days thereafter.[14] The Commission asks whether this is an appropriate time frame.[15]

While 90 days may be sufficient to deal with certain matters, the time needed to respond to a claim of wrongdoing depends on many factors, including the nature and complexity of the complaint, the location(s) of the persons or business units involved, and numerous other factors. In many cases, 90 days will not be sufficient to investigate alleged acts of wrongdoing. For example, where the alleged misconduct implicates matters involving overseas subsidiaries and possible violations of the Foreign Corrupt Practices Act, more time would no doubt be needed for the company to determine the validity of such claims and to deal with them. The Associations believe that a period of at least 180 days would be more appropriate.

More importantly, to give companies a reasonable time to investigate whistleblower claims, we believe that where whistleblowers use internal procedures, the 180-day time period, rather than being the maximum amount of time that a whistleblower may wait before going to the Commission, should be the amount of time that a company is given to respond to the whistleblower before the whistleblower goes to the Commission.[16] Similarly, if the Commission does not require whistleblowers to report internally, the company should, as discussed above, be notified as soon as possible after the Commission receives a complaint. In such cases, the company should again be given at least 180 days to investigate and respond to the Commission before the Commission makes a determination whether to proceed further with the matter. In either event, the goal should be to provide the company with sufficient time to fully assess and investigate such claims, and make a determination with respect to what it believes to be the most appropriate response to the information. Giving companies 180 days to review, investigate and respond to whistleblower claims will not prejudice the whistleblower, so long as the whistleblower can document the date on which she or he made the report to the company.[17]

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[14] *See* Proposed Rule 21F-4(b)(7). In addition, any person who provides information to Congress, any other federal, state, or local authority, any self-regulatory organization, or the Public Company Accounting Oversight Board and, within 90 days, submits the same information to the Commission will be deemed to have provided the information to the Commission as of the date of their original disclosure, report or submission to one of these other authorities. *See id.*

[15] Proposing Release at 36, 75 Fed. Reg. at 70496.

[16] The whistleblower could be required, as part of his or her complaint to the Commission, to attest that she or he reported the matter to the company, waited 180 days, and received no response after the initial acknowledgement. Of course, if the company provides a response to the whistleblower in less than 180 days, and the response is such that the whistleblower determines to then approach the Commission, the whistleblower would be able to do so.

[17] A process could be incorporated into the company's internal procedures. Alternatively, the SEC could maintain the time limit as a "default" to protect whistleblowers where the company fails to take action, but provide for "tolling" of the period if the company responds to the whistleblower with an attestation that it is in the process of investigating the complaint and that the company will respond to the whistleblower in writing upon completion of the investigation. That way, the whistleblower's place in line would remain protected.

D. If the Commission Does Not Require the Use of Internal Policies and Procedures, It Should Make Their Use a Specific Factor in Determining the Amount of an Award.

As explained above, the Associations believe strongly that where a company has established procedures for receiving, responding to and investigating claims, whistleblowers should be using those procedures (subject to the limitations and exceptions noted above). However, even if the Commission chooses not to require the use of internal policies and procedures, the Associations believe that, at the very least, a whistleblower's use of internal policies and procedures must be a specific factor in determining the amount of any award, not just something that the SEC may consider in appropriate cases.

Proposed Rule 21F-6 lists four specific criteria that the Commission will "take into consideration" in making an award. In the Proposing Release, the Commission discusses a longer list of "permissible considerations" to be used as the Commission sees fit, one of which is "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."[18] The Associations believe that the use of internal procedures should be added to the list of specific factors that must be considered in determining the amount of awards. Making clear that the use of internal controls will have an impact on any recovery should encourage increased use of those procedures, providing a good measure of the benefits described above. Given that the Commission is attempting to "strike a balance between two competing goals" – facilitating operation of effective internal compliance procedures and permitting persons to act as whistleblowers where the company knows about material misconduct but has not taken appropriate steps to respond,[19] we believe that making the use of such internal procedures a specific factor in the determination of how much to award the whistleblower will advance that effort by reducing the possibility that whistleblowers will be unduly influenced to bypass the company's procedures because of the potential for a large cash award.

Furthermore, to reinforce the positive effects of having whistleblowers pursue available internal procedures, the Associations also suggest that the Commission strongly consider, in accordance with its statutory mandate to prescribe regulations for the payment of whistleblower awards, and its discretion to determine the amount of such awards (within the prescribed statutory minimum and maximum),[20] providing that a whistleblower's failure to utilize available internal procedures without clear, appropriate justification, will generally result in the whistleblower receiving a bounty of no more than the statutory minimum of 10 percent of the total monetary sanctions collected in the action.

II. Persons With a Duty to Report to the Company Should Not Be Entitled to Whistleblower Awards.

Under the Proposed Rules, certain persons will not be considered for awards because they will not be deemed to have independent knowledge or to have done independent analysis of a potential violation. These are persons with pre-existing legal or contractual duties to report; attorneys who obtain information from clients and make whistleblower claims for themselves (unless disclosure is permitted under SEC or state bar rules); independent public accountants who obtain information through an

[18] Proposing Release at 49-51, 75 Fed. Reg. at 70499-70500.
[19] Proposing Release at 25-26, 75 Fed. Reg. at 70494.
[20] *See* Exchange Act §§ 21F(b)(1), 21F(c)(1)(A).

engagement required under the securities laws; foreign government officials; and people who learn about violations through company compliance programs, or are in positions of responsibility for an entity, where the information is reported to them with the expectation that appropriate steps will be taken. However, this latter exclusion does not apply where the company does not disclose the information to the SEC "within a reasonable time" or otherwise acts in "bad faith."

These persons have established professional obligations to the company, and play a crucial role in the company's efforts to comply with the federal securities (and other) laws. The Associations believe that the value of these functions would be undermined by monetary incentives for such persons to take their information to the Commission rather than the company. Instead, persons with a duty to report information to the company, whether by virtue of a professional relationship (*e.g.*, an attorney), the terms of the person's employment and job function (*e.g.*, a compliance officer or internal auditor), or an outside service provider (*e.g.*, a compliance consultant or outside auditor), should not be entitled to whistleblower bounties. Such persons have a duty to report misconduct to the company, to work with the company to resolve such matters and, to the extent of their authority, to take all available steps to see that such issues are resolved (including, in appropriate circumstances, reporting it to the Commission). They should not be tempted to instead serve their own interests by seeking to report information to the SEC in order to reap a personal reward.

The Associations are also very concerned with the idea of allowing persons providing "legal, compliance, audit, or similar functions or processes for identifying, reporting, and addressing potential non-compliance with applicable law" to become whistleblowers if the company does not disclose the information to the Commission "within a reasonable time" or the entity proceeds in "bad faith." As much as any of the other persons discussed above, these persons have a duty to bring such information to the company's attention, and they are compensated by the company for doing so. They should not be able to use that information for personal profit.

Moreover, the terms "reasonable time" and "bad faith" are not defined. Instead, the Commission will review the circumstances of a case after the fact and determine whether the company disclosed the misconduct to the Commission within a reasonable time or proceeded in bad faith. Using such vague standards to define when a person performing a control function for the Company can become a whistleblower has the potential to entice certain persons to make their own, self-serving determination as to when the company has failed to act within a "reasonable time" or has acted in "bad faith," and report information to the Commission even thought the firm may be conducting an investigation or otherwise acting in a perfectly appropriate manner. It could even create an incentive for persons to inhibit or prevent internal processes from moving forward, so that they can report the matter to the Commission in hopes of profiting personally. The Associations believe that, like other professionals, persons providing legal, compliance, audit, or similar functions or processes for identifying, reporting, and addressing potential non-compliance with applicable law, should not be eligible to receive whistleblowers bounties.

III. The Proposed Rules Provide Little Protection From False and Frivolous Claims.

There is considerable concern expressed in the Proposing Release and the Proposed Rules for protecting employees from retaliation for whistle blowing activities. This is entirely appropriate and consistent with our view that the best way to approach potential violations of law by company insiders is to enable

those with information about such violations to report it to the company in an atmosphere that fosters open and candid discussion. However, neither the Proposed Rules nor the Act offer much protection for companies faced with false and frivolous whistleblower claims, such as baseless claims by a disgruntled employee, a competitor seeking to gain an unfair advantage, or a shareholder who is unhappy that a proposal was not carried at the annual meeting. Each of these persons could use the whistleblower process to raise unfounded claims or report perceived violations that have no basis in fact, in hopes of damaging the company and/or its personnel, and at the same time realizing a significant financial windfall.

The Associations acknowledge that whistleblowers will be required to submit complaints in writing, and to declare that they are acting in good faith with personal knowledge of facts that might demonstrate that the company is violating the securities laws. These requirements are important but, in many cases, they will not provide sufficient protection. Many claims will be drafted without the assistance of an attorney (although whistleblowers have the right to seek the assistance of an attorney, and must do so if they file anonymous complaints). Thus, they are likely to be unclear or imprecisely drafted, and it will be difficult to prove that the allegations were not made with the requisite good faith, making it very difficult to pursue perjury or similar claims. The Associations believe that the rules must permit a company to take good faith actions that are not retaliatory if they are based on factors other than a whistleblower's status; for example, actions relating to the legitimate discipline of employees. The Commission should also consider whether it can apply additional sanctions to any person who uses the whistleblower process as a sword rather than a shield, whether it is to protect employment; make reports to harm the company or its employees, officers, or agents for competitive or other reasons; or otherwise make claims for which there are no reasonable bases for believing that the allegations are true.

IV. The Proposed Rules Should Not Reward Bad Conduct.

The Act expressly prohibits persons who are criminally convicted from being eligible for a reward, but is silent as to the effects of a civil judgment. While there are some limitations on the amount of payment to persons who direct, plan, or initiate a violation, it remains possible for a wrongdoer to get an award. The Associations believe strongly that wrongdoers, criminal or civil, should not receive awards.[21] Proposed Rule 21F-15 provides that the Commission, in determining whether the required $1,000,000 threshold has been satisfied, will not count monetary sanctions that the whistleblower is ordered to pay, or that are ordered against any entity whose liability is based substantially on conduct that the whistleblower directed, planned, or initiated. It also provides that the Commission will not add those amounts to the total monetary sanctions collected in the action for purposes of calculating the amount of payment to the culpable individual. The Proposing Release explains that "[t]he rationale for this limitation is to prevent wrongdoers from financially benefiting by, in essence, blowing the whistle on their own misconduct [and that] it would not be consistent with the purposes of the statute to pay awards to persons based on monetary sanctions arising from their own misconduct." The Associations respectfully submit that the Commission should take this rationale to its logical conclusion and exclude

[21] *See* Proposing Release at 8, 75 Fed. Reg. at 70489.

from the definition of "whistleblower" anyone who engages in or participates in the conduct giving rise to the action and resulting monetary sanction.[22]

At the Open Meeting, Commissioner Aguilar commented that "[i]t seems odd that a program to deter and ferret out wrongdoing may pay financial incentives to those doing the wrong,"[23] and Commissioner Walter expressed a strong belief that the Commission "should take steps to minimize other culpable whistleblowers from benefitting from their own misconduct."[24] The Associations agree fully. As Commissioner Aguilar pointed out, there are already incentives for wrongdoers to come forward. They can receive reduced sanctions and credit for cooperating, and indeed the Commission has established a program for this purpose.[25] It would be wrong to permit them to also profit (perhaps handsomely) from their wrongdoing or their involvement in wrongdoing. Also, there may be cases where the fund from which bounties are paid is not sufficient to cover a whistleblower's award, in which case the whistleblower will be paid from monies that otherwise would go to victims of the wrongdoing.[26] It would be an outrageous result for a whistleblower who participated in the wrongdoing to receive an award paid for out of the victim's pocket.

V. The Proposed Rules Should Provide Stronger Protections From Those Who Obtain Information Improperly.

The Proposed Rules would create powerful financial incentives for unscrupulous persons to download, copy, and steal confidential corporate and customer information in order to substantiate their claims and receive monetary rewards. Proposed Rule 21F-4(b)(4)(vi) provides that "[t]he Commission will not consider information to be derived from [the whistleblower's] independent knowledge or independent analysis" if the knowledge or the information upon which the analysis is based is obtained "[b]y a means or in a manner that violates applicable federal or state criminal law."

The Proposing Release says that "a whistleblower should not be rewarded for violating a federal or state criminal law," doubting whether "Congress intended to encourage whistleblower assistance to a law enforcement authority where the assistance itself is undertaken in violation of federal or state criminal law."[27] The Proposing Release asks whether the exclusion is appropriate, whether it should extend to other types of criminal violations, and whether it should exclude persons who provide information in violation of judicial or administrative orders such as protective orders.

The Associations agree that bounties should not be paid for information based on illegally obtained material, or information obtained or provided in violation of judicial or administrative orders.

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[22] Although the statutory definition of whistleblower does not by its terms exclude wrongdoers from whistleblower status, the Proposed Rules already diverge from the statutory definition, providing that a "whistleblower" is one who provides information relating to a "potential" violation of the securities laws, even though the word "potential" is not in the statutory definition. The Commission says that the change is necessary to avoid it being required to determine at the time information is submitted whether the alleged conduct constitutes a violation, or leaving the person's whistleblower status unknown, which the Commission "do[es] not believe is the intended result." Proposing Release at 6, 75 Fed. Reg. at 70489. We respectfully submit that an equally compelling argument can be made that paying large bounties to those who participate in wrongdoing is likewise "not the intended result," and that the exclusion is therefore appropriate.

[23] Statement of Commissioner Luis A. Aguilar, SEC Open Meeting (Nov. 3, 2010).

[24] Statement of Commissioner Elisse B. Walter, SEC Open Meeting (Nov. 3, 2010).

[25] *See also* footnote 6, above.

[26] *See* Exchange Act § 21(F)(g)(3)(B).

[27] Proposing Release at 28, 75 Fed. Reg. at 70494.

Furthermore, bounties should not be paid for reports based on information obtained in violation of any civil law prohibition, including any legal or regulatory privacy requirement, any foreign civil or criminal law or regulation, any other legal proscription, or any company policy designed to facilitate compliance with such criminal laws, judicial or administrative orders, civil laws (including legal or regulatory privacy requirements), foreign civil or criminal laws or regulations, or other legal proscriptions. Quite simply, violations of such laws, court orders, legal proscriptions or company policies should not be rewarded. Moreover, the whistleblower program should include provisions making it clear that whistleblowers responsible for obtaining information in violation of any of the above prohibitions will not be protected by the anti-retaliation provisions, and will be subject to criminal prosecution and/or civil actions under applicable state and federal law.[28]

VI. The Proposed Rules Raise Serious Issues With Respect to the Attorney-Client Privilege.

Finally, the Associations are concerned about the overall approach that the Commission is taking in connection with the Proposed Rules with respect to the attorney-client privilege.

Proposed Rule 21F-4(b)(4)(i) provides that information will not be considered to derive from an individual's "independent knowledge" or "independent analysis" if the knowledge or information upon which the analysis is based was obtained "[t]hrough a communication that was subject to the attorney-client privilege." The literal scope of Proposed Rule 21F-4(b)(4)(i) means that knowledge or information covered by privileged attorney-client communications cannot serve as the basis for a whistleblower's reward. However, the Proposing Release states that it is the Commission's position that this "exclusion" from the definitions of independent knowledge and independent analysis only applies "to attorneys and to persons such as accountants and experts when they assist attorneys on client matters." This statement is puzzling since the text of Proposed Rule 21F-4(b)(4)(i) does not contain any language that would limit the scope of the exclusion to attorneys and those persons who assist them. In order to exclude privileged attorney-client communications as a basis for independent knowledge or independent analysis, the proposed exclusion must necessarily apply with equal force to exclude privileged information when it is obtained by the client, *i.e.*, officers, directors, employees, etc. Otherwise, a strange anomaly would develop that would only protect and exclude attorney-client privileged information from whistleblower disclosures if the person with the privileged information happens to be an attorney or such persons who assist attorneys on client matters.

In our view, the Proposing Release is inconsistent with the language of Proposed Rule 21F-4(b)(4)(i) and should not represent the Commission's position. The Associations believe that Proposed Rule 21F-4(b)(4)(i) must apply with equal force to any person—attorney or client—who is a party to a privileged attorney-client communication. Further, to avoid any confusion, the Proposed Rule should be amended to explicitly clarify that it has such broad application.

[28] Financial services companies are particularly concerned about data breaches, because so much of their corporate information consists of non-public customer information. Whistleblowers who download information to support whistleblower claims may, deliberately or inadvertently, come into possession of such customer information. The costs to the banking industry of preventing and detecting data breaches, and notifying customers when their information is at risk of misuse, is already huge. Moreover, once corporate and customer information leaves its corporate data environment (especially if it leaves in electronic form) further distribution is virtually guaranteed We believe that there is no good reason to create new incentives for such breaches.

Moreover, the Associations believe that the Commission needs to incorporate safeguards to ensure that privileged information is not collected in the investigative process through whistleblowers' disclosures. For this reason, the Associations are very troubled by the Commission's Proposed Rule regarding communications between Commission staff and represented parties, as it directly undermines well-established ethical considerations intended to protect the attorney-client relationship and the confidential communications made pursuant to that relationship. Proposed Rule 21F-16(b) is said to "authorize" Commission staff to "communicate directly" with a "director, officer, member, agent, or employee of an entity that has counsel" who has contacted the Commission regarding a potential securities law violation "without seeking the consent of the entity's counsel." Such communications are inconsistent with the SEC Division of Enforcement's Enforcement Manual (Office of Chief Counsel, Jan. 13, 2010) (the "Manual"). The Manual states that, "in the absence of a compelling reason to contact an individual directly, staff members should contact company counsel" before initiating communications with: (i) employees with managerial responsibility; (ii) employees who supervise, direct, or regularly consult with corporate counsel regarding the matter at issue; (iii) employees who have power to compromise or settle the matter at issue; (iv) employees whose acts or omissions may be imputed to the company for liability purposes; or (v) employees whose statements would constitute an admission on the part of the company or bind the company with respect to proof of the matter at issue.

Even more significant, the communications contemplated by Proposed Rule 21F-16(b) run afoul of ABA Model Rule 4.2, which provides that "[i]n representing a client, a lawyer shall not communicate about the subject matter of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order." In the Proposing Release, the Commission takes the view that Proposed Rule 21F-16(b) does not violate Model Rule 4.2 because unpermitted contact with represented parties is "necessarily authorized" by Section 21F of the Exchange Act.[29] We respectfully disagree. To be sure, no such authorization appears in the actual text of Section 21F or, for that matter, Section 922 of the Act. The Commission appears to justify such communications by what it perceives as a "Congressional purpose" to facilitate disclosure and preserve confidentiality.[30] However, the Associations believe that the important and well-established ethical considerations that embody Model Rule 4.2 should not be discarded by the Commission where no explicit authorization is given by Congress to do so.

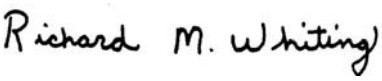
Accordingly, the Associations respectfully submit that the Commission should withdraw Proposed Rule 21F-16(b), and instead follow the procedures set forth in the Manual.[31] In addition, to ensure that disclosures by whistleblowers are grounded upon independent knowledge or independent analysis, and to avoid any inappropriate or inadvertent encroachment on attorney-client communications, the Associations suggest that the Commission incorporate a warning into its protocol for communications with whistleblowers that explicitly disclaims that the Commission is seeking attorney-client communications.

Conclusion

[29] Proposing Release at 87, 75 Fed. Reg. at 70510.
[30] *See id.*
[31] As a practical matter, the Proposed Rules in theory could cause SEC staff to run afoul of ethical rules of the states in which they are admitted, and thus subject themselves to disciplinary action by state bar authorities.

The Associations recognize that the Commission was mandated by Congress to develop a whistleblower process by which information about potential wrongdoing by companies and their insiders is uncovered in a manner that protects the integrity of the information and the interests of the person uncovering and disclosing the information. The Associations applaud the Commission for its efforts in trying to balance that mandate with the legitimate interests of companies in being involved in the process of detecting and dealing with such wrongdoing. Our comments are offered in the hope that they will help the Commission in its goal of developing final rules that strike the appropriate compromise between the desire to encourage and reward whistleblowers and the need to protect the integrity of well developed, robust compliance procedures by which companies hope to root out wrongdoing at the earliest possible stages.

Sincerely,



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