

THE HILL



Whistleblowers to remain prominent fixtures in securities regulation

By William McClucas
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• The SEC's Dodd-Frank Whistleblower Program provides monetary awards to eligible individuals who provide the agency with information that leads to an SEC enforcement action in which significant financial sanctions are ordered.

As the SEC completes year five of the program, it is obvious that public companies — especially those in the financial services industry — cannot afford to ignore employees who speak up about corporate misdeeds.

Neither should companies ignore the broader effect that whistleblowers have had on the corporate landscape. This evolution has become corporate America's new normal and it will require a renewed commitment to compliance and controls, corporate culture and sound corporate governance to effectively mitigate the attendant risks.

THE EMERGENCE OF SEC WHISTLEBLOWERS

As securities lawyers — one of whom served as the Director of the SEC's Enforcement Division for more than eight years — we are well aware that there have always been whistleblowers willing to disclose their employer's alleged wrongdoing to the government.

Some of these individuals are just plain unhappy employees; some are poor performers; some have either credible concerns or hardcore evidence of wrongdoing; and a few fall into all of these categories.

Whatever the motive, the ascendancy of whistleblowers to the well-protected status and unique stature they now occupy in our markets, poses an enormous challenge for all institutions. That challenge is particularly difficult for public companies and regulated entities, their senior management teams and, ultimately, the boards of directors.

What has happened and how did we get here?

There have always been individuals who have acted as solitary crusaders intent on exposing corporate misdeeds, but over the past two decades we have experienced a number of developments that have altered the landscape dramatically.

Beginning with the parade of corporate meltdowns some 15 to 20 years ago, along with the scandals at Enron, WorldCom, Adelphia, Tyco and a host of other companies, whatever legitimate skepticism the average person may have felt toward corporate America, that disdain has grown into a much broader, and more enduring, view of potential wrongdoing in the corporate world.

The passage of Sarbanes-Oxley in 2002 and the Dodd-Frank Act eight years later legiti-

mized whistleblowing and gave legislative blessing to financial incentives for valuable tips. Since then, the whistleblower phenomenon has affected not only a growing swathe of public companies, but has been felt in institutions across society.

The near collapse of the financial system in 2008 only aggravated the situation. Many still view the government action taken to rescue the banking system less as a necessary step to save the capital markets and the overall economy than as a bailout of the banks and Wall Street.

For many, the government's solution — no matter how effective — added to the growing disaffection and further erosion of confidence in both corporate America and in the government. It is against this reality that we now see the current explosion of whistleblower complaints, coupled with government incentives for those who believe they see accounting irregularities, illicit payments or other corporate misdeeds.

RISING NUMBER OF SEC WHISTLEBLOWER TIPS

The SEC recently published data showing the agency continues to receive an increasing number of whistleblower complaints. The SEC received 4,218 total tips in fiscal year 2016, a nearly 8 percent increase from fiscal year 2015 (3,923).

The 2016 numbers also represent a greater-than 40 percent increase from 2012 (3,001), which was the first full year of the program. These are staggering numbers and include complaints from individuals in 67 foreign countries.

The number and size of SEC awards continues to rise as well. The Commission paid more than \$57 million to 13 whistleblowers in 2016. That figure included the SEC's second-highest award of \$22 million paid in August 2016 to a company insider who, according to the SEC, provided information about a "well-hidden securities violation that would have been unlikely to have been detected but for the whistleblower's information."

A \$30 million award paid to a single whistleblower in September 2014 remains the highest bounty paid under the SEC's program to date. The size of these awards alone is significant.

If Congress wanted to establish an incentive for individuals who believe — fairly or unfairly — that they have identified wrongdoing, these awards are tantalizing bait. The corporate resources necessary to deal with whistleblower complaints, including the need to investigate thoroughly and to address problems that are exposed by whistleblowers, or by the company's own efforts, are significant.

WHAT LIES AHEAD?

It is by no means clear whether the SEC might change the whistleblower program or change the agency's approach to the quantity or size of awards issued under the program. The SEC's practice of generally seeking extraordinarily large financial penalties against companies and firms charged with securities law violations might well get revisited under a Trump-appointed Commission.

Opponents of such large financial penalties have asserted that large penalties punish shareholders who, in many cases, already have been victimized by the company's misconduct, especially when accounting fraud is alleged.

Instead, there could be an even more intense focus on holding individuals within these enterprises accountable for any alleged corporate violations. This would reduce the magnitude of the financial penalties being obtained by the SEC, and in turn, would cause a concomitant reduction in the size of SEC whistleblower awards.

If high-dollar awards begin to fade, it is unclear whether the overall interest in the program and number of whistleblower tips will start to wane as well.

Aside from any possible effect on the quantity or size of SEC whistleblower awards, certain critics of the program have pointed to specifics they view as simply bad public policy. For example, the SEC has no requirement that whistleblowers first report wrongdoing to their own companies before contacting the SEC.

Critics have asserted that this aspect of the program has an adverse effect on self-policing and on corporate internal compliance processes. Whether the SEC, under new leadership, would revisit this issue is an open question.

One thing, however, seems to be a safe bet — the stature whistleblowers now hold is unlikely to diminish in the near term. Addressing the challenges of the current climate requires not simply more effective ways of dealing with potential whistleblowers or problem employees.

Rather, corporate entities and their boards must accept that it requires a long term commitment to good compliance, sound corporate governance and, in some cases, changing the corporate culture from the top down.

Even in companies that have solid compliance systems and controls, employees who do not identify with the enterprise mission, who do not trust management all the way up the chain of command, or who otherwise feel disconnected from the company, are far more likely to see whistleblowing and its financial rewards as a worthy alternative to working within the system to address problems.

While even the best corporate governance environment provides no inoculation from whistleblowers, the better the corporate culture, the less likely employees are to believe that going outside the enterprise to deal with potential compliance issues is a preferred route — even with the current bounty system and its potential for supersized financial rewards.

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