SULLIVAN & CROMWELL LLP

September 30, 2020

SEC Enhances Whistleblower Program

New Rules Aim to "Properly Award Whistleblowers to the Maximum Extent Appropriate"

SUMMARY

On September 23, the Securities and Exchange Commission ("SEC") amended Rule 21F, which relates to its whistleblower program, in order to "ensure whistleblowers are properly incentivized." Among other things, the amendments introduce the presumption that the statutory maximum award will be made where it is $5 million or less—which represents the substantial majority of all whistleblower awards to date—if no negative award factors (such as culpability or unreasonable delay) are present.[1]

The SEC approved the amendments by a 3-to-2 vote, with Commissioners Lee and Crenshaw dissenting.[2] The full text of the whistleblower program amendments is available here, and the SEC's press release announcing these changes is available here. The whistleblower program amendments will become effective 30 days after publication in the Federal Register.

OVERVIEW

Presumption of Maximum Award if 30% of Monetary Sanctions Collected Is $5 Million or Less

Under Rule 21F, whistleblowers whose tips lead to successful enforcement actions may be awarded between 10% and 30% of monetary sanctions collected. The amendments added a specific provision to Rule 21F-6 that will create a presumption that, when (1) the statutory maximum authorized award amount is $5 million or less and (2) the negative award factors under Rule 21F-6(b) are not present, Rule 21F-6(c) will result in an award amount that is the statutory maximum (*i.e.*, 30% of sanctions collected), subject to the SEC's discretion to apply certain exclusions. (Awards over $5 million will continue to be assessed without a presumption.)

According to the SEC's release, this change is aimed at increasing the efficiency and transparency of the SEC's application award factors and at encouraging a potential whistleblower to come forward where the aggregate maximum award for the actions resulting from that whistleblower's original information is likely to be $5 million or less. The amendments further clarify that the SEC will continue to have broad discretion to consider and apply the award factors specified in Rule 21F-6(a) and (b) in percentage terms, dollar terms or some combination of percentage terms and dollar terms when determining the award amount. However, the SEC did not adopt its proposed rule allowing for downward adjustments in whistleblower awards for cases involving monetary sanctions exceeding $100 million. The proposed rule would have expressly provided that the SEC could (1) consider the dollar figure of the award and (2) set the final award within the statutory range at a level "reasonably necessary to reward the whistleblower[s] and to incentivize similarly situated whistleblowers" in such cases.[3]

Expanded Definition of "Administrative Action"

Under Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act"), the SEC is required to pay whistleblower awards in relation to the "successful enforcement" of "any covered judicial or administrative action" brought by the SEC and certain "related actions" of other governmental entities, including the U.S. Department of Justice ("DOJ"). The amendments added a new paragraph to Rule 21F-4(d) to provide that the term "administrative action" includes a deferred prosecution agreement or a non-prosecution agreement entered into by the DOJ, as well as a settlement agreement entered into by the SEC outside of the context of a judicial or administrative proceeding to address violations of the securities laws. Relatedly, under the amendments, any money required to be paid in such actions will be deemed a "monetary sanction" eligible for whistleblower awards under Rule 21F. This change is intended to assure meritorious whistleblowers that their awards will not be denied simply because of the procedural vehicle that the SEC (or another governmental entity) has chosen for resolving a particular enforcement matter.

The amendments also clarified that, under the current definition of "related actions," recovery from the SEC in connection with the successful enforcement of related actions of other governmental entities is not available if the SEC determines that a separate whistleblower award program more appropriately applies to the non-SEC action.

Revision of "Whistleblower" Definition in Light of Digital Realty

As part of the amendments, the SEC adopted Rule 21F-2, which seeks to "conform whistleblower status, award eligibility, confidentiality, and retaliation protection" in light of the Supreme Court's holding regarding Section 21F in *Digital Realty Trust, Inc.* v. *Somers*.[4] In *Digital Realty*, the Supreme Court held the definition of "whistleblower" codified in Section 21F(a)(6) of the Exchange Act requires a report to the SEC as a prerequisite for retaliation protection, and therefore the SEC's broader interpretation of the term was not entitled to deference. Since the revised "whistleblower" definition under Rule 21F-2 is intended to conform to *Digital Realty*'s narrower reading of what is required to qualify as a whistleblower for Section 21F's employment retaliation protections, the SEC has repealed its 2015 formal interpretation,[5] which explained

that compliance with Exchange Act Rule 21F-9 was not required to qualify as a whistleblower for purposes of Section 21F's employment retaliation protections. Citing *Digital Realty*, the amendments further require that whistleblowers provide notice to the SEC "in writing" (either through a portal on the SEC website or by submitting Form TRC) and, in order to qualify for retaliation protection, the notice must be provided before the alleged retaliation.

Ability to Bar Award Applicants Who Abuse the Application Process or Submit False Information

As part of the amendments, the SEC adopted Rule 21F-8(e)(1), which provides the SEC with the ability to permanently bar individuals from submitting award applications when they have submitted three or more award applications that are frivolous or lack a colorable connection between the tip and the action. However, with respect to the initial three applications reviewed by the Office of the Whistleblower and deemed to be frivolous or lacking a colorable connection to the matter, the Office must notify the claimant of its assessment, and give the claimant the opportunity to withdraw the application before the Office recommends a bar. The SEC also adopted a new Rule 21F-8(e)(4), which codifies the SEC's existing practice of barring applicants who submit materially false, fictitious, or fraudulent statements in their dealings with the SEC. In addition, the SEC added clarifying language to Rule 21F-8(c)(7) to provide that an individual who has been deemed ineligible for an award for knowingly and willfully making false statements to the SEC or another governmental entity may be permanently barred from making future whistleblower award applications or otherwise participating in the whistleblower program.

Interpretive Guidance Regarding "Independent Analysis"

Whistleblowers must submit "original information" to be eligible for awards, which Section 21F of the Exchange Act defines as "independent knowledge or analysis" that is not known to the SEC and not exclusively derived from a variety of public sources. Simultaneous with the adoption of the amendments, the SEC released guidance requiring that independent analysis provide "evaluation, assessment or insight" beyond what would be reasonably apparent to the SEC from publicly available information. The new guidance provides that a tip will qualify as "independent analysis" if "(1) the whistleblower's conclusion of possible securities violations derives from multiple sources, including sources that, although publicly available, are not readily identified and accessed by a member of the public without specialized knowledge, unusual effort, or substantial cost; and (2) these sources collectively raise a strong inference of a potential securities law violation that is not reasonably inferable by the [SEC] from any of the sources individually."

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ENDNOTES

1 The full release of the whistleblower program amendments can be found here.

2 Commissioner Lee's and Commissioner Crenshaw's statements in dissent of the amendments can be found here and here, respectively.

3 Release No. 34-83557, *available at* https://www.sec.gov/rules/proposed/2018/34-83557.pdf.

4 *Digital Realty Trust, Inc.* v. *Somers*, 138 S. Ct. 767 (2018).

5 *Interpretation of the SEC's Whistleblower Rules under Section 21F of the Securities Exchange Act of 1934*, 80 Fed. Reg. 47,829 (Aug. 10, 2015).

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