

Whistleblower Rules – Time for an Ombudsman?

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Dodd-Frank Act

- Section 922 of the Dodd-Frank Act added Section 21F, entitled “Securities Whistleblower Incentives and Protections,” to the Securities Exchange Act of 1934.
 - Section 21F directs the Securities and Exchange Commission to make monetary awards to individuals who voluntarily provide original information that leads to successful Commission enforcement actions resulting in the imposition of monetary sanctions over \$1 million.
 - Awards are required to be made in the amount of 10% to 30% of the monetary sanctions collected.
 - Awards will be paid from the Commission’s Investor Protection Fund.
- Exchange Act Section 21F provides that the whistleblower awards will be paid under regulations prescribed by the Commission.

SEC Adoption of the Whistleblower Regulations

- May 25, 2011, the Commission adopted Regulation 21F, which became effective August 12, 2011.
- Regulation 21F includes 17 rules (21F-1 through 21F-17) that:
 - Define terms essential to the operation of the whistleblower program, including “whistleblower” itself;
 - Establish procedures for submitting tips and applying for awards;
 - Describe the criteria the Commission will consider in making award amount decisions; and
 - Implement the Dodd-Frank Act’s prohibition against whistleblower retaliation.

Key Sections of the Whistleblower Regulations

- Voluntary submission of information.
- Original information.
- Information must lead to a successful enforcement action.
- Payment of award.
 - Anti-retaliation protection applies if “reasonableness” standard is met, even if no award is paid.
- Factors impacting the percentage amount of the award:
 - The significance of the information;
 - The degree of assistance provided by the whistleblower;
 - The interest of the Commission in deterring violations by awards; and
 - Whether the whistleblower participated in internal compliance systems and reported any violation internally or assisted in an internal investigation.

2011 SEC Annual Whistleblower Report

August 12 – September 30, 2011

- 334 Total Tips – average of about 10 per business day.
- Balance of SEC's Investor Protection Fund, which is funded by money recovered by SEC penalties and disgorged profits: \$452,788,043.

Criticisms and Limitations

- Responses to the Commission's approach to constructing and administering the whistleblower regulation assert that the rules may:
 - Undermine internal compliance and reporting systems;
 - Discourage employees from improving or correcting corporate misconduct;
 - Hinder the ability of companies to timely address the underlying misconduct; and
 - Theoretically incent employees to delay reporting to maximize the bounty.
- Potential legislative response to the Commission's final rules.

What have fund companies and management companies done?

- Recognized the risks presented by an ineffective internal reporting process.
 - The Commission's whistleblower rules do not require internal reporting.
 - Strategies to encourage employees to come forward.
- Risk oversight by Boards – risks of public administrative or enforcement proceedings and loss of control over escalation can be mitigated by encouraging and facilitating internal reporting.
- Dangerous Silence – consider approaches to promote and incent internal reporting.
 - An ombudsman program to encourage “whisperblowers”?

On a conflict resolution continuum of 1 - 15

- WHISTLEBLOWING HAPPENS AT ≈ 14
- “WHISPERBLOWING” WITH THE OMBUDSMAN HAPPENS AT ≈ 1 OR 2



The Organizational Ombudsman

AN ORGANIZATIONAL OMBUDSMAN IS

- INDEPENDENT
- NEUTRAL
- CONFIDENTIAL
- INFORMAL

The Organizational Ombudsman

AN ORGANIZATIONAL OMBUDSMAN IS NOT

- AN AGENT OF MANAGEMENT

DOES NOT

- MAKE POLICY
- ENFORCE POLICY
- KEEP RECORDS
- ACCEPT “NOTICE”

WHISTLEBLOWING

- REFLECTS A CULTURE

THE ORGANIZATIONAL OMBUDSMAN

- CREATES/FOSTERS A CULTURE

How can ombudsman confidentiality/privilege be protected?

- When the following actions are taken, courts of law usually recognize the confidential and privileged nature of communications with the ombuds:
 - The program is properly structured.
 - It operates in a manner consistent with the preservation of confidentiality.
 - When a challenge is made to the ombuds' confidentiality, adequate documentation and legal support for the ombuds position is provided to the court.
- There is abundant legal authority to support the assertion that communications with the ombuds should not be considered notice to the organization.

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Questions?