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Invested in America

December 17, 2010

Ms. Elizabeth M. Murphy, Secretary
U.S. 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 (Release No. 34-63237)

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced filing. SIFMA fully supports Congress' and the Commission's efforts to identify and address potential violations of the federal securities laws and regulations. We recognize the value of robust and effective whistleblower statutes and rules in accomplishing those goals. SIFMA members agree with much of what the Commission has included in its Proposing Release (the "Proposing Release")[2] to propose rules to implement Section 21F of the Securities Exchange Act of 1934 (Section 922 of the Dodd-Frank Act) (the "Proposed Rules").

I. EXECUTIVE SUMMARY

SIFMA agrees with the SEC's stated concern that the Proposed Rules should not undercut internal corporate compliance reporting systems, which are a critical component of what the Commission has recognized is the first and most important line of defense against securities law violations. SIFMA believes that in some important respects the Proposed Rules do not go far enough to protect the critical role played by internal compliance reporting systems, and

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] Exch. Act Rel. No. 63237 (Nov. 3, 2010).

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therefore weaken the overall system of prevention and detection. As a result, our comments below are intended to strengthen these features of the Proposed Rules.

SIFMA believes that internal corporate compliance reporting systems are particularly important in the financial services industry. We believe that individuals, at least in the financial services industry if not more broadly, should be required to report potential misconduct to effective internal compliance reporting systems and allow those systems a chance to work in order to be eligible for a whistleblower award. SIFMA agrees with the Commission's proposal to require individuals in legal, supervisory and other control functions to escalate potential violations through internal reporting lines. We support the Commission's suggestion that only whistleblowers who report potential violations by "another person" should be eligible for awards, to prevent culpable individuals from benefitting by their own misconduct, and that whistleblowers should be required to report promptly upon learning of the potential misconduct. SIFMA urges the SEC to harmonize its whistleblower rules with the Commission's cooperation initiative, and to incorporate the whistleblower programs of the self-regulatory organizations ("SROs"). Finally, we urge the SEC to clarify that the anti-retaliation provisions of Section 21F permit companies to take personnel actions against individuals for appropriate reasons other than whistleblowing, such as their involvement in violations of law, rules or firm policies, or their obstruction of internal or SEC investigations.

II. BACKGROUND

The financial services industry – perhaps more than any other industry – has devoted significant resources in recent years to strengthening its internal corporate complaint reporting systems as well as its legal, compliance, risk management and internal audit functions. Public companies in the financial services industry, like all other public companies, have established internal complaint reporting systems as required by Section 301 of the Sarbanes-Oxley Act to address complaints that relate to a potentially material effect on financial reporting, accounting or disclosure controls. But in addition, broker-dealers also have internal compliance reporting systems as required by the Supervisory Control Rules.[3] Investment advisers and investment companies have comparable compliance program requirements in Rule 206(4)-7 and Rule 38a-1.[4] These rules collectively require financial services firms to investigate potential violations of the federal securities laws and rules, as well as (in the case of broker-dealers) potential violations of SRO rules. In short, the compliance program rules require financial services firms to investigate the same potential violations as are the subject of the Proposed Rules. Broker-

[3] These rules, sometimes referred to as the Gruttadauria rules because of an enforcement action that led to their adoption, included the adoption of NASD Rules 3012 and 3013, and amendments to NASD Rules 2510, 3010, and 3110, as well as parallel changes to NYSE rules. See NASD Notice to Members 04-71 (October 2004) (summarizing rule provisions). NASD Rule 3013, the CEO certification rule, is now FINRA Rule 3130.

[4] See Inv. Adv. Rel. No. 2204 (Dec. 17, 2003).

dealers generally are required to report the results of these investigations to their regulators under NASD Rule 3070 and NYSE Rule 351 (both soon to be replaced by FINRA Rule 4530). As a matter of practice, most investment advisers and investment companies do so as well. SIFMA members have taken extraordinary efforts to make these compliance programs a priority.

Firms in the financial services industry devote substantial resources to the legal, compliance, risk management, internal audit and supervisory functions that are responsible for identifying and investigating potential misconduct. The ability of Chief Compliance Officers ("CCOs") and their staffs to investigate potential violations and their causes is absolutely critical to fulfilling their obligation to report to the Chief Executive Officer ("CEO") (or the fund board, in the case of mutual funds) concerning the effectiveness of the firms' compliance programs and to address necessary enhancements. Moreover, the Commission and the SROs have rigorously examined the compliance program functions, the CCO annual reports, and the CEO compliance certifications, since these rules were adopted in 2003 and 2004. We understand that the SEC and the SROs have found that, in general, these compliance programs are operating effectively and have materially improved compliance with the securities laws.

Internal compliance reporting and investigation structures are effective because the financial services firms themselves are uniquely positioned to address immediately potential violations in a manner that protects the investing public. The legal, compliance, risk management, internal audit and supervisory functions within financial services firms understand the firms' own personnel, structure, products, policies and procedures better than any outside regulator. This familiarity allows misconduct to be identified swiftly and addressed effectively. These internal control functions can assess and remedy harm to customers much more efficiently than can an outside regulator. Indeed, the regulators have long said that firm compliance is the first and best line of defense against legal and regulatory violations.

It is vitally important for firms, especially in financial services, to instill a culture of compliance, making it clear that the firms take their legal and regulatory responsibilities seriously and respond appropriately to indications of wrongdoing. If a firm creates an atmosphere in which misconduct and corner-cutting is not tolerated, this deters employees from engaging in that misconduct. Compliance programs simply cannot work effectively if employees do not have a sufficient incentive to make the firms aware of potential violations. The culture of compliance will be undermined if the firms are deprived of an opportunity to demonstrate that they do not tolerate legal violations or unethical conduct, because complaints go to outside regulators rather than to the firms.

Especially in the current budget environment, the SEC will not soon have the resources to investigate fully all whistleblower reports. Indeed, because of budgetary uncertainty, the SEC recently has had to defer creating the Office of the Whistleblower contemplated by Section 924

of the Dodd-Frank Act.[5] The Proposing Release (at p.96) estimates the SEC will receive some 30,000 whistleblower reports per year, which is only part of the several hundred thousand tips it has received in recent years. With this volume of whistleblower complaints and tips, the SEC may have difficulty distinguishing the serious complaints from the frivolous ones. The effectiveness of internal compliance reporting and investigation depends in large part on the cooperation of individual employees and on the firms' ability to respond thoroughly and accurately to reports of potential misconduct. SIFMA is concerned that encouraging whistleblowers to bypass the internal compliance process will negatively impact the ability of both the SEC and financial services firms to detect and address potential violations. As the comments below detail, SIFMA believes that, as currently drafted, certain aspects of the proposed rules would do just that.

III. THE PROPOSED RULE SHOULD REQUIRE INDIVIDUALS TO REPORT VIOLATIONS INTERNALLY TO BE ELIGIBLE FOR AN AWARD.

We support the Commission's proposal to give credit in the calculation of award amounts to whistleblowers who follow established internal procedures for the reporting and investigation of complaints about misconduct.[6] SIFMA believes, however, that the Commission should go further, and as the Proposing Release suggests in Request for Comment 18, require individuals first to report violations internally to be eligible for a whistleblower award. After a company receives a report of suspected misconduct, it should have the opportunity to investigate that misconduct before the whistleblower goes to the Commission.[7] Such an internal reporting requirement should only apply at companies that have an effective internal compliance reporting system. The Commission could require that to be deemed effective, such an internal compliance reporting system would have to provide for a complaint-reporting hotline.[8] In order to be deemed effective, an internal reporting system also would require a designated

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[5] See http://www.sec.gov/spotlight/dodd-frank/dates_to_be_determined.shtml (last visited Dec. 9, 2010).

[6] Proposing Release at p.33-36.

[7] This discussion assumes the reported violation concerns conduct involving the employer or its affiliates. SIFMA also believes that the Commission should encourage whistleblowers to report internally potential misconduct at third parties. Otherwise an entity will be unable to satisfy its obligation to file Suspicious Activity Reports (SARs) concerning that misconduct, and firms will not be able to protect themselves from exposure to high-risk counterparties. However, with respect to suspected third-party misconduct, these concerns may be addressed if whistleblowers notify their employers at the same time they notify the SEC.

[8] We suggest that the Commission use objective criteria (such as the existence of a complaint hot-line, the designation of an officer responsible for responding to complaints, and the adoption of an anti-retaliation policy - all discussed below), to determine if a company has an effective internal compliance reporting system. In that way, potential whistleblowers will not have to guess whether they are required first to report internally, or are permitted to report directly to the Commission.

officer (such as the CCO), who is ultimately responsible for overseeing investigations of complaints, and who has access to senior executive officers with authority to respond to well-founded complaints.[9] In addition, an effective internal compliance reporting system would have to provide protection to an individual against retaliation for submitting a complaint. Finally, an internal reporting requirement would not apply in instances it would be futile, for example where individuals responsible for investigating complaints were themselves involved in the alleged violations.[10]

After individuals report potential misconduct to their company, the company should have an opportunity to investigate before the whistleblowers go to the Commission. As discussed above, the Commission simply lacks the resources to investigate the 30,000 whistleblower reports it expects to receive per year. If the Commission begins its own investigation of a set of facts, the company's ability to complete an internal investigation will be compromised. We suggest a bright-line rule: if the company has an effective internal compliance reporting system and internal reporting would not be futile (both as discussed above), the company should be allowed at least 180 days to complete its internal investigation before the whistleblower reports to the Commission.[11] In contrast to the requirement that the whistleblower make an initial report to the company, we do not suggest the requirement to wait after making that initial report before going to the SEC as a strict eligibility requirement. Rather, the Commission should provide a financial incentive: in order to be eligible for the full amount of an award, the whistleblower should allow the company an opportunity to conduct an internal investigation. A whistleblower who prematurely reports to the Commission would still be eligible for an award, but only at the low end of the statutorily permissible range.

Further, SIFMA strongly urges the Commission to include in the final rules strong financial disincentives against individuals who violate company rules requiring them to report

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[9] Former employees also should be required at least to report the misconduct to their former employer. Otherwise, the Commission would be providing an incentive for employees to quit so that they can become eligible for whistleblower awards. Also, the same concerns that apply to "employees" also apply to individuals who are associated with a financial services firm as independent contractors. The SEC and the SROs have long held that firms have the same supervisory duties with respect to independent contractors as to employees, and the Commission should apply the whistleblower rules in the same way to both.

[10] By analogy, there is a well-developed body of law concerning the situations in which shareholder demands are considered futile, and are excused, in the context of corporate governance and other derivative action disputes. *See, e.g., Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

[11] For the same reason, SIFMA urges that "90 day" provision of Proposed Rule 21F-4(a)(7) be extended to at least 180 days. Internal investigations often can take longer than 90 days; a 180 day period would allow a reasonably longer period to complete these investigations while not extending indefinitely the period before the report to the Commission.

misconduct internally, or who have falsely certified that they are unaware of any misconduct.[12] We believe the Commission should deem such individuals not to be eligible for an award under Section 21F. As the Commission recognizes, the purpose of the whistleblower provisions of the Dodd-Frank Act are to encourage individuals "to come forward early," not to wait until misconduct has festered and additional investors have been harmed – but the potential size of a whistleblower award has grown.[13] An individual who "lays in the weeds" should not reap monetary awards as a result of that misconduct.

Similarly, SIFMA urges the Commission to deem ineligible for an award any individual who refuses to cooperate with the company's internal investigation, or who provides inaccurate or incomplete information or otherwise hinders such an investigation.[14] Internal investigations are most effective if the whistleblower who triggered the investigation has an obligation to assist in that investigation.[15] And if the whistleblower can provide false or incomplete information in the internal investigation with impunity, then that investigation has no opportunity to be successful. As the Commission recognizes, Proposing Release at 34-35, even when a whistleblower report goes to the SEC in the first instance, the Commission Staff in the ordinary course will allow the company to conduct the initial investigation of that complaint. If the SEC does not require whistleblowers to cooperate fully and candidly with those internal investigations, then this process will not be effective.[16]

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[12] Most financial services firms have an annual process in which all employees certify that they have complied with various disclosure and other regulatory requirements, they have received and will comply with the firm's compliance policies and procedures, and they are not aware of any violations. The Commission should not reward individuals who subvert this important internal control.

[13] Proposing Release at p.13.

[14] Proposed Rule 21F-8(c)(7) already provides that if an individual is ineligible if, in dealing with the Commission, he or she knowingly and willfully makes any false, fictitious, or fraudulent statement or representation, or uses any false writing or document, knowing that it contains any false, fictitious, or fraudulent statement or entry. Similarly, Proposed Rule 21F-8(b)(1)-(2) requires that whistleblowers (1) provide explanations and other assistance in order that the staff may evaluate and use the information that they submit, and (2) provide all additional information in their possession in a complete and truthful manner. The Commission should extend these eligibility requirements to individuals who commit similar misconduct, or fail to provide complete cooperation, in connection with company internal investigations.

[15] We recognize that in some cases whistleblowers may choose to submit anonymous reports, and the company may not know who the whistleblower is. Nevertheless, if the company asks the whistleblower (whether or not his or her status is known to the company) to cooperate in an internal investigation and the whistleblower refuses, then the whistleblower should become ineligible for an award.

[16] In a number of recent cases, criminal prosecutors have treated misstatements or omissions in internal investigations as constituting criminal false statements to the government, or as obstruction of government investigations, because of the likelihood that the information would be conveyed to government investigators. See

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Moreover, the Commission already recognizes that if a purported whistleblower only reports after becoming aware of a request for information in a government investigation, then that report is not "voluntary," and should be ineligible for an award.[17] For exactly the same reasons, the Commission should extend this principle to requests for information in companies' internal investigations. A whistleblower should not be viewed as making a "voluntary" submission if he or she does so only after becoming aware of an internal investigation. The point of the whistleblower award program is to encourage individuals with knowledge of misconduct to come forward promptly; if the company is already investigating that misconduct, then the whole purpose of the incentive is lost. Internal investigations would be further undermined by the incentive for individuals to conceal information from the company so that they can be the first to turn over the information to the SEC. Allowing whistleblowers to make a submission after becoming aware of an internal investigation will not "facilitate the operation of company compliance processes, audits, and internal investigations";[18] it will do exactly the opposite. The concerns about encouraging true whistleblowers to come forward promptly, and to cooperate fully in any existing investigation by any relevant authority, all counsel in favor of deeming such "after the fact/piggy-back" reports to be ineligible for an award.[19]

IV. FOR INTERNAL REPORTING AND COMPLIANCE SYSTEMS TO WORK EFFECTIVELY, THE PROPOSED RULES SHOULD EXCLUDE FROM WHISTLEBLOWER ELIGIBILITY LEGAL STAFF, OTHER CONTROL FUNCTION STAFF, AND SUPERVISORY STAFF.

SIFMA agrees with the Commission's suggestion in Proposed Rule 21F(b)(4) that information obtained by persons with legal, compliance, audit, or supervisory responsibilities should be excluded from the definitions of "independent knowledge" or "independent analysis" and thus from eligibility for whistleblower awards. The functions performed by the legal, compliance, audit and supervisory staff are integral to the efforts of companies to detect misconduct and prevent harm to the public. Individuals in these departments generally have access to confidential information about clients, and are charged with building a strong internal compliance processing and investigation program. As discussed below, we suggest that this group of functions be broken up into three groups, which present related but distinct issues:

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Michael J. Farhang, Section 1519: Why Obstructing an Investigation By Company Counsel May Now Be a Federal Crime, 4 White Collar Crime Rep. (BNA) 191 (Mar. 13, 2009).

[17] Proposing Release at p.12-13.

[18] Proposing Release at p.12 n.11.

[19] Similarly, in response to Request for Comment 3, SIFMA believes that whistleblowers should not be viewed as making "voluntary" submissions if they have already received a formal or informal request, inquiry or demand from a foreign regulatory authority, law enforcement organization, or self-regulatory organization.

(1) legal, (2) control functions (including but not limited to compliance and audit), and (3) supervisory personnel.[20]

With respect to lawyers, as the Proposing Release recognizes:

> Compliance with the federal securities laws is promoted when individuals, corporate officers, and others consult with counsel about potential violations, and the attorney-client privilege furthers such consultation.[21]

Lawyers, in particular, have knowledge that is protected by the attorney-client privilege and the work product doctrine, which they are not permitted to waive.[22] Moreover, lawyers have state law ethical obligations to maintain client confidentiality that extend beyond information that is privileged. In addition, both outside and in-house lawyers already have internal "up-the-ladder" reporting obligations imposed by the Commission's Part 205 Rules, with which they are required to comply before they may breach client confidentiality and report matters to the Commission. The Proposing Release already contains two exceptions (Proposed Rules 21F(b)(4)(i) and (ii)) which relate to lawyers and to experts, paralegals and others directed by lawyers.[23] We suggest that the reference to lawyers be taken out of Proposed Rule 21F(b)(4)(iv), and that the duties of lawyers be treated separately in those two earlier exceptions.[24]

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[20] SIFMA suggests that the Commission clarify that all of the exceptions in Proposed Rule 21F(b)(4) continue to apply after an individual has left his or her firm; otherwise the Commission would simply create an incentive to quit.

[21] Proposing Release at p.20; *accord*, *Scott G. Monson*, Inv. Co. Rel. No. 28,323 (June 30, 2008) (noting "'[s]ignificant public benefits [that] flow from the effective performance of the securities lawyer's role,'" recognizing that "'[i]n the course of rendering securities law advice, the lawyer is called upon to make difficult judgments, often under great pressure and in areas where the legal signposts are far apart and only faintly discernible'" and expressing "concern that, to the extent lawyers exercising their professional judgment are excessively motivated by 'fear of legal liability or loss of the ability to practice before the Commission,' clients may well decide not to consult lawyers on difficult issues.") (internal quotes citing *William R. Carter*, 47 S.E.C. 471 (1981)).

[22] We suggest the Commission clarify that these provisions apply equally to in-house and outside counsel, and apply whatever the basis for the counsel's duty of confidentiality.

[23] We support the Commission's proposal that any information obtained through communications that are the subject of any common law evidentiary privilege, including the attorney-client privilege, work-product doctrine and other privileges, should be excluded from the definition of "independent knowledge" or "independent analysis." We also urge that Proposed Rule 21F-16 be clarified to provide that, if the Commission remains in contact with a whistleblower during the course of a company's internal investigation, it cannot seek from the whistleblower information about counsel's views and advice (or other privileged information and discussions) that the whistleblower obtains during that investigation.

[24] The result of this suggestion is that lawyers would not be subject to the "good faith" or "prompt reporting" exceptions in Proposed Rule 21F(b)(4)(iv). SIFMA opposes these exceptions as currently drafted. However, even

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Proposed Rule 21F(b)(4)(iv) currently contains an exception for compliance, audit and governance functions. We believe this exception should be broadened to include internal control functions more generally (and perhaps this is what the Commission means by "governance" in this context). At most financial services firms (including all such firms that are part of bank or financial holding company structures), there are risk management personnel who have similar functions requiring them to monitor for and address potential violations of firm policies and legal and regulatory requirements. At many firms, there are product management or personnel responsible for independent valuations of positions who also play an important role in detecting and preventing regulatory violations. We believe all of these internal control functions should treated equivalently because they all play important roles in maintaining the firm's control environment.

SIFMA agrees with the Commission's proposal to exclude "supervisors" from being deemed to have "independent knowledge" in Proposed Rule 21F(b)(4)(iv), but we urge the Commission to define more clearly who is excluded by virtue of being a "supervisor."[25] "Supervisors" for these purposes should be defined broadly, to include individuals who would have supervisorial responsibility under the SEC's failure to supervise precedents, including not only line supervisors, but others who have the practical ability to respond to potential violations. When a person with knowledge of potential wrongdoing comes to a supervisor in an effort to redress the violations, it should be the obligation of the supervisor to respond promptly and effectively – and not to attempt to profit on that information by positioning themselves as whistleblowers. Any contrary result would undercut the carefully thought-out "failure-to-supervise" provisions of the federal securities laws.[26]

SIFMA notes that in the CFTC's proposed whistleblower rules, the provisions comparable to Proposed Rule 21F(b)(4) are substantially narrower than the provisions in the Commission's Proposed Rules.[27] SIFMA intends to urge the CFTC to conform its proposal with that of the SEC. With the clarifications proposed here, we believe the policy concerns that led the SEC to include these provisions should be persuasive to the CFTC as well. Moreover, we believe it is important that the SEC's and CFTC's rules be consistent; there is no difference between the

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if the Commission retains these exceptions, the proper tests for when a lawyer may breach client confidentiality are the tests contained in state bar ethics rules as well as the Commission's Part 205 "up-the-ladder" reporting rules, and it would be confusing and inappropriate to have separate "bad faith" or "prompt reporting" exceptions for lawyers as well.

[25] Proposed Rule 21F-4(b)(4)(iv).

[26] *See, e.g.,* Exchange Act Section 15(b)(4)(E), Advisers Act Section 203(e)(6) and NASD Rule 3010.

[27] *See* 75 Fed. Reg. 75727 (Dec. 6, 2010) (available at http://www.cftc.gov/LawRegulation/FederalRegister/ProposedRules/2010-29022.html).

securities and commodities markets that would justify different standards for whistleblower eligibility.

Similarly, SIFMA agrees with the provision in Proposed Rule 21F-4(a)(3) that if a person has a pre-existing legal or contractual duty to report violations, the person should not be eligible for a whistleblower award.[28] We urge that this principle be applied to cover individuals who have a duty to report violations (or facts that may constitute violations) pursuant to binding ethical rules or have a similar duty under a contractually binding code of conduct. This same general principle should apply when individuals have a duty to report the underlying facts that constitute the violation, even if they may not have a legal duty to reach a conclusion that those facts constitute a violation of law.[29]

For the same reasons, as the Proposing Release recognizes in Proposed Rule 21F-8(c)(4), we agree that this same general principle should apply to outside auditors as well. Independent public accountants have pre-existing legal duties to report potentially illegal acts. As discussed in the Proposing Release,[30] Section 10A of the Exchange Act[31] prescribes requirements for auditors if they detect information indicating an illegal act, which in certain circumstances includes reporting directly to the SEC. There are other SEC-required engagements that require an accountant to report instances of noncompliance, and there are professional standards for independent public accountants which prescribe duties when a potential illegal act is detected. These individuals do not need the incentive of whistleblower awards to do what is already their legal and professional responsibility, which is to report any potential violations they encounter.

The Proposing Release requests comment on whether the Commission should adopt any specific time period in place of the "reasonable time" requirement. But different internal investigations have different levels of complexity and take different amounts of time. We believe a "reasonable time" exception would be simply unworkable.[32] As discussed above, if

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[28] For similar reasons, the Commission should explicitly expand this principle of ineligibility for individuals with a duty to detect and report misconduct to Independent Compliance Consultants appointed pursuant to SEC, SRO or state securities commission mandates, or pursuant to similar agreements with the U.S. Department of Justice, other federal agencies, or state attorneys general.

[29] We also support the provision in Proposed Rule 21F-8(c)(1) and (2) that all government and SRO employees (including foreign government employees) that have some level of involvement in securities law regulation and enforcement should be ineligible for a whistleblower award.

[30] Proposing Release at p.22-23.

[31] 15 U.S.C. § 78u-6(c)(2)(C).

[32] Proposing Release at p.30, Request for Comment 13. We note that the CFTC has proposed a 60 day reporting requirement for legal, compliance, audit and supervisory staff. We do not believe 60 days is sufficient to complete many of the more complex internal investigations, which may involve multiple individuals in different locations

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the Commission believes that a specific time period is necessary, we believe it should allow companies at least 180 days to complete their internal investigations.

Moreover, a carve-out based on time in which the event is reported to the Commission precludes the company from reaching a good faith determination that no violation occurred, and that the matter is not reportable. If the Commission adopts either a "reasonable time" exception or a specific reporting time-period, companies will feel completed to report the results even of investigations that found no violations. Otherwise they will be at risk of a Commission investigation as a result of a whistleblower reporting that the company failed to report at all. The Commission should not want companies to be compelled to report the results of investigations that determined there were no violations – the Commission simply does not have the resources to evaluate all of those investigations.

V. THE PROPOSED RULES SHOULD BE STRENGTHENED SO THAT CULPABLE INDIVIDUALS ARE NOT ELIGIBLE FOR AWARDS.

If a person is involved in or knew about and could have prevented misconduct, then that person should not be able to profit from the violation as a whistleblower. SIFMA supports the alternative discussed in the Proposing Release that would define the term "whistleblower" to include only individuals who provide information about potential violations of the securities laws "by another person."[33] Allowing a person to participate in misconduct and then profit as a result, by making a whistleblower report concerning that misconduct, is directly contrary to the clear intent of Congress to reduce the overall number of securities law violations.[34] Paying awards to participants in the misconduct would be an absurd result Congress could not have intended.[35] SIFMA is concerned that without this change to the Proposed Rules, the net effect

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and even different countries. More generally, we see no legitimate reason for the whistleblower rules of the CFTC and SEC to differ.

[33] Proposing Release at p.8, Request for Comment 1.

[34] Section 21F expressly provides that individuals who have been criminally convicted of misconduct cannot receive whistleblower awards concerning the same misconduct. This provision may raise some question whether the Commission is authorized to adopt a rule providing that other individuals, whom the Commission has concluded were involved in the misconduct but have not (yet) been criminally convicted, are not eligible. But the Proposing Rules exclude from eligibility a variety of individuals (e.g. lawyers, independent auditors, SRO and foreign government employees) who are not expressly excluded in the statute. We believe a categorical exclusion of participants in the violation clearly would further Congress' intent.

[35] SIFMA believes that Proposed Rule 21F-15, which would exclude from the calculation of the amount of the award, for purposes of the threshold and bounty calculations, any sanctions against the individual or against an entity where the individual directed, planned, or initiated the misconduct, does not go far enough to deter other participants from assisting in or furthering the misconduct.

will be to encourage more misconduct, and to provide incentives for individuals to allow problems to grow and fester rather be reported so they can be promptly resolved.

The Commission has a separate program, its cooperation initiative, for individuals who are involved in a violation.[36] It may be appropriate in some circumstances to give individuals credit, in terms of reduced sanctions or even in some cases deferred prosecution or non-prosecution agreements, for reporting on their own misconduct.[37] But it is not appropriate to give individuals monetary rewards for reporting on their own misconduct – such a result creates an incentive to engage in the misconduct in the first place, or to allow it to continue and grow in the hope that the violator will reap a higher reward as a whistleblower.

SIFMA strongly urges that, at a minimum, anyone who directed, planned or initiated misconduct should be categorically disqualified from receiving a whistleblower award.[38] Individuals should be ineligible for an award if they knew or reasonably should have known that their conduct was improper. To the extent that individuals who are unwitting participants in a violation become aware that activity is improper during the course of that activity, then they should be eligible for an award if they report promptly upon becoming aware of the impropriety.

The Commission should not credit an individual with acting "voluntarily" in submitting a report when the individual was aware of fraudulent conduct, but failed to report that misconduct promptly.[39] It is vital to create an incentive for individuals to report misconduct promptly so that it can be stopped and its harm mitigated and remedied to the extent possible. Individuals should not have an incentive to allow misconduct to fester, grow and affect more innocent victims in the belief that the ultimate sanctions, and thus the award, will be much larger. As the Proposing Release itself recognizes, "the statutory purpose of creating a strong incentive for

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[36] *See* Securities and Exchange Commission, Policy Statement Concerning Cooperation by Individuals in its Investigations and Related Enforcement Actions (Jan. 13, 2010) (available at http://www.sec.gov/rules/policy/2010/34-61340.pdf).

[37] *See* Robert S. Khuzami, Speech by SEC Staff: Remarks at News Conference Announcing Enforcement Cooperation Initiative (Jan. 13, 2010) (available at http://www.sec.gov/news/speech/2010/spch011310rsk.htm).

[38] As currently proposed, Rule 21F-15 would deduct from the award sanctions as a result of misconduct the whistleblower directed, planned or initiated. The Commission should go further and make such a whistleblower entirely ineligible for an award.

[39] The Proposing Release, at p.16 Request for Comment 5, specifically requests comment on this scenario. The Proposing Release, at p.11-3, already provides that an individual does not act "voluntarily" in submitting a report if he or she was aware of misconduct, but chooses not to come forward until after becoming aware of a governmental investigation or examination. As discussed above, we urge that this principle be extended to company internal investigations as well.

whistleblowers to come forward early with information about possible violations of the securities laws rather than wait[.]"[40] This important purpose is best served by requiring whistleblowers to come forward promptly, either to the company's internal compliance reporting system or to the Commission.[41]

SIFMA believes that whistleblowers should not be rewarded for providing information to the government in violation of judicial or administrative orders, including protective orders in private litigation.[42] Judicial and administrative orders are issued to protect the interests of the parties in the proceedings, and are legally binding on all parties to the matters and their agents. Persons who violate legally binding orders should not be rewarded under the whistleblower rules. If a person wishes to disclose information subject to a judicial or administrative protective order, he or she should be required to go first to the court or agency and seek relief from that order. The purpose of the whistleblower provisions is to encourage compliance with the law, not to reward violations.[43]

SIFMA supports the Commission's proposal, in Proposed Rule 21F-4(b)(vi), that if the person obtained the information in a way that violated any criminal law or rule (such as computer hacking or other theft of the information), or the reporting violated any criminal law or rule, then the person should not be eligible to profit as a result of their violation of law. This principle, however, should not be limited to instances where the individual has actually been convicted of the criminal violation. Moreover, we believe this principle should be extended to civil violations of laws or rules, as well as SRO rules: the Commission should not reward anyone for violating any applicable laws or rules, whether or not they are criminal laws and rules.[44] Again, we believe Congress' goal was to encourage compliance with law, not to incentivize and reward violators of laws.

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[40] Proposing Release at p.13.

[41] As discussed earlier, SIFMA believes it is particularly important not to reward individuals who failed to report misconduct in violation of firm rules that require them to report misconduct, or after they have (falsely) certified that they were not aware of misconduct.

[42] The Proposing Release requests comment on this scenario, at p.31 Request for Comment 15.

[43] We also suggest that the Proposed Rules should prohibit double-dipping - an individual should not be eligible to recover both a whistleblower award from a company and serve as a plaintiff in class action or derivative action against the same company concerning the same conduct. Proposed Rule 21F-3(d) already contains a similar provision to prevent whistleblowers double-dipping from both the SEC and CFTC.

[44] For example, whistleblowers should not be permitted to benefit from misusing nonpublic personal financial information about customers in violation of Regulation S-P, which is a civil, not a criminal, provision.

VI. THE COMMISSION SHOULD HARMONIZE ITS WHISTLEBLOWER RULES WITH ITS COOPERATION INITIATIVE.

The Commission should clarify the relationship between the proposed Section 21F rules and the Commission's cooperation initiative. The Commission has had a long-standing framework for evaluating the cooperation of entities in its enforcement investigations.[45] A significant factor in that analysis has been whether the company detected the potential violations itself and self-reported them, or whether its cooperation began only after the Commission was aware of the issues. The "credit" that the Commission (as well as other authorities such as the U.S. Department of Justice) has given companies for responding quickly and effectively to internal indications of potential misconduct has significantly encouraged the growth and success of internal compliance reporting systems.

The Commission should realize that, as a result of the proposed whistleblower rules, it is much more likely that an individual will bring a potential violation to the attention of the Commission staff, in order to become eligible for a lucrative whistleblower award, than to report that violation internally. No matter how committed a company is to strong internal compliance reporting systems, a company cannot match the financial incentives contained in the Proposed Rules. SIFMA urges the Commission to make an explicit statement that it will give companies full cooperation credit under the Seaboard Section 21(a) Report if, after being notified by the Commission of a whistleblower complaint, the company investigates the matter appropriately and makes a thorough report back to the Commission. The Commission reasonably expects companies to investigate a whistleblower complaint regardless of whether it was directed to the Commission or the company's internal hotline. Indeed, the Proposing Release explicitly states that in the ordinary course, the Commission will have to refer most whistleblower complaints to the affected company for investigation in the first instance, because the SEC simply lacks the resources to pursue most of those complaints itself.[46] This referral process is appropriate, because in most cases companies can move more quickly than the government to stop nascent wrongdoing by immediately removing those who are culpable from their positions, addressing activities that may be suspect, and providing redress to any affected customers or other market participants.

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[45] *See* 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, Exch. Act Rel. No. 44,969 (Oct. 23, 2001) (the "Seaboard Section 21(a) Report") (available at http://www.sec.gov/ litigation/investreport/34-44969.htm). The Commission recently expanded on this guidance with respect to cooperation by individuals, *see infra* at nn. 36-37.

[46] Proposing Release at p.33-34. As discussed above, the Proposing Release estimates that the Commission will receive an unmanageable volume of some 30,000 whistleblower complaints per year.

The Commission should state explicitly that the fact that a whistleblower reports to the Commission, rather than using an internal compliance reporting system, does not indicate that the company's internal compliance reporting system is ineffective or that the company lacks an appropriate internal culture of compliance. Rather, the Commission should measure the company's commitment to full and effective cooperation from the time the Commission informs the company about a whistleblower report.

If the company then cooperates fully and effectively in an investigation after receiving a whistleblower report from the Commission, by taking the steps outlined in the Seaboard Section 21(a) Report, then the Commission should commit that it will give the company full credit for its cooperation. We recognize that "full credit" for cooperation will not always mean (as it did in the Seaboard matter itself) that the company will not be charged with any violation at all – the Seaboard Section 21(a) Report sets out other factors which may result in charges even in situations where the company did provide full cooperation. However, SIFMA strongly urges the Commission to state clearly that it will not deem a company to have failed to cooperate, or to have had an ineffective internal compliance reporting system or to lack an appropriate culture of compliance, simply because a whistleblower chose to come first to the Commission (in order to be eligible for a lucrative whistleblower award) rather than first giving the company an opportunity to respond to the issue by reporting through its internal process.[47] With the Section 21F rules in effect, the Commission must expect that even the most cooperative and most compliant companies will have whistleblowers take their reports directly to the Commission.

VII. THE COMMISSION SHOULD INCORPORATE REPORTING TO SROS AS PART OF THE WHISTLEBLOWER RULES.

The SROs, and particularly FINRA, have active and important whistleblower programs.[48] Particularly for practices requiring industry-specific knowledge, or for conduct which may constitute a violation of SRO rules rather than the federal securities laws, some whistleblowers report to the relevant SRO rather than to the Commission. Moreover, broker-dealers investigate and report many types of potential misconduct to their SROs rather than the Commission. In many cases, broker-dealers are required to report these investigations by NASD Rule 3070, NYSE Rule 351, and the soon-to-be-effective FINRA Rule 4530. Of course, it is the SROs that conduct most inspections and examinations of broker-dealers, and the SROs typically have dedicated liaisons who have an ongoing dialogue with member firms about

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[47] As discussed above, SIFMA urges that the Commission not permit individuals to bypass a company's internal complaint reporting process. However, if the Commission does allow individuals to report directly to it, without reporting first to the company, then it should not hold those reports against the company.

[48] FINRA has established a dedicated Office of the Whistleblower. *See* http://www.finra.org/Industry/Whistleblower/ (last accessed Dec. 9, 2010).

compliance-related issues. Finally, the SROs bring far more cases against firms and individuals in the broker-dealer industry than does the SEC.[49] Currently, the SEC does not have the resources to replace the SROs in any of these respects. Historically, the SEC and the SROs have worked closely together, and the SROs and the SEC have referred investigations to one another depending on which agency is more appropriate to investigate a particular matter. Of course the Commission does not have SROs for many of the entities it oversees (such as public companies) – so where it does have SROs, it should effectively leverage their resources.

SIFMA believes that the Commission should draft its proposed rules to support the SROs whistleblower programs rather than attempting to replace them. SIFMA suggests that a whistleblower who reports to an SRO should have the same eligibility for an award as a whistleblower who reports to the SEC. On the other hand, if a company reports potential misconduct to an SRO (rather than the Commission), then we suggest that information about that misconduct should not constitute "original information" if a whistleblower subsequently reports that information to the Commission.

VIII. THE ANTI-RETALIATION RULES SHOULD NOT PROTECT INDIVIDUALS WHO ENGAGE IN VIOLATIONS OF LAW OR WHO LIE TO THE COMPANY.

On its face, the anti-retaliation provisions of Section 21F(h)(1) could be interpreted to protect even individuals who have violated criminal laws. As currently drafted, the Proposed Rules do not address the anti-retaliation provisions of the Act at all.[50] However, the Proposing Release requests comment on whether the Commission should adopt rules addressing the scope of the anti-retaliation provisions.[51] SIFMA strongly urges the SEC to adopt rules to clarify the anti-retaliation provisions of the Act, so these provisions do not undercut the intent and effectiveness of the remainder of the whistleblower rules.[52]

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[49] We note that in recent years, FINRA has brought more than 1,000 cases per year against firms and individuals in the broker-dealer industry, while the SEC has brought only approximately 100 such cases per year. Especially in the current budget environment, the SEC does not have the resources to replace FINRA and the other SROs.

[50] Proposed Rule 21F-2(b) simply provides that the limits on whistle-blower eligibility in the Proposed Rules do not limit the scope of the anti-retaliation provisions in Section 21F(h)(1) of the Act.

[51] Proposing Release at p.89-90 and Requests for Comment 42-43.

[52] We note that the statute of limitations for retaliation claims in Section 21F is much longer than firms are typically required to retain employment-related or other relevant records. Although we recognize that the Commission does not have the ability to adjust this statute of limitations itself, we urge it to suggest that Congress adopt a more reasonable statute of limitations period.

Companies must continue to have the ability to discipline (and terminate) individuals who have violated any applicable laws and rules (including civil laws and rules and SRO rules), and company policies. Indeed, one of the "cooperation factors" in the Seaboard Section 21(a) Report is whether the individuals responsible for the violations remain at the company.[53] As the Proposing Release suggests, in Request for Comment 43, companies must remain able to discipline or terminate individuals for violations of law, independent of whether individuals have made a whistleblower report. Moreover, if the individual obstructed, lied or failed to disclose material information in a company's internal investigation, then the company must remain able to discipline those individuals. The SEC does not tolerate individuals who obstruct its own investigations and it should not provide protection to individuals who do so in a company's internal investigation; otherwise those internal investigations are compromised and cannot reach appropriate conclusions. The company also should be able to discipline individuals whom it concludes misled the government or SROs during investigations to protect the integrity of those investigations. Finally if the company determines that an individual was aware of violations but failed to report them as required by firm policies, then the company should be able to discipline that individual.

In our experience, it is not uncommon for individuals who suspect that they are at risk of an adverse personnel action to submit a whistleblower report in attempt to forestall that personnel action and create a protected status for themselves. These whistleblower complaints can be meritless or made in bad faith.[54] In some instances, the whistleblower was directly involved in the misconduct at issue in the report. Whistleblower status should not be a guarantee of continued employment, especially for individuals who themselves have been knowingly involved in misconduct.

SIFMA urges the Commission to clarify that, as Request for Comment 43 suggests, companies are permitted to take adverse personnel actions against whistleblowers for any appropriate reason other than their whistleblower status. Otherwise the Proposed Rules will simply encourage people who suspect they are likely to be fired or disciplined for other reasons to file meritless whistleblower complaints. In the worst-case (but not uncommon) scenario, unless clarified as we suggest, the Proposed Rules will reward participants in serious wrongdoing with extended if not permanent employment and prevent employers from disciplining or terminating individuals who have violated the law, simply because the individual submitted a whistleblower complaint before their misconduct was discovered. And the Commission should clarify that

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[53] *See infra* at n.45. The Department of Justice likewise takes into consideration whether wrongdoers have been disciplined in determining how to resolve corporate criminal investigations. "Principles of Federal Prosecution of Business Organizations," Memorandum from Mark R. Filip, Deputy Attorney General, to Heads of Department Components and United States Attorneys (Aug. 28, 2008) at 9-28.900.

[54] Often whistleblower reports are submitted when firms are considering layoffs - with the result that instead of the poor performing or compliance-challenged whistleblower losing his or her job, some other, innocent person loses his or her job instead.

filing a whistleblower report does not protect an individual from discipline or termination if the individual was involved in or responsible for, or lied about, the misconduct described in that report. Otherwise, the Proposed Rules may have the unintended (but entirely foreseeable) consequence of actually encouraging individuals to commit securities law violations or to make up or exaggerate information in order to obtain a protected employment status. Congress could not have intended to create these incentives, and the Commission should not leave it to the courts to sort out the ambiguities in Section 21F(h)(1).

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SIFMA appreciates the opportunity to submit this comment letter on these important issues. We have attached as an appendix to this letter responses to certain additional issues as to which the Proposing Release specifically requests comments. We would be happy to meet with the Commission staff to discuss the issues in this letter. Please contact me at 202-962-7373 or Melissa MacGregor, Managing Director and Associate General Counsel at 202-962-7385 if you have any questions or would like to discuss these issues further.

Respectfully submitted,

Ira D. Hammerman
Senior Managing Director and General Counsel

cc: Chairman Mary L. Schapiro
Commissioner Kathleen L. Casey
Commissioner Elisse B. Walter
Commissioner Luis A. Aguilar
Commissioner Troy A. Parades
Director Robert S. Khuzami, Division of Enforcement
David M. Becker, General Counsel
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APPENDIX - OTHER ISSUES ON WHICH THE PROPOSING RELEASE REQUESTS COMMENT

The Proposing Release includes a number of requests for comment which, for the sake of brevity, SIFMA did not address in the body of the letter. In many cases, SIFMA's responses to these requests for comment relate to our concern that the Proposed Rules have the potential to undermine internal compliance systems or will encourage violations by providing awards to culpable individuals. This appendix will address the requests for comment that fall into these categories and that have not already been addressed expressly in the body of the letter.

I. SUPPORT FOR INTERNAL COMPLIANCE MECHANISMS

Many of the requests for comment in the Proposing Release express concern that internal compliance mechanisms would be undermined if whistleblowers are given an incentive to bypass their company's compliance department and report directly to the SEC. SIFMA believes that support for internal compliance programs is an essential component of the SEC's effort to combat securities violations, and the SEC should change the Proposed Rules to preserve a company's ability to investigate reports of misconduct.

In *Request for Comment 3*, the Proposing Release requests comment on whether the SEC should exclude from the definition of "voluntarily," in Proposed Rule 21F-4(a), 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. The Proposing Release also asks whether it should exclude from the definition of "voluntarily" situations where the information was received from a whistleblower 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. SIFMA believes the Commission should exclude from the definition of "voluntarily" situations where the information was received from a whistleblower after she received a request, inquiry, or demand from a foreign regulatory authority, law enforcement organization or self-regulatory organization. Proposed Rule 21F-4(a)(1) already would not categorize a submission as voluntary if a whistleblower provides the SEC with information after receiving any formal or informal request, inquiry, or demand from the SEC, Congress, any other federal, state or local authority, any self-regulatory organization, or the PCAOB. Adding foreign law enforcement agencies to this list would prevent potential whistleblowers who are tipped off by an internal investigation initiated by a foreign government from making a submission before the company has time to investigate the claim. Such a modification would result in better disclosures from companies, and a more efficient use of the SEC's limited resources.

In *Request for Comment 4,* the Proposing Release requests comment whether it is appropriate to consider a request or inquiry directed at an employer to be directed at individuals who possess the documents or other information that is within the scope of the request, and whether the class of persons who are covered by this rule should be narrowed or expanded. The Proposing Release further requests comment on whether the exception to this rule, which would permit an individual to become a whistleblower if the employer fails to disclose the information in a timely manner, would promote the effective operation of Section 21F. SIFMA believes it is appropriate for the Proposed Rules to consider a request or inquiry directed at an employer to be directed at the individuals who possess the documents or information within the scope of the request. By considering requests or inquiries directed at an employer to be directed at the individuals as well, the SEC would encourage those individuals to cooperate with internal

investigations instead of giving them an incentive to bypass internal compliance mechanisms. The SEC should eliminate the exception that permits an individual to become a whistleblower if the employer does not disclose the information in a timely manner, because it will serve to give individuals a further incentive to obstruct the employer's access to the information. Moreover, significant legal consequences already exist for companies that willfully fail to comply with a government request for information, and this exception would not provide a meaningful additional incentive for a company's compliance efforts.

In *Request for Comment 8,* the Proposing Release requests comment whether there is a different or more specific definition of "analysis" that would better effectuate the purposes of Section 21F. Subject to our comments in the main body of the letter, SIFMA generally agrees with the proposed definition of "analysis" in Proposed Rule 21F-4(b)(3). In the Proposed Rules, the SEC defines "analysis" to mean the whistleblower's examination and evaluation of information that may be generally available and that reveals information that is not generally known or available to the public. This definition is appropriate only because the rule goes on to exclude "analysis" in seven circumstances. The first two exceptions apply to attorneys, and accountants and experts hired by attorneys. The third applies to independent public accountants hired to perform a service required by the securities laws. The fourth and fifth apply to individuals with legal, compliance, audit, supervisory or governance responsibilities for a company. The sixth excludes information obtained by criminal means. The seventh excludes anyone who obtained information from a person subject to one of the first six exclusions. But we do suggest the SEC clarify the situation in which one person reports based on information obtained from a second person, and that second person (the original source of that information) later reports the same information. Similarly, it is not clear how the SEC will address the situation in which one person is an original source of information leading to a successful prosecution, but a second person then provides additional information that "materially aids" the successful prosecution of the same case.

In *Request for Comment 16,* the Proposing Release requests comment whether it is appropriate to credit individuals with providing original information to the SEC as of the date of their submission to another governmental or regulatory authority, or to company legal, compliance, or audit personnel. Further, the Proposing Release asks whether the provision regarding the providing of information to a company's legal, compliance, or audit personnel appropriately accommodates the internal compliance process. SIFMA believes it is appropriate for the SEC to credit individuals with providing original information as of the date of their submission to another governmental or regulatory authority (including SROs). Even more importantly, giving individuals credit for reporting to company legal, compliance, or other control function personnel will encourage the effectiveness of internal compliance programs. As discussed in the body of the letter, we believe the whistleblower should then allow the company's internal compliance system to investigate the matter before he or she must report it to the SEC.

We also suggest that the definition of "original information" be amended to exclude suspected violations outside of the SEC's five year statute of limitations period for civil money penalties. The SEC should not use its limited resources to investigate outdated information which, even if it was accurate, could not result in civil money penalties from which a whistleblower award could be paid.

In *Request for Comment 17,* the Proposing Release requests comment whether 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) is an appropriate timeframe.[55] The Commission also requests comment on whether a longer time period should apply in instances where a whistleblower believes that the company has or will proceed in bad faith. SIFMA believes the 90-day timeline is inappropriate, for several reasons. The practical effect of the 90-day timeline will be to require a company to report to the Commission every internal whistleblower complaint it receives, even if it determines the complaint is without merit. Such a requirement would waste the SEC's limited resources. Moreover, 90 days is simply too short for companies to complete all internal investigations, no matter how complex. If the Commission insists on a hard-and-fast deadline, we suggest 180 days is more appropriate than 90 days.

In *Request for Comment 18,* the Proposing Release requests comment whether the SEC should consider other ways to promote robust corporate compliance processes consistent with the requirements of Section 21F. First, as discussed in our letter, the SEC should make explicit that it will continue to give companies full cooperation credit under the Seaboard Section 21(a) Report if they take appropriate action upon being notified by the Commission staff about a whistleblower report. The Proposing Release does not indicate that the SEC will give credit for cooperation in the current draft of the Proposed Rules, only that it will, upon receiving a whistleblower complaint, "contact the company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back." The SEC should provide companies with an incentive to cooperate fully (by conducting an appropriate investigation and turning over the proceeds of that investigation) and explicitly state in its Adopting Release that, in such a scenario, a company can receive full credit, in the same way it would have had the whistleblower first called the company hotline instead of the SEC.

Also in *Request for Comment 18*, the Proposing Release requests comment whether the SEC should consider a requirement that whistleblowers use employer-sponsored complaint and reporting procedures. As discussed in the main body of the letter, the Proposed Rules should be modified to provide that a whistleblower who does not, prior to or concurrent with the submission of information to the Commission, report information relating to a potential violation of securities laws through an available internal reporting system, is ineligible for an award unless the company in question either lacked an internal reporting mechanism or, if an internal reporting mechanism did exist within the company, use of that internal reporting system would have been futile in the particular situation at issue. The determination of whether an internal reporting mechanism would have been futile should be made by the SEC.

In *Request for Comment 20,* the Proposing Release requests comment whether the standard for when original information voluntarily provided by a whistleblower "led to" successful enforcement action in Proposed Rule 21F-4(c) is appropriate. Because the current definition allows whistleblowers to qualify for a bounty even after an internal investigation has been launched, we believe it would frustrate a company's efforts to conduct an internal investigation, and indeed may provide an incentive for individuals to frustrate that internal investigation so that they may become eligible as a whistleblower. The definition in Proposed Rule 21F-4(c) would consider the significance of the whistleblower's information to both the decision to open an investigation and the success of any resulting enforcement action. The Proposed Rule should distinguish between situations in which the whistleblower's

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[55] We suggest that the Form WB-DEC be amended to include an express question whether the whistleblower has reported the matter to a company's internal compliance reporting system.

information causes the staff to begin an investigation, and situations in which the whistleblower provides information about conduct that is already under investigation. In the latter case, awards should be limited to rare cases in which the whistleblower provides essential information that the staff would not have otherwise obtained in the normal course of the investigation, and in which the whistleblower fully cooperated with the company's own internal investigation.

In *Request for Comment 21,* the Proposing Release requests comment whether, in cases where the original information provided by the whistleblower caused the staff to begin looking at conduct for the first time, there should also be a requirement that the information have "significantly contributed" to a successful enforcement action? We believe the SEC should require that the whistleblower's information "significantly contributed" to a successful enforcement action. The SEC should establish a standard for original information sufficiently high to discourage potential whistleblowers from reporting unfounded, unspecific rumors, which require time-consuming, expensive and fruitless investigations and divert SEC resources from other, more worthy investigations.

In *Request for Comment 22,* the Proposing Release requests comment whether it is appropriate to consider a whistleblower's information as "leading to" successful enforcement even in cases where the whistleblower provided information about conduct that was already under investigation. The SEC should not consider that a whistleblower's information "led to" successful enforcement in cases in which he or she gave information about conduct that was already under investigation. As discussed above, a definition that allows whistleblowers to qualify for an award even after a formal investigation has been launched may frustrate a company's efforts to conduct an internal investigation. The standard that information causes the agency "to inquire concerning new or different conduct as part of a current investigation" is vague, and will encourage people to believe they can obtain an award by coming to the SEC rather than cooperating in the company's internal investigation. This standard should be eliminated.

In *Request for Comment 27,* the Proposing Release requests comment whether the SEC should identify additional criteria that it will consider in determining the amount of an award under Proposed Rule 21F-6. The SEC should consider 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. The SEC also should consider whether, and the extent to which, a whistleblower cooperated with the company's internal investigation. If the SEC does not include these criteria, then whistleblowers will not have a sufficient incentive to use internal compliance mechanisms. If the SEC does not provide incentives for use of internal compliance processes, this decision will increase the burden on the Commission staff, deny companies the ability to discover and remedy violations, and lead to an overall weakening of compliance culture.

II. CULPABLE WHISTLEBLOWERS

As discussed in the body of the letter, SIFMA believes that if a person is knowingly involved in or could have prevented misconduct, then that person should not be eligible to profit from the violation as a whistleblower. Many of the requests for comment in the Proposing Release address this issue, and SIFMA believes that there are several important changes that should be made to the Proposed Rules in order to ensure that culpable are not eligible for awards.

In *Request for Comment 7,* the Proposing Release requests comment whether it is appropriate to consider knowledge that is not direct, first-hand knowledge, but is instead learned from others, as "independent knowledge" under Proposed Rule 21F-4(b)(2), subject to an exclusion for knowledge learned from

publicly-available sources. We concur that the SEC can appropriately consider independent knowledge to include knowledge that is not direct, first-hand knowledge. Direct, first-hand knowledge is often held by those engaged in the misconduct, who should not be eligible to profit as a result. Permitting knowledge that is not first-hand will provide an opportunity for whistleblowers who are not involved in the misconduct to be eligible for an award.

In *Request for Comment 14,* the Proposing Release requests comment whether the proposed exclusion for information obtained from a violation of federal or state criminal law is appropriate. SIFMA agrees that the proposed exclusion for information obtained from a violation of federal or state criminal law is appropriate, and believes it should extend to violations of civil law and regulations as well as SRO rules and foreign law or rules. Similarly, as discussed in the letter, obtaining or disclosing information in violation of court or administrative orders, such as protective orders, should not be eligible for an award. Information obtained by illegal means should be excluded in order to discourage potential whistleblowers from violating any laws, and because the SEC should not sanction or reward illegal conduct.

In *Request for Comment 23,* the Proposing Release requests comment on the definition of the term "action" in Proposed Rule 21F-4(d). The Proposing Release provides that a whistleblower's percentage award should not include any monetary sanctions that the whistleblower is ordered to pay or that is collected from an entity whose liability is "based substantially on conduct that the whistleblower directed, planned or initiated." We agree that the whistleblower's own culpable conduct would not be included when determining if the SEC's total recovery meets the $1 million threshold for an award. However, in both cases, we suggest that the standards be broadened to include any violations in which the whistleblower knowingly participated (not merely those that he or she directed, planned or initiated), and that whistleblowers should be ineligible if they knew of potential violations and did not promptly report them. Otherwise the Proposed Rules will provide an incentive to allow the misconduct to fester, grow and affect more innocent victims, so that the whistleblower can allow the size of the award to grow.

In addition, we urge that the definition of the term "action" be revised so that, for SEC enforcement actions with multiple counts, only those specific counts that result directly or indirectly from the whistleblower's report constitute the "action" for which that whistleblower is eligible for reward. The SEC should allocate the overall monetary sanction both so that only those counts are included in determining whether the $1,000,000 threshold has been met, and if so, then in calculating the size of the award. As proposed, the current definition does not require such an allocation in determining whether the threshold amount has been met, but does require an allocation in the calculation process. In failing to propose such an allocation for the threshold amount, 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." SIFMA disagrees with this rationale. The purpose of Section 21F is to encourage whistleblowers to report potentially serious violations that could result in sanctions exceeding $1 million, By failing to make an allocation for actions involving multiple individuals or claims, the Proposed Rules will encourage whistleblowers to report minor and trivial problems, in the hope that they will be grouped with other, more serious violations to result in an overall sanction that qualifies for an award. To encourage reporting of minor and trivial violations, however, would have real and negative consequences. The Proposing Release estimates that the SEC will receive some 30,000 reports per year. As a result, reports about potentially significant violations will be lost in a sea of reports about minor and trivial violations. As for the

"challenge" of having to allocate, the Proposing Release itself is internally inconsistent. The allocation issue is impossible to avoid. In the criteria for determining the amount of an award, the Proposing Release does include as a factor "whether the information provided by the whistleblower related to only a portion of the successful claims brought in the Commission or related action." But this is essentially the same allocation process the Proposing Release said it did not want to undertake in the definition of "action." In light of the negative effects of encouraging reports about minor and trivial violations, both on the SEC's ability to respond to truly serious whistleblower reports, and on companies who have to respond to requests for investigation, we urge the SEC to include the allocation concept in the definition of "action" as well as in the criteria for determining the amount of an award.

In *Request for Comment 28,* the Proposing Release requests comment whether the role and culpability of the whistleblower in the unlawful conduct should be included as an express criterion in Proposed Rule 21F-6, with the result that the amount of an award would be reduced within the statutorily-required range. As discussed above, we believe culpable participation in, or failure promptly to report, the misconduct should exclude the whistleblower from eligibility altogether. However, failing that, the SEC certainly should include the role and culpability of the whistleblower in the unlawful conduct as an express criterion that would reduce the amount of an award. The award amount is within the SEC's discretion, and should take into consideration the culpability of a whistleblower. Also, in addition to excluding pre-decisional or internal deliberative process materials from the record for review in connection with the determination of the amount and eligibility for the award, we suggest that the SEC should also exclude materials prepared in connection with settlement negotiations (similar to the principle reflected in Fed. R. Evid. 408).

In *Request for Comment 31,* the Proposing Release requests comment on the ineligibility criteria set forth in Proposed Rule 21F-8(c), and specifically, whether other statutes or activities should render an individual ineligible for a whistleblower award. We agree with the SEC's ineligibility criteria set forth in Proposed Rule 21F-8(c), but think they should be expanded to include anyone knowingly involved in the violation, whether or not they are convicted of a criminal violation, as well as anyone who violates any civil or criminal law or SRO rule in connection with the whistleblower report or the underlying conduct, or who fails to cooperate with or obstructs a company's internal investigation of the suspected misconduct. Also, while the "knowing and willful" standard for false statements in the whistleblower application may be an appropriate standard for criminal prosecution of the whistleblower, we believe that ineligibility for an award should be triggered by a scienter standard, including recklessness, to avoid cavalier behavior by potential whistleblowers.