No Holiday From Whistleblowers: A Scary Future Predicted for the Financial Industry

On July 30, 2016, the United States celebrated its National Whistleblower Appreciation Day, which the US Senate adopted through Senate Resolution 522. This annual designation is designed to help ensure that the federal government "implements the intent of the Founding Fathers, as reflected in the legislation enacted on July 30, 1778," by encouraging each executive agency to inform its employees and the public about the legal rights of US citizens to "blow the whistle" and to acknowledge the contributions of whistleblowers who combat "waste, fraud, [and] abuse" and other legal violations. Congress needed no such reminder when it enacted the Dodd-Frank Act in 2010 amending the Securities Exchange Act of 1934 (the "Exchange Act") by, among other things, adding Section 21F, creating Securities Whistleblower Incentives and Protections.

Now, more than a half a decade on from Dodd-Frank's creation, the question of what its whistleblower incentives mean for the financial industry has begun to be answered in the steadily increasing awards made by the SEC. But to get a clearer picture of how the this industry might be affected in the future, one might turn to awards made under another Act, the Federal False Claims Act ("FCA"), as the FCA appears to portend an increasing amount, significance and severity of whistleblower initiated cases, fines and awards.

Background: A Reminder of the SEC's Whistleblower Program

Whistleblowers Incentivized: As a result of Dodd-Frank adding Section 21F – concerning Whistleblowers – to the Exchange Act, the SEC is now authorized to make financial awards to individuals who voluntarily provide information that leads to enforcement actions where the monetary sanctions exceed $1 million. The awards program allows payment to whistleblowers in amounts from 10 to 30 percent of the sanctions that the SEC collects in a matter.

SEC Office of the Whistleblower: The SEC created the Office of the Whistleblower ("OWB") as a separate office within the Division of Enforcement to administer the Dodd-Frank whistleblower program. The number of whistleblower complaints filed with the office has risen significantly each year, from 334 tips in fiscal year 2011 to 3,923 tips in fiscal year 2015.[1] Since the program's inception, the OWB has received over 14,000 tips and, as of August 30, 2016, awarded more than $107 million to 33 whistleblowers. Included in these amounts are payments of $14 million to a whistleblower in October 2013, $30 million in September 2014 and $17 million in June 2016. In August 2016, the OWB awarded another whistleblower $22 million.

Under the program, a whistleblower may be eligible to receive an award when the information provided either caused the opening and successful conclusion of an examination or investigation or when the information significantly contributed to an already open enforcement action. Additionally, there is no requirement that the individual be a current or former employee to be eligible for an award.

Prohibitions on Retaliating Against or Impeding Whistleblowers: In addition to establishing the financial awards program, the Dodd-Frank Act and the implementing regulations include anti-retaliation provisions. These provisions prohibit retaliation against whistleblowers who report potential wrongdoing based on a reasonable belief that a possible securities violation has occurred, is in progress or is about to occur. The provisions generally provide that no employer may discharge, demote, suspend, threaten or harass, directly or indirectly, or in any other manner discriminate against a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower in, among other things, providing information to the SEC.

In July 2014, the SEC brought its first enforcement action against an employer for retaliating against an employee who reported potential securities law violations to the SEC. According to the SEC, an advisory firm's head trader reported to the OWB that the firm engaged in prohibited principal transactions with an affiliate when trading on behalf of clients. The SEC claimed that the advisory firm retaliated against its head trader for making the complaint by, among other things, removing him as head trader, stripping him of supervisory responsibilities, assigning him to investigate the very conduct he reported and changing his job function to a full-time compliance assistant. The firm entered into a settlement with the SEC that resolved these and other allegations. As part of the settlement the firm agreed to pay a penalty of $300,000.

Significantly, the protection afforded by the anti-retaliation provisions extends not only to individuals who report wrongdoing to the SEC, but also to employees who, among other things, report potential securities law violations internally to their employers. The SEC has long taken the position that the anti-retaliation provisions protect individuals who report potential wrongdoing internally, as well as those who report wrongdoing to the SEC. Although district courts have reached differing conclusions on this issue, in *Berman v. Neo@Ogilvy LLC*, 801 F.3d 145 (2nd Cir. 2015), the United States Court of Appeals for the Second Circuit deferred to the SEC's interpretation of the anti-retaliation provisions and held that they apply to an employee who reported internally to his employer an alleged accounting fraud scheme.

The Dodd-Frank amendments and implementing rules also prohibit attempts to impede potential whistleblowers from reporting wrongdoing. Rule 21F-17 states that "[n]o person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement…with respect to such communications." The SEC has taken aggressive enforcement action against companies that it believed impeded potential whistleblowers by requiring employees to enter into agreements with broad confidentiality provisions or waivers of rights to recover monetary awards under whistleblower programs.

In April 2015, the SEC brought an enforcement action against a public company for its use of confidentiality agreements that allegedly impeded whistleblowers. During an internal investigation, the company required witnesses to sign confidentiality statements that contained warnings that they could face disciplinary action if they discussed the matters with outside parties without the prior approval of the company's legal department. Although the SEC did not have any evidence that any company employee was, in fact, prevented from communicating directly with the SEC about potential securities law violations or that the company took any action to enforce the confidentiality requirement or to prevent any such communications, the SEC found that the language undermined the purpose of the Exchange Act, which was enacted to "encourag[e] individuals to report to the Commission." The company agreed to pay a $130,000 penalty to settle the charges and amended its confidentiality statements to clarify that employees are free to report possible violations without the company's approval and without fear of retaliation.

In June 2016, the SEC settled a matter with a financial services company for misusing customer data and, as part of the matter, addressed language in some employee severance agreements, which the SEC characterized as prohibiting the employees from disclosing confidential information or trade secrets of the company to any person or entity except pursuant to formal legal process or after first obtaining written approval from the company. As part of the settlement, the company agreed to amend its severance agreements and provide whistleblowing training.

In August, 2016, the SEC again took enforcement action based on a company's efforts to limit employee whistleblowing. In this matter, the company's severance agreements required departing employees to waive their rights to recover any money from whistleblower claims they filed with the SEC or other federal agencies. Such provisions became more widespread after the Dodd-Frank whistleblower program came into existence as companies sought to dissuade employees from filing complaints with the SEC. The company agreed to pay $265,000 and amend its severance agreements to settle the matter. Just six days later, the SEC announced a similar settlement with a health insurer whose severance agreements limited employees' rights to whistleblower awards. The company, which had already removed the waiver language from its agreements in October 2015, agreed to pay a fine of $340,000.

International Reach: While the history of rewarding whistleblowers for information that leads to successful collections has been ongoing and common within the United States, especially under the FCA, the Dodd-Frank program has significantly expanded this practice beyond US borders. In FY 2015, not only did the OWB receive complaints from all 50 states and the District of Columbia, but it also received complaints from 61 foreign jurisdictions. Since the inception of the program, complaints have been received from a total of 95 different foreign jurisdictions.

A Look in the Crystal Ball

Theodore Roosevelt is credited with the quote "The more you know about the past, the better prepared you are for the future." Accordingly, looking to the experience that the government contracting and health care industries have had with the FCA provides some guidance as to what the financial industry will likely face under the Dodd-Frank whistleblower program.

Most FCA actions are filed under the *qui tam* provisions that allow individual whistleblowers, known as relators, to file suits on behalf of the government. If the government prevails, the relator receives up to 30 percent of the recovery. The number of *qui tam* suits filed increased from 365 in 2007 to 638 in 2015. During the same period, the total amount of incentive payments awarded to whistleblowers more than tripled, from $197 million to $597 million. While the financial services industry has also had its share of FCA matters, the vast majority of these cases have been brought in the health care and contracting industries. As expected, the lessons learned from these two industries under the FCA suggest that the more awards granted under the Dodd-Frank whistleblower program, the more whistleblowers will be incentivized to make reports in order to take advantage of the potential for larger awards.

Certainly, the Dodd-Frank awards of $17 million, $22 million and $30 million also reinforce the "winning lottery ticket" optics of the program. Also, while American workers in all industries are now generally aware of the protections and rewards for whistleblowing activity, the geographical expansion of the whistleblower program under Dodd-Frank, as well as the increasing size of the awards, will lead to the creation of an international cottage industry of plaintiffs' law firms that will assist and encourage whistleblowers by marshalling complaints through the OWB process. They will also offer their representation in potential retaliation claims, thus increasing the risks to companies of investigations and enforcement actions. Lastly, as seen by the SEC's recent aggressive enforcement activity related to perceived restrictive actions by companies limiting employees' ability to report to, or participate in, whistleblower programs, we should expect a continued expansion of the circumstances that the SEC deems to impede whistleblowers.

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Endnote

[1] Only seven weeks of data was available for whistleblower activity in fiscal year 2011 because the whistleblower rules became effective in mid-August 2011.

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