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Directors Urged to Submit Comment to SEC on Whistleblower Provisions

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With the approach of the December 17th deadline to comment on the Securities and Exchange Commission's proposed rule to pay bounties to whistleblowers, now is the time for directors to voice their opinion on the proposal. It also is imperative for directors to satisfy themselves that their companies' ethics and compliance program are up to date.

The SEC's whistleblower proposal is the result of a directive contained in this summer's Dodd-Frank Wall Street Reform and Consumer Protection Act. It allows the Commission to pay a bounty of up to 30 percent to a whistleblower who provides "original information'' about securities law violations.

Critics argue that passage of the SEC proposal, in its current form, would undermine the years of work that companies have put in to creating internal whistleblower channels—as directed by the 2002 Sarbanes-Oxley Act—by encouraging employees to go straight to the SEC with suspicions of wrongdoing. At a time when regulators have reached numerous million and billion-dollar settlements following high-profile scandals involving fraud and violations of anti-bribery and corruption laws, the allure of a 30 percent bounty creates an enormous incentive for whistleblowers to do just that.

Although the SEC has publicly stated that it understands the potential damage that the proposed bounty program could inflict on existing internal compliance programs, the creation of the bounty program—in some form—appears to be inevitable. Tangible evidence of the government's commitment to the new rule is the SEC's creation of a $452 million fund for the whistleblower award program. In response, some companies have begun seriously considering their own bounty programs in order to encourage their employees to use internal reporting channels first, instead of immediately turning to the SEC when they suspect possible wrongdoing.

As opposition to some of the key provisions in the current bounty proposal has mounted during the past few weeks, the SEC appears to be listening to ideas on how to create a set of rules that lawmakers and the corporate compliance community can both endorse. The SEC recently said it understands the need "to strike the right balance'' between the SEC's requirement for a "strong and effective whistleblower awards program'' and a business's own structure "for self-policing and self-reporting."

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Part of the reason for creation of the SEC bounty program may be the result of suspicion among lawmakers and regulators that too many compliance programs are ineffective and leave potential whistleblowers exposed to retaliation. Further, there appears to be a sense among lawmakers and regulators that many public companies must do more to foster a culture of compliance and ethical conduct.

Now more than ever, directors must demonstrate a visible, uncompromising commitment to compliance with securities laws by examining the rigor of compliance programs and ensuring that board members have sufficient oversight of them. One key question that directors will want to ask is whether their compliance programs mirror the standards contained in the recently revised Federal Sentencing Guidelines, adherence to which may mitigate certain penalties in the event of an enforcement action by the government.

It is a job that will require a significant effort, given that so many businesses have greatly expanded their footprint through outsourcing, off-shoring, joint ventures, and strategic alliances. For boards to gain a sufficient understanding of the extent and complexity of those arrangements—and corporate compliance (or noncompliance) with ethics programs—outside counsel or consultants may provide assistance.

The foundation of an effective compliance program is open communication, where those at the very top of the organization make certain that the culture of integrity is consistently reinforced and recognized throughout the organization. Directors can play an important role in overseeing such an effort.

And, at the same time, and especially at this critical period in a shifting regulatory landscape, directors should also take the time to consider submitting a comment to the SEC on a proposal that could have a dramatic impact on their businesses' reputation and future success.

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