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Whistleblowers

Investor Protection Act Whistleblower Plan Seen by Some as Not Being Effective Enough

The whistleblower program contained in the Investor Protection Act (H.R. 3817) sponsored by Rep. Paul Kanjorski (D-Pa.)—while generally beneficial in motivating and protecting certain individuals—has questionable potential for success, observers told BNA in recent interviews.

The House Financial Services Committee voted Nov. 4 to recommend H.R. 3817, which would impose a fiduciary duty on all providers of financial advice, create a whistleblower ''bounty'' and protection program, and which could double the authorized funding of the Securities and Exchange Commission and increase its enforcement authority.

Under the proposed bill, an incentive program for whistleblowers would kick in for cases that result in sanctions greater than $1 million. The SEC would be allowed to pay a reward in such cases of up to 30 percent of sanctions to one or more informants who provided information that led to the successful action. The determination of the amount of an award would be in the sole discretion of the SEC, according to the bill.

Whistleblower Program Is Not New Idea. The whistleblower program under H.R. 3817 is not a novel concept, according to J. Robert Brown Jr., a business law professor at the University of Denver Sturm College of Law, in a Dec. 8 e-mail to BNA.

''On the margins, there may be a fraud or two that's uncovered because a financially motivated whistleblower comes forward. However, [the proposed whistleblower program] just won't have a big impact,'' Brown said.

''The SEC back in the 1980s attained the authority to pay bounties to anyone who provided information that resulted actions brought for insider trading. As far as I know, it has never had much impact,'' Brown said.

According to Brown, the approach in H.R. 3817 is also unlikely to have a significant effect. The payout for a whistleblower's case will be uncertain, because there will be questions regarding whether the whistleblower's tip indeed resulted in the action, and the reward amount will be undefined, he said.

Also, ''there will likely be lengthy delay in any payment [because] enforcement proceedings can take years to complete, Brown said.

''All of this suggests that whistleblowing bounties will not provide much of an incentive to come forward,'' Brown said.

''Moreover, many of those who might blow the whistle are likely to have been involved in the fraud—otherwise, how would they know about it? They will be more concerned about avoiding liability than collecting bounties,'' Brown said.

Impact of Bill's Program Is Questionable. Despite problems with the whistleblower program, Brown said, ''I don't see how the [bill's program] can hurt.''

A potentially negative aspect to the bill's program is that rewards for whistleblowing are at the SEC's discretion and are not subject to judicial review, Jonathan K. Tycko, a partner at Tycko & Zavareei LLP in Washington, told BNA in a Dec. 8 interview.

Nonetheless, any attempt at enacting a formal whistleblower program by the SEC is a major step in the right direction for an agency that has been criticized for not seriously considering whistleblowers, Tycko said.

The anonymity promised to whistleblowers through the bill's program, however, is a very positive aspect, Tycko said.

''Whistleblowers are often company insiders who may have fears about losing their jobs, being blacklisted, or being harassed, so protection is crucial to them,'' Tycko said.

The SEC is trying to encourage and incentivize these people to come forward, Tycko said. ''Companies are not going to announce in their public disclosures if they are engaged in fraudulent activity,'' he said.

''Public disclosures are what the public and the SEC see and rely on,'' Tycko said. Therefore, insider cooperation is invaluable to the commission, he said.

SEC Can Find Examples in Other Programs. With this bill, legislators are going down the same unsuccessful road that the IRS did before, Tycko said. ''The Internal Revenue Service underwent a similar ordeal in designing their whistleblower program,'' he said.

The IRS initially had a whistleblower program—much like the one being proposed in H.R. 3817—that was very discretionary and open-ended, generating very little impact, Tycko said. ''The IRS's program was

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unsuccessful because there was no certainty for the whistleblower as to whether he or she would be paid or not for reporting a problem,'' he said.

''Predictably, very few people came forward. The IRS eventually changed their program in 2006 to make it less discretionary by providing minimum reward amounts for whistleblowers, and provided an appeal system that allowed individuals to argue for higher rewards as well,'' Tycko said.

Quantifiable Rewards Will Increase Success. According to Tycko, ''the mere change from having an undefined reward system to having a clear system with quantifiable rewards plus rights to rewards resulted in a major increase in information and recovery of funds for the IRS.''

The proposed whistleblower program in H.R. 3817 would be better served if the SEC gave up some of its discretion, Tycko said.

''The commission could at least state that if it recovers any penalties or money for investors as a result of information provided by a whistleblower, the individual making the report would be guaranteed a reward—subject to an exact minimum amount,'' he said.

''There is a historical analogue with the IRS that Congress can look to in designing the program covered by the Investor Protection Act,'' Tycko said.

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