

Private Fund Regulators Double Down on Whistleblower Programs

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In a series of recent actions, the SEC and the Commodity Futures Trading Commission reaffirmed their commitment to their respective whistleblower programs, including awarding a record-breaking \$114-million SEC whistleblower payout.

On Sept. 23, 2020, the SEC announced changes to its decade-old whistleblower program¹ intended to streamline the determination of reward amounts and speed payments to tipsters. The whistleblower program has become an important part of the SEC's enforcement effort and, while the new rules include provisions that seek to make it easier to weed out meritless claims,² the overall goal is to "get more money to whistleblowers faster."

Whistleblowers are typically awarded a percentage of the amount recovered by the SEC and, in the 2020 fiscal year alone, the SEC paid over \$175 million in whistleblower awards.³ However, the actual percentage of a recovery (which is capped at 30% by statute) is determined by weighing a number of factors, such as whether the specific violation is an SEC priority. The Commission controversially proposed specifically considering the size of the award as a factor in setting the award, including the ability to make downward departures for "exceedingly large" awards.⁴ While this provision was not adopted, the adopting release indicates that the Commission already has the authority to consider the size of the award as part of its broader authority. The uncertainty that results from the Commission's discretion in setting awards can dis-incentivize reporting smaller violations.

The revised rules, however, set out criteria that create a presumption that a whistleblower is entitled to the maximum 30% award if it would be less than \$5 million.⁵ The revisions also ease the number of procedural requirements for whistleblowers to qualify for awards and clarify that while the SEC has

¹ 17 CFR Parts 240 and 249; Release No. 34-83557; File No. S7-16-18

² Public Statement of Jay Clayton, Strengthening our Whistleblower Program, Sept. 23, 2020, available at <https://www.sec.gov/news/public-statement/clayton-whistleblower-2020-09-23>.

³ [SEC Whistleblower Program Ends Record-Setting Fiscal Year With Four Additional Awards](#).

⁴ [SEC Proposed Whistleblower Rule Change](#) at 10-11.

⁵ These criteria are the absence of any "negative award factors." These include (1) culpability; (2) unreasonable reporting delay; and (3) interference with internal compliance and reporting systems. 17 C.F.R. § 240.21F-6(b).

discretion over both the percent and dollar amount of awards, particularly for the largest awards, this discretion does not suggest any cap on large awards other than the statutory maximum of 30%.

Soon after announcing the revised program, the SEC put it into action. First, on Oct. 15, 2020, the SEC awarded \$800,000 to a whistleblower — overruling the SEC staff’s recommendation to deny the claim. This award exemplifies the increased flexibility of the new rules; the SEC seemingly considered information provided prior to the submission of a formal whistleblower complaint and approved the award.

Then, on Oct. 22, 2020, the SEC awarded \$114 million to a whistleblower — the highest award in the program’s history. That single award — issued only three weeks into the SEC’s new fiscal year — represented 65% of the total of all whistleblower awards in fiscal year 2020, which itself was a record-setting year. The SEC whistleblower program has come a long way since its first award of \$50,000 in 2012.

Though more modest by comparison, the CFTC has also increasingly rewarded whistleblowers, including a \$9-million award in July and a \$6-million award in June.⁶ The CFTC’s program, which started under Dodd-Frank and was designed to harmonize with the SEC’s program, provides for awards between 10% and 30% where the information leads to fines over \$1 million.

The net result is that the two primary U.S. regulators of private fund managers are actively seeking, and incentivizing, whistleblowers. Further, the increasingly broad awareness of these programs in the industry may make it more likely that employees will “report out” internal problems, instead of pursuing internal solutions.

These developments highlight the importance of investing in regulatory compliance and internal audit resources and personnel, conducting rigorous assessments and self-examinations and creating (or reinforcing) a culture that values integrity and rewards internal reporting of issues and potential wrongdoing. Indeed, in a recent panel discussion about the success of the whistleblower program, a former SEC deputy director encouraged firms to “hug your whistleblower” and “treat them with respect and care and thoughtfulness.”⁷

This article appeared in the November 2020 edition of SRZ’s Private Funds Regulatory Update. To read the full Update, [click here](#).

⁶ See [Press Release, CFTC Awards Approximately \\$9 Million to Whistleblower, July 27, 2020](#); [Press Release, CFTC Announces \\$6 Million Whistleblower Award, June 9, 2020](#).

⁷ [Law360](#)