Schulte Roth&Zabel

Investment Management Hot Topics

New Whistleblower Rules: The Impact on Fund Managers

October 25, 2011

1. About the Speakers
2. PowerPoint Presentation
3. Outline
4. Additional Materials

Schulte Roth&Zabel

Investment Management Hot Topics

1. About the Speakers

David J. Efron
919 Third Avenue
New York, NY 10022
+1 212.756.2269 | david.efron@srz.com

David J. Efron is a partner in the New York office of Schulte Roth & Zabel, where he practices in the areas of domestic and offshore hedge funds, including fund formations and restructurings. Additionally, he advises hedge fund managers on structure, compensation and various other matters relating to their management companies, and structures seed capital and joint venture arrangements. David also represents hedge fund managers in connection with SEC regulatory issues and compliance-related matters.

A published author on subjects relating to investment management, David is a sought-after speaker for hedge fund industry conferences and seminars and a frequent guest lecturer at New York-area law schools. He discussed "Ethical Issues Facing In-House Counsel" at SRZ's Investment Management Alumni Roundtable, and presented on "Crisis Management" at UBS Premier Hedge Fund Client Conference.

David has been recognized by *The Legal 500 United States* for his work in investment management. David received his B.A. from Vassar College, his J.D. from Syracuse University College of Law and his LL.M. in securities regulation, with distinction, from Georgetown University Law Center.

© 2011 Schulte Roth & Zabel LLP

David K. Momborquette
919 Third Avenue
New York, NY 10022
+1 212.756.2268 | david.momborquette@srz.com

David K. Momborquette is a partner in the New York office of Schulte Roth & Zabel, where his practice focuses on complex commercial litigation and regulatory matters primarily for financial services industry clients, including hedge funds, funds of funds and private equity funds. David has substantial experience in both private securities litigation and securities regulatory matters, including class action litigation and investor disputes, as well as investigations by the Securities and Exchange Commission, the New York Stock Exchange, the Financial Industry Regulatory Authority and state attorneys general offices.

David has written extensively on securities regulation and frequently presents on regulatory compliance and enforcement issues. He recently authored a chapter on "Big Boy Letters" in PLI's forthcoming *Insider Trading Law and Compliance Answer Book*, and presented on "Rule 13h-1 and Form 13H" at Goldman Sachs Prime Brokerage Regulatory Reporting Overview.

David is a graduate of Boston University, College of Liberal Arts, and graduate of Boston University School of Law, where he was notes editor of the *Boston University Law Review*, a G. Joseph Tauro Scholar and an Edward F. Hennessey Scholar.

© 2011 Schulte Roth & Zabel LLP

Richard J. Morvillo
1152 Fifteenth Street, NW, Suite 850
Washington, D.C. 20005
+1 202.729.7479 | richard.morvillo@srz.com

Richard J. Morvillo, a partner in the Washington, D.C. office of Schulte Roth & Zabel, has, for more than 30 years, made the focus of his practice SEC enforcement, related white-collar criminal matters and private securities litigation. A former branch chief with the SEC's Division of Enforcement, Rich represents corporations, corporate executives, brokerage firms, investment advisers, accounting firms, auditors, law firms, hedge funds and individual investors in connection with SEC, PCAOB, NYSE, FINRA, Congressional, state attorney general and grand jury investigations; SEC litigation; and complex securities cases. In addition to litigating to a successful judgment a number of SEC enforcement cases and defending numerous class actions and shareholder derivative suits in federal courts throughout the country, Rich has conducted many internal investigations for corporations, and advised members of numerous special committees of boards of directors as to their rights and obligations regarding the handling and evaluation of corporate transactions, internal investigations and shareholder litigation.

Rich is a frequent speaker at professional seminars and serves as the co-chair of two PLI annual programs: "Internal Investigations" and "Auditor Liability." He has served on the adjunct faculty of Georgetown University School of Law, teaching a course in "Professional Responsibility in Corporate and Securities Practice."

Chambers USA called Rich "one of the deans of the securities enforcement bar." He is also listed as a leading litigator in numerous other peer-review publications, including *Benchmark Litigation*, *The Best Lawyers in America*, *The Legal 500 United States*, *Ethisphere: Attorneys Who Matter*, *Washington DC Super Lawyers*, *The Legal Times*, which named him one of Washington's "Top 10 Securities Lawyers," and *Washingtonian Magazine*. Rich received his J.D. from Fordham University School of Law and his A.B. from Colgate University.

© 2011 Schulte Roth & Zabel LLP

Holly H. Weiss
919 Third Avenue
New York, NY 10022
+1 212.756.2515 | holly.weiss@srz.com

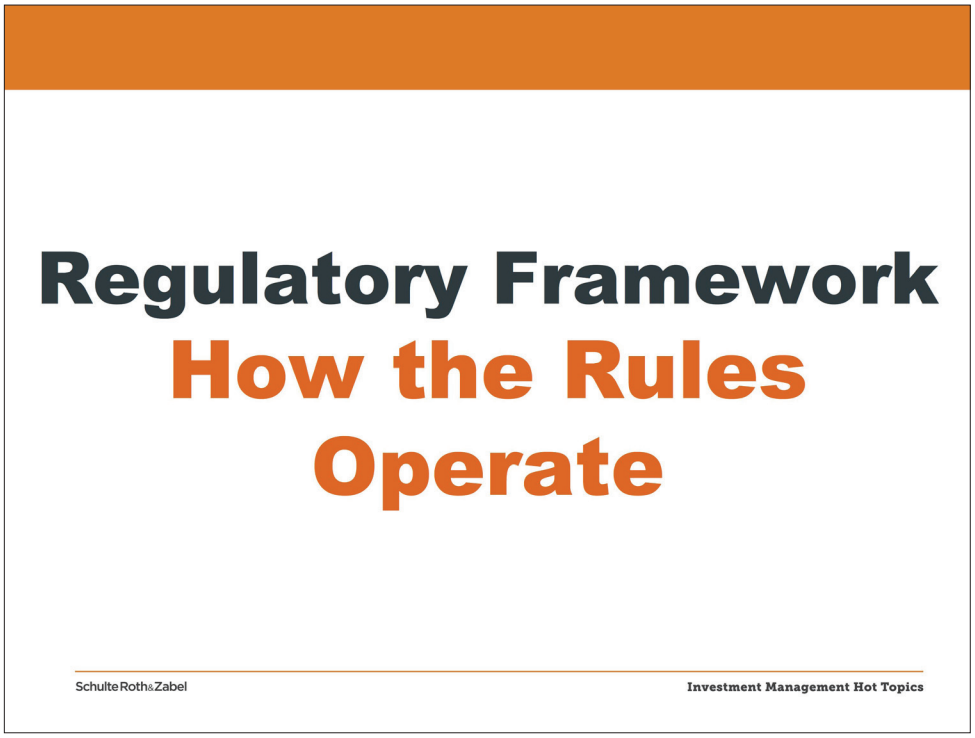
Holly H. Weiss is a partner in the New York office of Schulte Roth & Zabel, where she focuses her practice on the representation of employers in all aspects of employment law and employee relations. Holly handles disputes involving statutory employment discrimination claims, ERISA claims, executive compensation, employment agreements, restrictive covenants, and common law tort and contract claims, in federal and state courts, before administrative and government agencies and in arbitral forums. She advises employers on employment law compliance, human resources matters, hiring and termination, and litigation avoidance, negotiates employment agreements, separation agreements and other employment-related agreements, provides training, and conducts investigations.

Holly has authored or co-authored numerous articles of interest to employers, a recent example of which, "Alternative Dispute Resolution in the Executive Employment Context," was published in *BNA's Executive Compensation Library on the Web*. She also authored "Effective Client Communication," which appeared in *Labor and Employment Client Strategies: Leading Lawyers on Preventing Litigation, Minimizing Risks and Dealing with Employee Legal Problems*.

Holly has been recognized by *The Best Lawyers in America*. She earned her B.A. from Emory University and her J.D. from the University of Virginia School of Law.

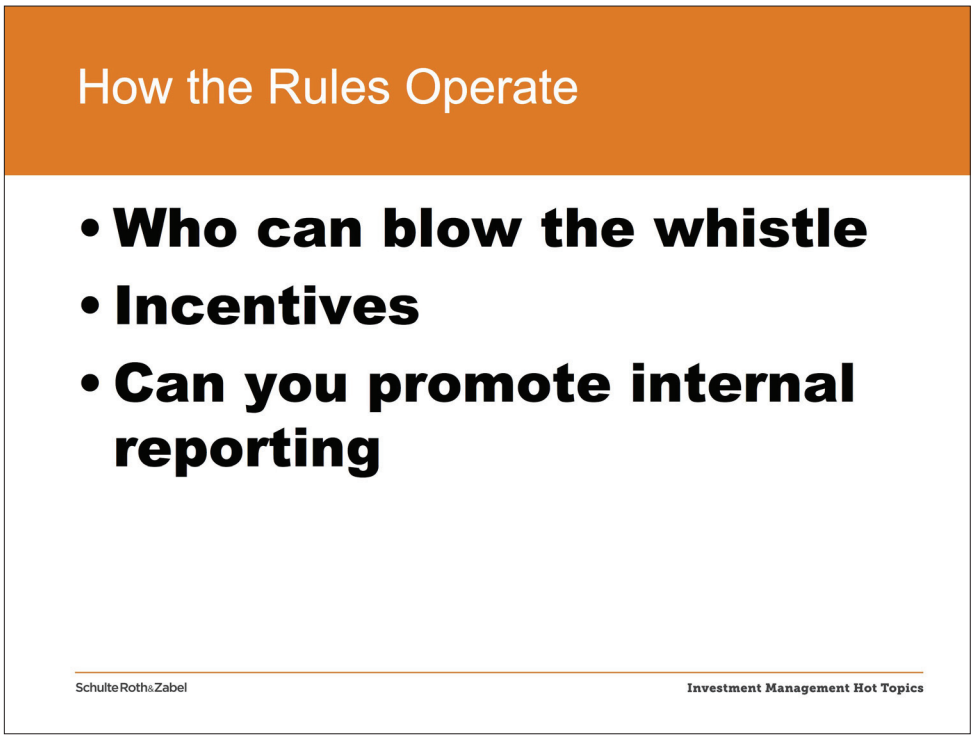
© 2011 Schulte Roth & Zabel LLP

2. PowerPoint Presentation



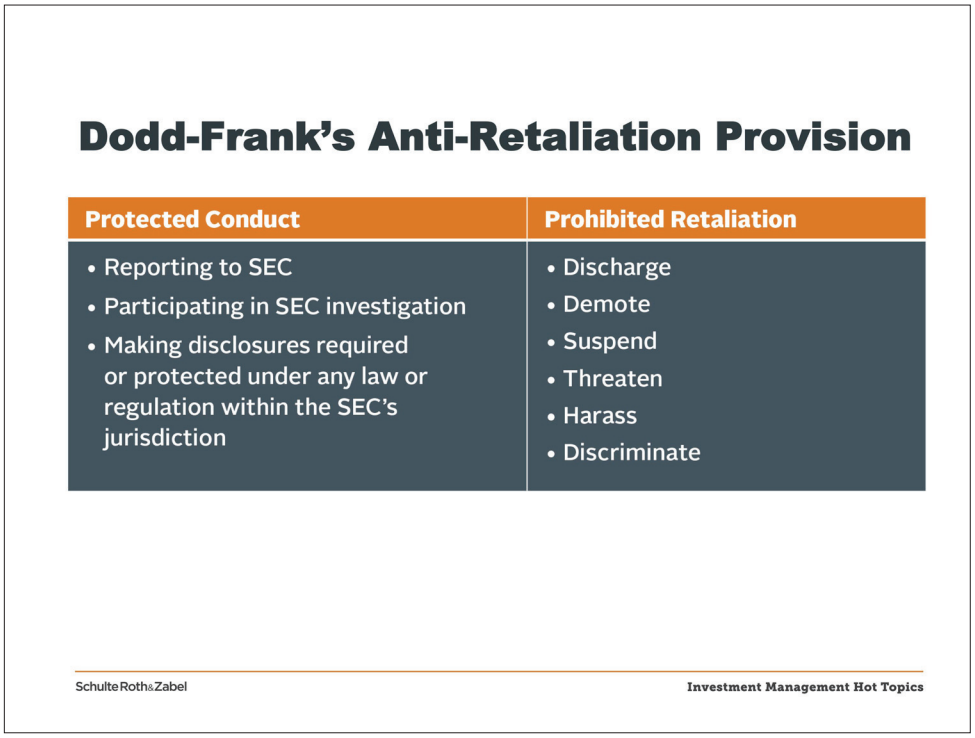
Notes:

© 2011 Schulte Roth & Zabel LLP



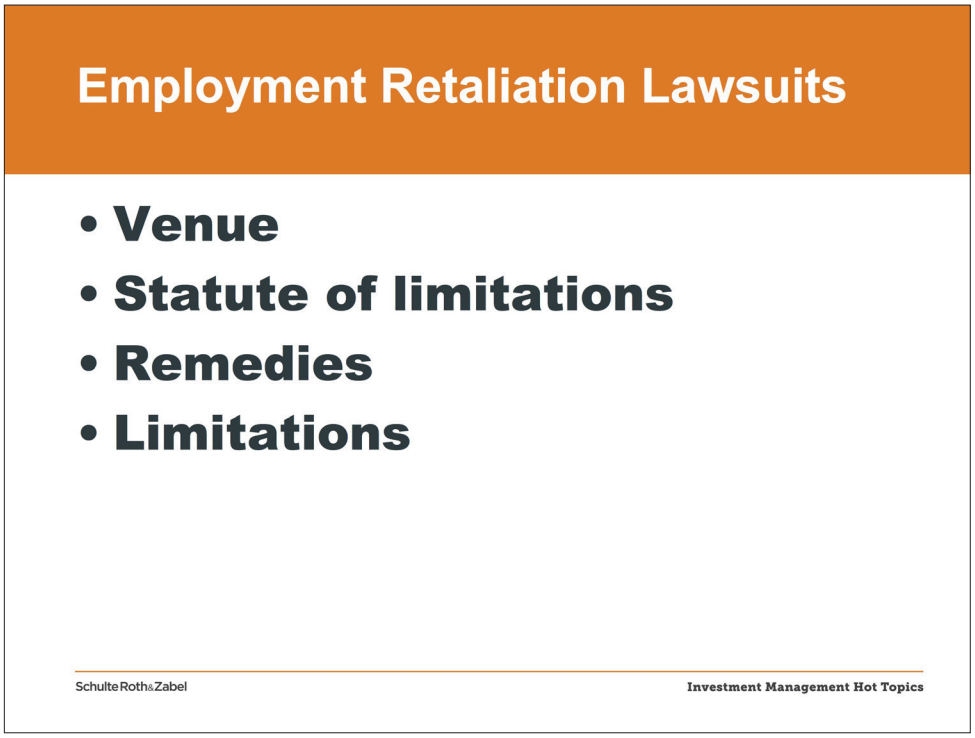
Notes:

© 2011 Schulte Roth & Zabel LLP

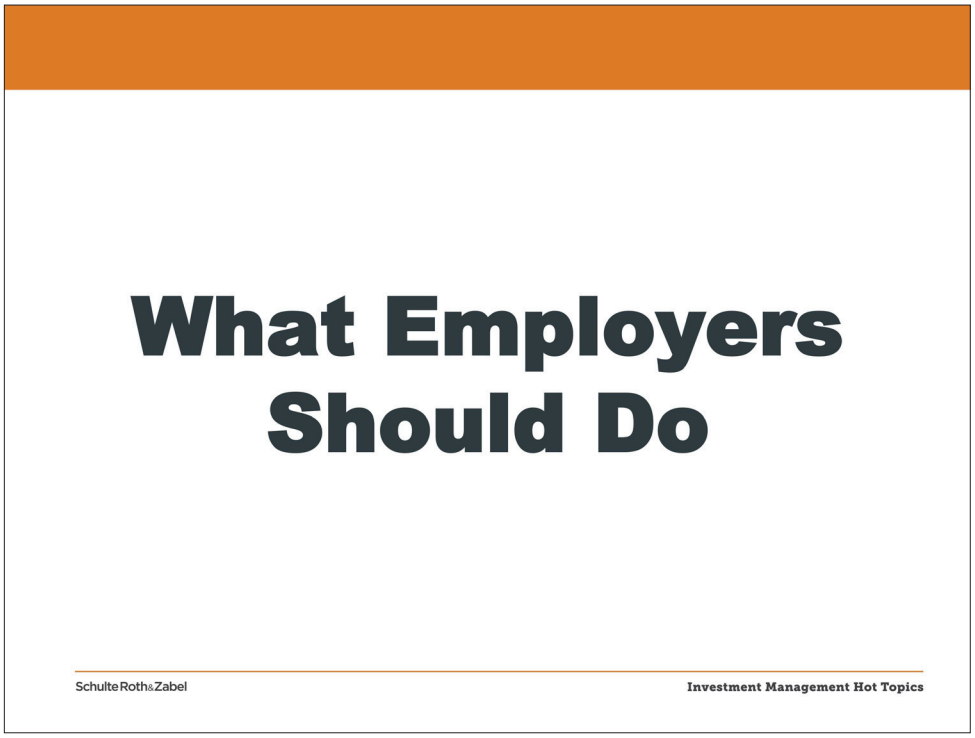


Notes:

© 2011 Schulte Roth & Zabel LLP


Employment Retaliation Lawsuits
• Venue
• Statute of limitations
• Remedies
• Limitations
Schulte Roth&Zabel
Investment Management Hot Topics

Notes:



Notes:

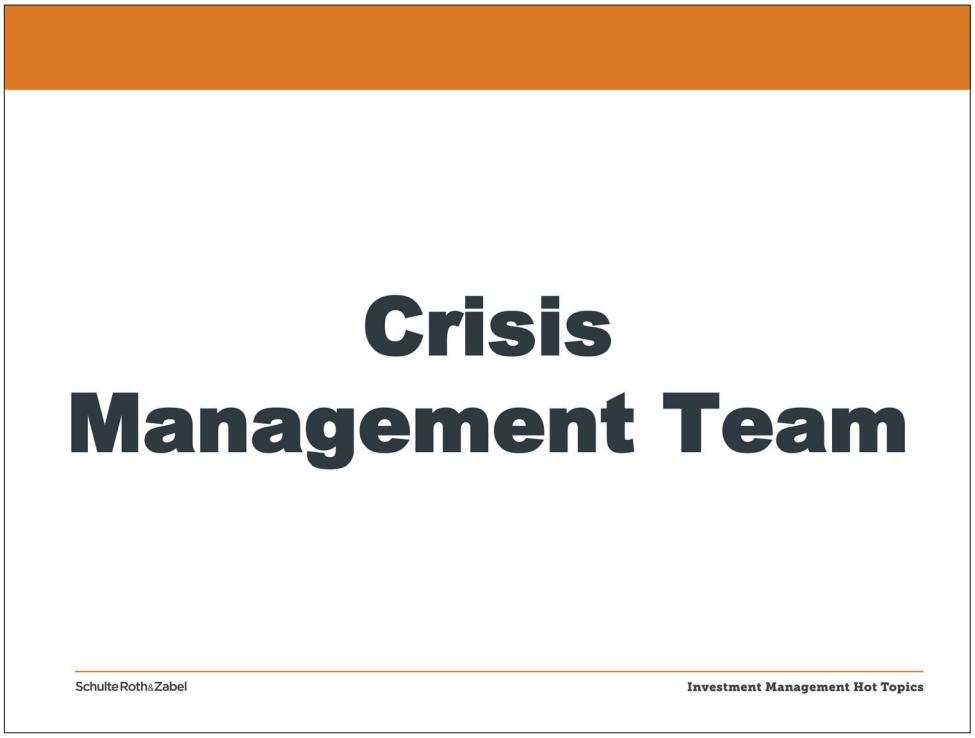
© 2011 Schulte Roth & Zabel LLP


Enhancing Compliance
Implementing
Whistleblower Policy
Schulte Roth&Zabel
Investment Management Hot Topics

Notes:

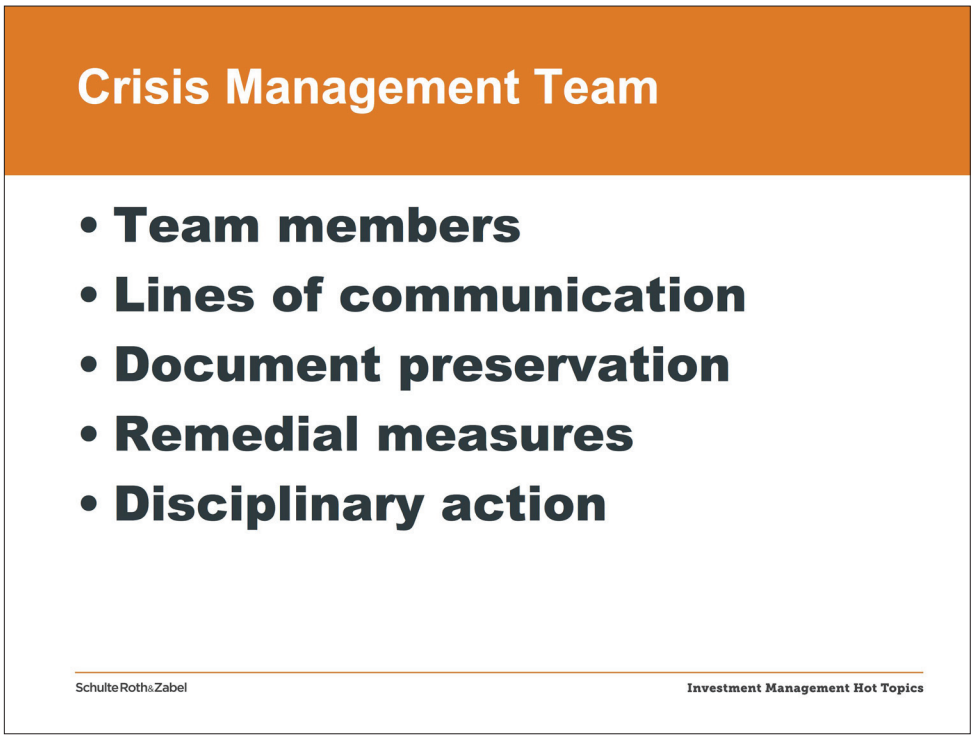
Notes:

© 2011 Schulte Roth & Zabel LLP



Notes:

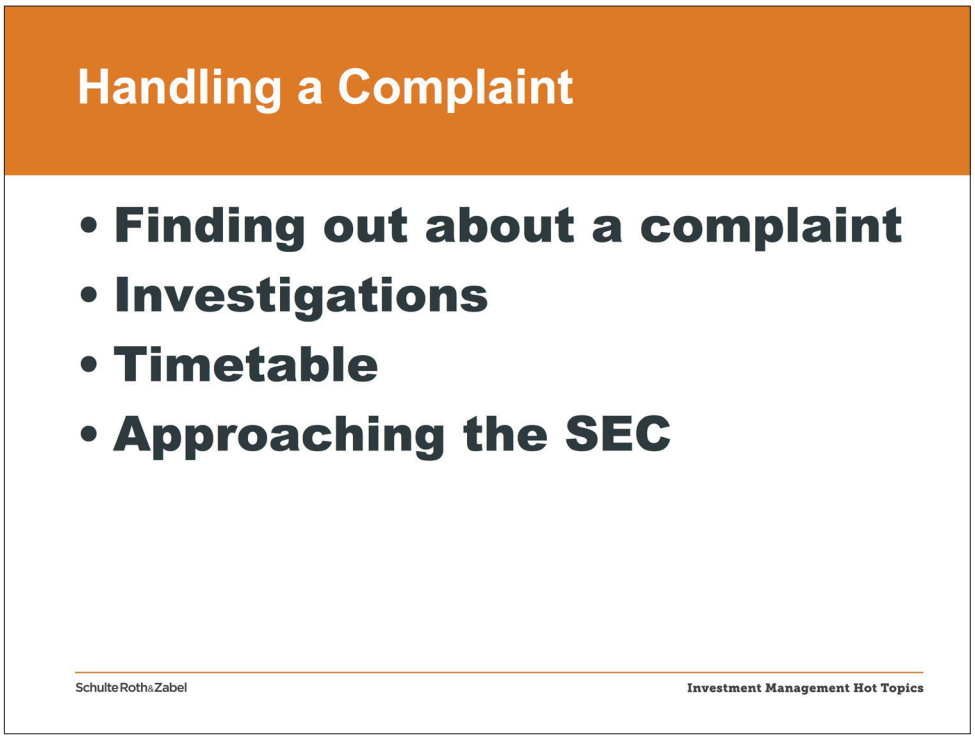
© 2011 Schulte Roth & Zabel LLP


Crisis Management Team
• Team members
• Lines of communication
• Document preservation
• Remedial measures
• Disciplinary action
Schulte Roth&Zabel
Investment Management Hot Topics

Notes:

Notes:

© 2011 Schulte Roth & Zabel LLP



Notes:

© 2011 Schulte Roth & Zabel LLP

3. Outline

New Whistleblower Rules: The Impact on Fund Managers

I. Introduction

A. The SEC has long maintained that the receipt of useful tips is crucial to its ability to protect investors and to take action against wrongdoers

B. Prior to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), the SEC's "bounty" program was limited to insider-trading cases and awards were capped at 10 percent of the penalties collected in the action

C. Dodd-Frank added new Section 21F to the Securities Exchange Act of 1934, which requires the SEC to award whistleblowers 10 percent to 30 percent of the total monetary sanctions collected if those sanctions exceed $1 million

D. On Nov. 3, 2010, the Securities and Exchange Commission ("SEC") proposed widely anticipated rules that would implement the whistleblower provisions of Dodd-Frank

E. The SEC received numerous comments from interested parties, a number of whom expressed concerns that the proposed rules did not require a putative whistleblower to bring his concerns to internal compliance at his employer before bringing them to the attention of the SEC

These commentators worried that the proposed rules would undercut internal compliance efforts as a result

F. On May 25, 2011, by a 3–2 vote, the SEC adopted its final rules, which became effective Aug. 12, 2011. The rules were published in the Federal Register on June 13, 2011

G. The final rules differ from the proposed rules in a number of respects, but the SEC declined to require internal reporting by whistleblowers

H. Still, the final rules reflect the SEC's attempt to balance rewarding individuals who provide the SEC with high-quality tips leading to successful actions and minimizing potential, unintended consequences, such as undermining internal compliance programs and rewarding wrongdoers

I. The final rules will have a significant impact on corporate compliance and how employers may deal with employees who fall within the protections afforded by Dodd-Frank and the rules the SEC has promulgated

II. Who May Be a Whistleblower

A. Only *natural persons* are eligible to be whistleblowers, although they may provide information alone or jointly with others and may do so anonymously

B. Certain persons are not typically eligible for whistleblower awards under the final rules. These include:

1. Officers, directors, trustees and partners who receive information through a company's internal compliance program, employees whose principal duties involve compliance or internal audit responsibilities, and employees of independent firms that have such responsibilities

© 2011 Schulte Roth & Zabel LLP

2. Attorneys who attempt to use information they obtain from attorney-client relationships to make whistleblower claims for themselves (unless disclosure of the information is permitted under SEC or state bar rules)

3. Independent public accountants who obtain information through an engagement required under the securities laws

4. Employees of entities retained to investigate violations of law

C. Persons in these categories may, however, receive a whistleblower award if they report a possible violation to the SEC and (1) reasonably believe that the disclosure is necessary to prevent the entity from causing substantial injury to the entity or investors, (2) reasonably believe the entity is impeding the investigation of misconduct, or (3) at least 120 days have passed since they provided information internally or learned that persons with internal authority were aware of the information

D. The SEC will not reveal the whistleblower's identity, except under certain circumstances, such as when disclosure is required in connection with related litigation

E. The SEC will not pay culpable whistleblowers awards that are based on either (1) the monetary sanctions that such persons themselves pay in the resulting SEC action or (2) sanctions paid by entities whose liability is based substantially on conduct that the whistleblower directed, planned or initiated

This provision is intended to prevent wrongdoers from blowing the whistle on themselves and collecting a windfall from the SEC

III. Qualifying as a Whistleblower

A. The rules establish several requirements for being deemed a whistleblower:

1. Whistleblowers must *voluntarily provide* the SEC with the information. In general, they are deemed to have provided information voluntarily if they provide information before the government, a self-regulatory organization or the Public Company Accounting Oversight Board asks for such information

2. Whistleblowers must provide *original information* based on their independent knowledge or independent analysis, not on information already known to the SEC and not derived exclusively from certain public sources

3. A whistleblower's information must lead to *successful enforcement* by the SEC of a federal court or administrative action

4. The information may be deemed to have led to successful enforcement in two circumstances: (1) if the information is sufficiently specific and timely to cause the SEC to open (or re-open) or expand an examination or investigation and the SEC brings a successful case based on the conduct at issue in the information, (2) if the conduct was already under investigation when the information was submitted, but the information significantly contributes to the success of the action, or information is provided to internal compliance before or at the same time it is provided to the SEC and a successful action under (1) or (2) results

5. If a whistleblower reports a potential violation to the SEC *within 120 days* of providing the same information through internal compliance channels, the whistleblower will be deemed to have reported the information to the SEC as of the date he reported it to his employer

6. Through this provision, employees would be able to report their information internally first, while preserving their "place in line" for a possible SEC award

© 2011 Schulte Roth & Zabel LLP

B. The rules contemplate that a whistleblower who first reports internally will get credit for any additional information her employer provides to the SEC after investigating her complaint

   This means that, when it comes to calculating a whistleblower's award, one who reveals to internal sources the tip of what turns out to be an iceberg will be treated as having provided information about the entire iceberg

C. The last requirement for whistleblower status is that the SEC obtains monetary sanctions totaling more than $1 million

IV. Criteria for Award Amounts

A. Section 21F mandates awards of 10 percent to 30 percent of monetary sanctions collected based on the information provided

B. Under the final rules, when determining the amount of the award within the statutory range, the SEC will consider the following factors that may increase the award:

   1. Significance of the information, including reliability, completeness and the extent to which it contributed to the success of the action

   2. Timeliness, degree, reliability and effectiveness of assistance provided by the whistleblower, including attempts to remediate harm

C. The SEC may also consider the following, among other, factors:

   1. Programmatic interest of the SEC in deterring violations by rewarding whistleblowers, including whether the subject matter is an SEC priority and the magnitude of the danger to investors or others

   2. Participation in internal compliance — whether whistleblower reported internally and assisted with internal investigation system

D. The SEC may consider the following to decrease the award:

   1. Culpability of the whistleblower

   2. Unreasonable reporting delay — acting only after investigation began

   3. Whether the whistleblower interfered with internal compliance and reporting programs

V. Employment Issues: Anti-Retaliation

A. Dodd-Frank provides new private right of action for whistleblowers

   1. No employer may discharge, demote, suspend, threaten, 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

      (a) In providing information to the SEC in accordance with this section;

      (b) In initiating, testifying in, or assisting in any SEC investigation or judicial or administrative action based upon or related to such information; or

      (c) In making disclosures that are required or protected under SOX, the Securities Exchange Act of 1934, or any other law, rule, or regulation subject to the jurisdiction of the SEC

© 2011 Schulte Roth & Zabel LLP

2. A whistleblower who reports a possible violation only internally may be protected from retaliation, if the report results in the company or its counsel reporting the same possible violation to the SEC. *Egan v. TradingScreen, Inc.* (S.D.N.Y. 2011)

3. Venue: Federal district court

4. Statute of limitations: Within six years of the date of violation, or within three years of the date when the employee knew or reasonably should have known facts material to the right of action. May not bring action more than 10 years after the violation occurred

5. Remedies: Reinstatement, double back pay, interest, litigation costs, expert witness fees, reasonable attorney's fees

6. The SEC may enforce the anti-retaliation provisions in an action or proceeding brought by the SEC

7. No waiver: "The rights and remedies provided for in [Section 922] may not be waived by any agreement, policy form, or condition of employment including by a pre-dispute arbitration agreement"

8. No arbitration: Dodd-Frank Section 21-F forbids pre-dispute arbitration agreements that mandate arbitration of whistleblower claims

VI. Enhancing Compliance

A. The new whistleblower rules present another layer of complexity and challenges for internal controls and compliance functions

B. These rules likely will require an increase in resources devoted to compliance, and may require revisions to existing policies and procedures

C. In addition, immediate steps need to be taken to:

1. Mitigate the risk of a person reporting to the SEC without internally reporting, and

(a) Organize a team and create procedures to respond quickly to an internal whistleblower complaint

D. To mitigate the risk of a person reporting to the SEC without internally reporting:

1. Strengthen internal controls aimed at detecting improper activity

2. Maintain a culture of integrity and accountability: this works best when it is a top-down message

3. Properly train employees:

(a) Contact people must know how to properly handle complaints;

(b) Employees must be aware of the internal complaint process and their obligations thereunder; transparency is critical; employees need to understand that the company takes internal complaints seriously

E. It is imperative that an employer has in place now a crisis management team that can quickly respond to an internal complaint

1. Team membership: In addition to legal and compliance personnel, identify the relevant human resource and IT individuals

© 2011 Schulte Roth & Zabel LLP

2. Lines of communication: Give careful consideration to who will interact with the whistleblower, as well as the regulators

3. Document preservation: Confirm procedures for quickly (and, sometimes, discreetly) preserving potentially relevant material

4. Remedial measures: Make sure policies and procedures provide some guidance as to steps that should be taken if any improper conduct is discovered, including sanctioning wrongdoers

5. Involve HR personnel: Prompt disciplinary action upon and accurate reporting of occurrence of work problems is critical

VII. Handling a Whistleblower Complaint: Regulatory Implications

A. The prospect of substantial compensation has already increased the volume of whistleblower complaints provided to the SEC, which scarcely has the resources to review all the complaints

   The SEC cannot risk being chastised for ignoring whistleblower reports or not pursuing those that appear to have merit

B. The SEC may, "upon receiving a whistleblower complaint, contact a company, describe the nature of the allegations, and give the company an opportunity to investigate the matter and report back" to the SEC

   Doing so would both work with, rather than circumvent, existing internal compliance programs and permit the SEC to leverage its resources by deputizing companies to investigate their own alleged violations

C. In the face of a complaint, a manager has little choice but to determine whether the complaint has merit

D. How far it has to go to is a fact-specific inquiry

E. The rules are also designed to ensure that the firm in receipt of a whistleblower complaint moves quickly

   1. A whistleblower will receive credit for reporting internally on the date that he originally reports, provided that he also reports to the SEC within 120 days

   2. That means the firm has, at most, only 120 days from the date of an employee's internal report to make some critical decisions, which may not be enough time to complete a thorough investigation

F. Once it completes its investigation or time runs out, a firm will have to decide whether to share its findings with the SEC, knowing that the whistleblower is likely to do so regardless of what the company decides

G. Whatever decision the firm makes on the merits of a whistleblower complaint, it must be able to defend its investigation and its conclusions

H. Because a whistleblower will be free to go to the SEC at any point, the firm should be prepared to explain what it did and why that was adequate

I. The dynamics of self-reporting are changing as whistleblowers are introduced into the equation

   The new twist is that the SEC has an "independent" source, one whose economic interests can only be advanced if the SEC concludes that a violation has occurred

J. If the firm concludes that a complaint has (or may have) merit, it should consider whether to bring the matter to the SEC's attention to obtain whatever benefits cooperation may hold, lest the whistleblower's view will be the first one the SEC hears

© 2011 Schulte Roth & Zabel LLP

K. Even if the firm concludes that a complaint is unfounded, there may still be circumstances in which it is advantageous to discuss reports and concerns that are not frivolous with the SEC

L. There is no guarantee that the SEC will agree that a complaint is unfounded

M. The SEC has been trying to promote publicly the benefits of cooperation, using tools, such as non-prosecution and deferred prosecution agreements

The SEC announced its first deferred prosecution agreement in the Spring of 2011

N. But statistics show that, while companies that self-report to the SEC may arguably receive some leniency in terms of sanctions, the vast majority of these companies are still named in SEC enforcement actions

O. The SEC staff typically will want to develop its own record and draw its own determinations and therefore whistleblower complaints portend more follow-up investigations by the staff

P. The SEC staff will be careful to make a record establishing that it looked into complaints and tips where warranted

Q. The SEC staff will be cautious about accepting a firm's findings

R. The SEC's natural bias as a law enforcement agency lends itself to balancing competing assertions in favor of someone who comes forward ostensibly to reveal misconduct

S. The more substance and plausibility a complaint has and the more likely corroboration may exist, the harder it will be for the staff to conclude that no further inquiry is warranted

T. If the SEC believes that a violation of law took place and that the firm ignored it or covered it up, the SEC will not only focus on the conduct underlying the complaint, but also on what the firm did after becoming aware of the complaint

U. Anything that suggests that the firm's efforts were incomplete or its factual findings inaccurate will threaten a cooperative relationship with the SEC

V. A firm that addresses a complaint with the staff may be able to affect the staff's views by planning and conducting a well-designed and professionally executed internal investigation and sharing the facts developed with the staff

W. If a firm hopes to convince the staff that a colorable complaint is misguided, it will need to be prepared:

1. To disclose in detail the investigative steps it planned and the reasons

2. To identify the specific investigative steps taken

3. To provide an objective recitation of the facts (good and bad) and

4. To furnish the staff with documentary or other evidence the staff may request to support the firm's assertions

© 2011 Schulte Roth & Zabel LLP

4. Additional Materials

Schulte Roth&Zabel

Alert

SEC Whistleblower Rules Encourage but Do Not Require Internal Reporting

June 2, 2011

A month after their scheduled release date, the Securities and Exchange Commission ("SEC") voted 3-2 to adopt final rules implementing the hotly-debated whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] Differences between the proposed rules released in November 2010 and the final rules approved on May 25, 2011 center around the role of internal compliance programs in the reporting process, the extent of anti-retaliation protections, eligibility criteria for awards, and the factors affecting award amounts.

Comments and debate about the proposed rules focused on whether a whistleblower should be required to report possible violations internally before contacting the SEC to be eligible to receive an award. Several commentators argued that the absence of an internal reporting requirement would undercut internal compliance programs. While the SEC's final rules do not require internal reporting, they encourage internal reporting by providing whistleblowers with credit for internally-reported information that is later provided by the company to the SEC, and factoring in cooperation with internal compliance programs when determining the amount of an award.

Background
The Dodd-Frank Act added Section 21F to the Securities Exchange Act of 1934. It requires the SEC to award whistleblowers — individuals who provide original information that leads to successful SEC enforcement actions — 10 to 30 percent of the total monetary sanctions collected if sanctions exceed $1 million. The $1 million threshold may be met by aggregating monetary sanctions in SEC and "related" actions by federal or state criminal authorities, appropriate regulatory agencies or self-regulatory organizations.

Expanded Whistleblower Eligibility
Under the final rules, a "whistleblower" is an individual — an employee, consultant, or other person outside the company — who provides the SEC with information about a possible violation of the federal securities laws that has occurred, is ongoing or is about to occur. To receive an award, a whistleblower must meet several requirements:

- Only natural persons are eligible to receive awards, although they may provide information alone or jointly with others and may do so anonymously. Corporations or other legal entities cannot receive whistleblower awards.

[1] The SEC's final rules are available at http://sec.gov/rules/final/2011/34-64545.pdf. An SRZ *Client Alert* about the proposed whistleblower program is available at http://www.srz.com/111210_SEC_Proposes_Whistleblower_Program_Rules/. The final rules, which implement Section 922 of the Dodd-Frank Act, are effective 60 days from publication in the Federal Register.

- A whistleblower must "voluntarily" provide the SEC with the information. In general, a whistleblower will be deemed to have provided information voluntarily if he provides information before a request, inquiry or demand relating to the information is directed to the whistleblower by the SEC or by the Public Company Accounting Oversight Board ("PCAOB"), a self-regulatory organization or the government in connection with an investigation, inspection or examination.

- A whistleblower must provide "original" information based on his independent knowledge or independent analysis — not on information already known to the SEC and not on information derived exclusively from certain public sources.

- The whistleblower's information must lead to "successful enforcement" by the SEC of a federal court or administrative action. The information may be deemed to have led to successful enforcement in three circumstances: (1) if the information is sufficiently specific, credible, and timely to cause the SEC to open an investigation, reopen an investigation, or inquire about different conduct in a current examination, and the SEC brings a successful judicial or administrative action based on the conduct that was the subject of the information; (2) if the conduct was already under investigation when the information was submitted, and the information significantly contributes to the success of the action; or (3) information is provided to an internal compliance program before or at the same time as it is provided to the SEC, the company reports the information to the SEC, and a successful action under (1) or (2) results.

If a whistleblower reports a potential violation to the SEC within 120 days of reporting the same potential violation through an internal compliance program, the whistleblower will be deemed to have reported the potential violation to the SEC as of the date he reported it to his employer. The proposed rules provided for a 90-day "grace period."

Inclusion of the third category of "successful enforcement" reflects the outcome of the debate over whether internal reporting should be mandatory. Many commentators expressed concern that failing to require internal reporting, coupled with the possibility of a significant monetary reward, would incentivize employees to report information to the SEC before reporting problems internally, if at all. In a statement before the SEC's vote, Chairman Schapiro stated that the final rules strike "the correct balance between encouraging whistleblowers to pursue the route of internal compliance when appropriate — while providing them the option of heading directly to the SEC."[2] The SEC also noted that this provision increases the likelihood that a whistleblower will receive an award, because the award could be based solely on the whistleblower's tip to the SEC, or on the information provided by the whistleblower's employer. For instance, the employer's submission may meet the "specific" and "credible" requirements, even though the original tip did not, thus qualifying the whistleblower for an award that he would not have otherwise received.

In light of comments on the proposed rules, and concerns about deterring submissions, the final rules expand the range of information deemed to be given "voluntarily." The proposed rules excluded information that was provided to the PCAOB, a self-regulatory organization, or the government in response to *any* request or inquiry. Under the final rules, information is given "voluntarily" unless it is provided to regulators in response to a request or inquiry *relating to an investigation*.

Other Key Issues

Eligibility Exclusions: The proposed rules excluded certain individuals from whistleblower awards to ensure that those most responsible for an entity's conduct and compliance lacked any incentive to promote their own interests at the expense of the entity. Those excluded included individuals with pre-existing legal duties to report information to the SEC, such as attorneys and accountants. The SEC's final rules cut back on these exclusions, although the following individuals generally are not eligible to receive whistleblower awards:

- Officers, directors, trustees and partners who learn information in connection with an entity's internal controls or legal processes;

[2] Speech by Mary Schapiro, Opening Statement at SEC Open Meeting: Item 2 - Whistleblower Program, May 25, 2011, available at http://www.sec.gov/news/speech/2011/spch052511mls-item2.htm.

© 2011 Schulte Roth & Zabel LLP. All Rights Reserved.

- Employees whose principal duties involve compliance or internal audit responsibilities, and employees of independent firms that have compliance or audit responsibilities;

- Employees of entities retained to investigate violations of law; and

- Independent public accountants who obtain information in connection with an engagement required under federal securities laws.

Persons in these categories may, however, receive a whistleblower award if they report a possible violation to the SEC and (1) reasonably believe that disclosure is necessary to prevent the entity from causing substantial injury to the financial interest or property of the entity or investors, (2) reasonably believe the entity is impeding investigation of the misconduct, or (3) at least 120 days have passed since they provided the information to internal authority or compliance programs, or learned that they were aware of the information.

Attorneys who learn information through privileged communications or in connection with legal representation are not eligible to receive whistleblower awards except when disclosure of the information is permitted under SEC or state bar rules.

Criteria for Award Amounts: Dodd-Frank Section 21F mandates awards of 10 to 30 percent of monetary sanctions collected based on the information provided by the whistleblower. Under the SEC's proposed rules, the award amount was based on evaluation of four mandatory factors and 11 discretionary factors. The SEC's final rules jettisoned the mandatory/discretionary dichotomy in favor of identifying factors that will increase or decrease the amount of a whistleblower's award.

Factors that may increase the amount of a whistleblower's award include:

- Significance of information — including reliability, completeness, and degree to which it supported successful actions;

- Timeliness, degree, reliability and effectiveness of the whistleblower's assistance, including attempts to remediate harm;

- Programmatic interest of the SEC in deterring violations by rewarding whistleblowers, including whether the subject matter is an SEC priority and the danger to investors or others from the underlying violations; and

- Participation in internal compliance systems — whether the whistleblower reported internally and assisted with internal investigation.

Factors that may decrease the amount of a whistleblower's award include:

- Culpability — including role in actions, education, training, responsibility, scienter, and egregiousness of underlying fraud;

- Unreasonable reporting delay — failing to take action or acting only after an investigation began; and

- Interference with internal compliance and reporting systems.

Cooperation or interference with internal compliance programs will affect the amount of a whistleblower's award — thus encouraging internal reporting. The SEC will not pay awards to whistleblowers when the monetary sanctions are based on payments by the whistleblowers themselves or by entities whose liability is substantially based on the whistleblower's unlawful conduct.

© 2011 Schulte Roth & Zabel LLP. All Rights Reserved.

Whistleblower Anti-Retaliation Protections
In addition to the incentive provisions, the Dodd-Frank Act significantly enhances whistleblower protections by prohibiting employers from discharging, demoting, suspending, threatening, harassing or otherwise discriminating against whistleblowers who provide information to enforcement authorities. The Dodd-Frank Act also creates a private right of action for employees who experience retaliation as a result of whistleblower activity. Such protections and rights do not extend to non-employee whistleblowers, even though they are eligible for awards.

The final rules clarify that a whistleblower need not be eligible for an award or even report an actual violation of the securities laws to be protected from retaliation. To be protected, a whistleblower need only have a reasonable belief that the reported information relates to a possible violation. The anti-retaliation provision, however, does not apply to employees who only report possible violations internally. Generally, to be protected from retaliation, the employee must report the possible violation to the SEC, directly or indirectly.

Implications of the Whistleblower Rules
In recent remarks, Chairman Schapiro acknowledged the impact of the SEC's whistleblower program to date, including the increased volume and quality of tips since the Dodd-Frank Act became law. There is little doubt that the new whistleblower program will result in increased complaints and SEC enforcement activity. Unfortunately, the SEC's final rules do little to quell concerns voiced regarding the proposed rules. Despite provisions intended to encourage whistleblowers to report possible violations internally, whistleblowers are eligible to receive awards if they bypass internal reporting procedures, and generally are protected from retaliation only if they report violations to the SEC. Accordingly, all companies should:

- Review codes of conduct to assess whether changes are appropriate, including provisions regarding reports of potential whistleblower concerns and anti-retaliation policies;
- Review internal reporting and investigation processes, including documentation requirements for internal investigations and any adverse employment actions taken against potential whistleblowers;
- Train employees to understand relevant policies and procedures including how they can bring possible violations to management's attention without surrendering eligibility for any whistleblower awards;
- Consider whether to require, or provide rewards or other incentives for, employees to report possible violations internally, whether periodic acknowledgements that employees are not aware of potential violations are appropriate, whether and how to permit anonymous reporting, and whether and to what extent to promise no retaliation for internal reporting;
- Prepare for an increased need to conduct internal investigations, establish basic protocols for investigating whistleblower complaints and develop processes for reports to senior management and, if appropriate, to the SEC;
- Investigate whistleblower complaints as warranted, recognizing that employees may report complaints to the government notwithstanding the results of an internal investigation; and
- Be prepared to explain to the SEC what management did in response to complaints and to defend the investigative efforts and findings, regardless of whether violations are established.

Authored by David K. Momborquette, Richard J. Morvillo, Holly H. Weiss and Jeffrey F. Robertson.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

© 2011 Schulte Roth & Zabel LLP. All Rights Reserved.

New York
Schulte Roth & Zabel LLP
919 Third Avenue
New York, NY 10022
+1 212.756.2000
+1 212.593.5955 fax

Washington, DC
Schulte Roth & Zabel LLP
11152 Fifteenth Street, NW, Suite 850
Washington, DC 20005
+1 202.729.7470
+1 202.730.4520 fax

London
Schulte Roth & Zabel International LLP
Heathcoat House, 20 Savile Row
London W1S 3PR
+44 (0) 20 7081 8000
+44 (0) 20 7081 8010 fax

www.srz.com

U.S. Treasury Circular 230 Notice: Any U.S. federal tax advice included in this communication was not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal tax penalties.

This information has been prepared by Schulte Roth & Zabel LLP ("SRZ") for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with SRZ. Electronic mail or other communications with SRZ cannot be guaranteed to be confidential and will not (without SRZ agreement) create an attorney-client relationship with SRZ. Parties seeking advice should consult with legal counsel familiar with their particular circumstances. The contents of these materials may constitute attorney advertising under the regulations of various jurisdictions.

© 2011 Schulte Roth & Zabel LLP. All Rights Reserved.

Speech by SEC Staff:
Remarks at Georgetown University

by

Sean X. McKessy
Chief, Office of the Whistleblower

U.S. Securities and Exchange Commission

Washington, D.C.
August 11, 2011

The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission, or of the author's colleagues upon the staff of the Commission.

Thank you for that kind introduction and for inviting me here today.

As many of you know, the Securities and Exchange Commission serves to protect investors from fraud and ensure our markets operate fairly.

We are a relatively small agency responsible for regulating more than 35,000 entities – from investment advisers to corporate filers to national exchanges. In fact, our entire operating budget is smaller than the amount that some individual financial firms spend on their IT systems alone.

Because we simply cannot be everywhere, our Chairman -- Mary Schapiro -- constantly urges us to find new ways to leverage the resources of others to fulfill our mission.

That is why the new whistleblower program authorized by last year's financial reform legislation is so crucial to our work. It will help us to more quickly identify and pursue frauds that we might not have otherwise found on our own. It will strengthen our ability to carry our mission. And, it will save us much time and resources in the process.

To summarize, the WB program provides a monetary incentive of between 10 and 30 percent of sanctions we collect for WB who voluntarily provide us with original information that lead to a successful SEC action with sanctions exceeding $1 million.

This speech on the whistleblower program is particularly timely now because tomorrow marks the first day that our final rules implementing this

program go into effect. So I am excited to be here and to announce the launch tomorrow of our new Office of the Whistleblower website tomorrow morning, which I hope you will check out.

And, as the first Chief of the SEC's Office of the Whistleblower, I am excited about the promise that this program holds.

Since the Final Rules were adopted by the Commission in May, I have focused my efforts on reaching out to various sectors and constituencies to let people know about the benefits of the whistleblower program and the way the rules work.

It has been the part of this job that I have enjoyed the most, as it helps me put a face to the names of people who will be directly affected by this new program –whistleblowers, in-house compliance officers and lawyers.

I have been impressed at how thoughtful many have been in parsing through the rules to try to understand what they require and how they may play out. But, my outreach efforts -- and review of the widely distributed commentary on the rules -- have led me to conclude that there still exists some misunderstanding about certain hotly debated issues related to the whistleblower program. So I'd like to try to address three of them here today. As I do so, please keep in mind that my remarks represent my own views and not necessarily those of the Commission, the staff or any of the Commissioners.

Issue Number 1:The Whistleblower program will bolster, not hamper, the internal compliance systems at companies across the country.

This seems rather apparent to me, yet no topic has been, and continues to be, more heavily debated than this one. The fact is that the SEC whistleblower program is the first and only such program in the country that makes available a monetary award from the government to an individual that reports possible wrongdoing internally. Put another way, the SEC's WB program is the only one in the country that extends significant benefits to individuals that report internally that enhance the opportunity for a whistleblower award, and possibly an award at a higher end of the allowable range.

Here's how: the rules specify that employees who report wrongdoing internally first and, within 120 days, then report the wrongdoing to the SEC, benefit in two significant ways.

First, those employees will be deemed to have reported the information to the SEC on the date they reported internally. This preserves their place in line in terms of when information was provided to the SEC.

Second, the employees who report internally first receive the benefit of all the information uncovered by the company in connection with its own internal investigation of the alleged wrongdoing.

These are not hypothetical or inconsequential benefits. Under this scenario, an employee who reports information internally that itself might not have warranted an SEC investigation, could nonetheless become eligible for an

award if the internal investigation uncovers such information that does lead to an SEC investigation. For example, imagine an employee who, based on his experience, knows but does not have sufficient proof to substantiate that something is amiss with the company's accounting for a certain matter. That "gut feeling" in and of itself, may not be sufficiently timely, specific and credible to cause the SEC to open an investigation if it were reported to us. If, however, the employee were to report that gut feeling internally, and the company's subsequent investigation were to uncover specific, timely and credible information that is reported to us, the reporting employee – who might not have otherwise even qualified for an award – would then be eligible.

Additionally, the employee gets the benefit of all the facts and details uncovered and reported to us by the company in connection with its internal investigation of the issue. So, the percentage of the award to the employee could be increased based on the enhanced quality and value of the information uncovered by the company's internal investigation. So the same employee that reported the "tip of the iceberg" – something is wrong – gets the benefit of the full iceberg – everything that the internal investigation uncovered. That employee's award will be based on the whole iceberg – likely a higher award than if just the tip were uncovered. The rules also require that cooperation with internal compliance programs be considered as a positive factor that could increase a whistleblower award, and interference with such programs as a negative factor that could decrease an award.

These significant benefits to those who report internally first offer a great opportunity for companies and their compliance officers and personnel. Rather than undermining or weakening internal compliance programs, I believe the whistleblower program actually should empower internal compliance personnel to advocate for stronger and more transparent internal compliance programs. Why? Because the rules leave it to the employee to decide whether to report internally first – or to contact the SEC -- and those companies that best ensure that their employees view internal reporting as a viable and credible option to address possible securities law violations are more likely to have the wrongdoing reported internally first.

In my view, the net effect of the incentives for reporting internally is a rising tide that should lift all boats when it comes to the strength and effectiveness of internal compliance programs.

Issue Number 2: The final rules recognize that in most instances, attorneys, compliance personnel and external auditors should not be allowed to become whistleblowers.

Some have argued that by failing to adopt an *absolute* exclusion on attorneys, auditors and compliance officials, the final rules provide negative "incentives" – that is to say, it encourages these individuals to abandon their professional responsibilities in favor of a potential bounty award. But I don't believe the rules have created any negative incentives.

The best way to address this issue is to take a step back and consider the purpose of the whistleblower award program. While I certainly hope and expect that the SEC will end up paying awards to individuals who have

provided information, such payment is the end result, but not the purpose, of the whistleblower program. Instead, the program was created to add a tool to the SEC's arsenal to identify wrongdoing, prevent or stop it and, if appropriate, punish those responsible. By providing for the possibility of a whistleblower award to attorneys, compliance officials and auditors, the final rules recognize that we may *in some narrow circumstances*, need these individuals to come forward, in order to accomplish that goal. And I believe that, in the narrow circumstances described below, these individuals can and should be eligible for an award.

But, make no mistake, those circumstances are limited. In essence, a monetary incentive is provided to these types of professionals to report to the Commission *only* when

i. it is necessary to prevent imminent or ongoing misconduct; or,
ii. the misconduct has been identified and reported, but not remediated in a timely fashion.

Let's consider each group and the rationale to understand why these exceptions that allow for the possibility of an award are appropriate.

Attorneys . With respect to attorneys, the final rules are very clear that attorneys may not break their attorney-client privilege for the purposes of reporting wrongdoing and receiving an award. Indeed, the rules specifically exclude from the definitions of "independent knowledge" or "independent analysis" (required to be eligible for an award) any information obtained through a communication subject to the attorney-client privilege.

However, the final rules make reference to policy determinations -- made long before the whistleblower program was created -- that permit attorneys to come forward with potentially privileged information under very limited parameters.

First, the rules provide for the possibility of an award to an attorney if disclosing the information is permitted under the Commission's attorney conduct rules adopted in connection with the Sarbanes-Oxley Act of 2002. Those rules – adopted in 2003 -- are limited to the issuer context and permit attorneys to disclose information only if they reasonably believe that disclosure is necessary:

i. to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
ii. to prevent the issuer from interfering with an ongoing Commission or investigation or
iii. to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury.

Similarly, the final rules do not preclude an award to an attorney who provides information when disclosure is permitted by state attorney conduct rules. These rules -- which pre-date the creation of the whistleblower program by decades -- vary by state but generally permit attorneys to disclose information:

i. to prevent reasonably certain death or substantial bodily harm;

ii. to prevent a client from committing a crime or fraud; or,
iii. to prevent, mitigate or rectify substantial injury to the financial interests that is reasonably certain to result or has resulted from the client's commission or a crime or fraud.

By allowing for the possibility of an award to an attorney who reports under these circumstances, the final rules have created no negative incentives for attorneys. Think about the circumstances I just described. If the ultimate goal is to ferret out wrongdoing, how is it negative to provide for the possibility of an award to attorneys when severe harm is imminent?

Compliance and Internal Audit Personnel. As for compliance and internal auditors, some claim the final rules allow for the possibility of an award to these professionals merely for doing what the company is paying them to do.

But, as with attorneys, an employee with compliance or internal auditor responsibilities may only be eligible for a whistleblower award under the same limited circumstances as attorneys; that is if they have a reasonable belief that reporting is necessary to prevent actions that will result in imminent harm or impede an investigation.

For the same reasons as with attorneys, allowing for the possibility of a whistleblower award under these circumstances does not encourage a breach of their responsibilities – it rewards them for taking those obligations seriously.

The third circumstance under which there is a possibility of an award to compliance or internal audit personnel occurs only when more than 120 days have passed since the information was reported to certain officials – including the entity's audit committee, chief legal officer, chief compliance officer or supervisor.

In this case, an award is possible only after these professionals have done what they are paid to do: They reported wrongdoing internally with a view of having it addressed -- – but, for whatever reason, the entity failed to take timely remedial action.

Keeping in mind the ultimate goal to prevent or stop possible violations of the securities laws, I see nothing wrong with incentivizing compliance and internal audit employees to come forward when the internal compliance process has failed.

External Auditors. And, with respect to external auditors, their eligibility is also limited to narrow circumstance. In their case, it's where the auditors have a reasonable basis to believe that their employer (the audit firm) failed to make the required disclosures of the audit client's wrongdoing under Section 10A of the Exchange Act. In these rare instances, the eligibility for an award is limited to the reporting of misconduct that has been detected but not reported to us.

Issue Number 3: The whistleblower program ensures that efforts to address misconduct are sped up, not delayed.

Of course, I've heard the claim that employees will delay reporting ongoing

misconduct to increase the size of the potential award. The theory is that since the whistleblower award percentage is calculated against the monetary sanctions obtained, whistleblowers will be incentivized to allow misconduct to grow so the sanctions will be greater. However, this theory ignores some significant aspects of the final rules.

First, to be eligible for an award, a whistleblower must provide the SEC with "original" information – that is, information not already known. This requirement is a natural and powerful disincentive for an individual to "sit on" information about ongoing misconduct – because doing so means someone else may come forward first.

Second, information reported to us must be specific, credible and timely if it is to lead us to open an investigation. So an individual who delays reporting risks that the information will not lead to an investigation -- a no investigation, no case, and no case, no award.

Third, the final rules include an 'unreasonable delay' as one of the factors that might decrease the size of an award. So, the whistleblower who waits may end up with a lesser percentage than he or she might have gotten if he or she had report promptly.

Additionally, I've also heard some claim that wrongdoing reported by a whistleblower will be allowed to continue because the SEC will needlessly keep management in the dark about the report, depriving the company of the opportunity to take swift responsive action. This theory rests on the assumption that because a whistleblower is involved, the SEC cannot or will not involve the company in the investigation.

In fact, the SEC has been working with insiders and whistleblowers long before the whistleblower award program was established, and, when appropriate, we have included the company in efforts to investigate and punish wrongdoing most effectively and efficiently.

Companies should expect that the SEC's practice of involving them where appropriate will continue. The possibility that there could be a monetary award paid to the whistleblower at the conclusion of a successful action should in no way alter this historic practice.

* * * * *

While the final rules go into effect tomorrow, we have already seen an increase in the quality of the tips we have received since the passage of Dodd-Frank in July 2010. Long letters that include detailed information about potential violations. It's information like this that can save our attorneys months of investigation and allow us to stop a fraud earlier in the process.

Violations of the securities laws have far-reaching consequences even beyond those directly affected by the wrong. Surely, the enormous losses suffered by investors are tragic enough, but perhaps a greater harm is the loss of confidence by the public in the fairness of the investment process.

While the vast majority of companies and securities professionals are honest and law-abiding, the actions of a few rotten apples can unfairly taint

the entire industry in the minds of much of the public.

It is in the interest of all of us -- investors, companies, securities professionals, regulators and whistleblowers -- to stop those who seek to violate the securities laws, manipulate the markets and cheat investors. At the same time, we also understand the need to ensure that the heavy hand of government does not place an undue burden on the proper functioning of our markets and the capital formation process.

The Whistleblower Program is a balanced approach designed to aid the SEC' by encouraging those aware of misconduct to come forward while at the same time incentivizing those individuals to report their suspicions of misconduct to their companies first – so the companies take appropriate action to remedy it.

The Whistleblower Program recognizes that we all have a stake in eliminating wrongdoing and that only when we act together can we effectively stop those who seek to take unfair advantage of the vast majority of investors and companies that play by the rules.

Thank you for your time and attention and I will be pleased to take any questions.

http://www.sec.gov/news/speech/2011/spch081111sxm.htm

This information and any presentation accompanying it (the "Content") has been prepared by Schulte Roth & Zabel LLP ("SRZ") for general informational purposes only. It is not intended as and should not be regarded or relied upon as legal advice or opinion, or as a substitute for the advice of counsel. You should not rely on, take any action or fail to take any action based upon the Content.

As between SRZ and you, SRZ at all times owns and retains all right, title and interest in and to the Content. You may only use and copy the Content, or portions of the Content, for your personal, non-commercial use, provided that you place all copyright and any other notices applicable to such Content in a form and place that you believe complies with the requirements of the United States' Copyright and all other applicable law. Except as granted in the foregoing limited license with respect to the Content, you may not otherwise use, make available or disclose the Content, or portions of the Content, or mention SRZ in connection with the Content, or portions of the Content, in any review, report, public announcement, transmission, presentation, distribution, republication or other similar communication, whether in whole or in part, without the express prior written consent of SRZ in each instance.

This information or your use or reliance upon the Content does not establish a lawyer-client relationship between you and SRZ. If you would like more information or specific advice of matters of interest to you please contact us directly.

© 2011 Schulte Roth & Zabel LLP. All Rights Reserved.

Schulte Roth&Zabel

Schulte Roth & Zabel LLP
New York
919 Third Avenue
New York, NY 10022
+1 212.756.2000
+1 212.593.5955 fax

Schulte Roth & Zabel LLP
Washington, DC
1152 Fifteenth Street, NW, Suite 850
Washington, DC 20005
+1 202.729.7470
+1 202.730.4520 fax

Schulte Roth & Zabel International LLP
London
Heathcoat House, 20 Savile Row
London W1S 3PR
+44 (0) 20 7081 8000
+44 (0) 20 7081 8010 fax

www.srz.com