



## Securities Litigation / Securities Law ADVISORY ■

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### SEC Amends Regulations to Streamline Whistleblower Award Process

By *Alex Ingoglia, Susan Hurd, Dave Brown, Matthew Mamak, and Julie Mediamolle*

As a part of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Congress established the SEC’s now decade–old whistleblower program that provides incentives to people with knowledge of possible securities violations to come forward voluntarily and share information with the SEC. A whistleblower can receive anywhere between 10 percent and 30 percent of the total fine paid by the company accused of violating the securities laws.<sup>1</sup> Dodd–Frank gave the SEC discretion to decide what percentage to award whistleblowers depending on a series of both positive and negative factors.<sup>2</sup> On September 24, 2020, the SEC approved new regulations seeking to make it easier for the SEC to dispose of frivolous and untimely claims, to use SEC resources more efficiently for smaller claims, and to properly tailor large awards to incentivize future whistleblowers.

When the rule changes were first announced, the SEC signaled the possibility that it might impose additional award criteria to give it more flexibility in trimming the size of awards when it was appropriate to do so under the particular facts presented. Instead, the SEC chose to amend the rules to make it clear that it had the power to adjust award dollars through the use of the factors already in existence.

Since its inception, the whistleblower program has awarded over \$500 million to qualifying whistleblowers who assisted in the SEC’s pursuit of over \$2.5 billion in financial remedies.<sup>3</sup> In the last three and a half years alone, two whistleblowers received sums of \$50 million.<sup>4</sup> Other large awards in the last three and a half years include a \$39 million award and a \$33 million award.<sup>5</sup> However, despite what the SEC views as a successful track record associated with the

<sup>1</sup> 15 U.S.C. § 78u-6(b)(1) (2010).

<sup>2</sup> The positive award factors are: (1) significance of the information provided by the whistleblower; (2) assistance provided by the whistleblower; (3) law enforcement interest; and (4) participation in internal compliance systems. 15 U.S.C. § 78u-6(c)(1)(B) (2010). On the other hand, the negative award factors are: (1) culpability; (2) unreasonable reporting delay; and (3) interference with internal compliance and reporting systems. 17 C.F.R. § 240.21F-6(b) (2011).

<sup>3</sup> Press Release, Securities and Exchange Commission, SEC Adds Clarity, Efficiency and Transparency to Its Successful Whistleblower Award Program (Sept. 23, 2020).

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

program, the SEC nevertheless recognized some inefficiencies in the process that have resulted in the SEC expending time and resources on small and frivolous claims. As a result, in June 2018, the SEC proposed new regulations to streamline the system and fix the perceived inefficiencies.

## Important Changes in the Rules

Here are some key changes as a result of these amendments that are most likely to have a significant impact on the functioning of the program.

- *Max Award Percentage (30%) for Certain Small Awards.* In order to avoid the drain on SEC time and resources arising from smaller investigations, the new rules presumptively grant the max percentage (30 percent) for awards under \$5 million, as long as none of the negative factors are present. Historically, over 75 percent of whistleblower awards are under \$5 million.<sup>6</sup> This incentivizes smaller meritorious whistleblowers to come forward while streamlining the process for awards under \$5 million, which as noted above, made up the vast majority of the awards in the past 10 years.
- *Three-Strikes-You're-Out Frivolous Claim Rule.* The new regulations solidified the SEC's practice of barring frivolous claims. Now, someone who has submitted three claims with materially false, fictitious, or fraudulent statements is barred from being considered for or receiving whistleblower awards. Those false statements can come in whistleblower submissions, other SEC dealings, or related actions. The claimant can avoid a "strike" by withdrawing the false statements upon receipt of notification from the SEC that it intends to invoke the three strikes rule. The three-strikes-you're-out rule is designed to make the process more efficient by saving the SEC time and resources on repeat players whose information is not likely worthy of the staff's time or attention.
- *Summary Disposition for Common Denials.* The new regulations also increase efficiency by allowing the SEC to use summary disposition for certain common denials, such as untimely award applications, incorrectly filed award applications, and award applications pertaining to information the SEC did not use in its investigation. Summary disposition allows the SEC to discard these claims easily and quickly, while still granting the claimant the opportunity to contest the SEC's summary disposition before the final determination.
- *Additional "In Writing" Requirement.* In order to qualify as a "whistleblower" for retaliation protection under the new regulations, the submission to the SEC must be "in writing." The SEC adopted this rule to comply with the U.S. Supreme Court's decision in *Digital Realty Trust, Inc. v. Somers*.<sup>7</sup> However, using the SEC's Form TCR, online tips portal, email, or fax will all satisfy the SEC's "in writing" requirement.
- *Consideration of Award Amount.* As a part of the new regulations, when deciding an award percentage, the SEC may now consider the amount of the award in addition to the positive and negative factors. While the new rule may lead potential whistleblowers to infer that the SEC will no longer give huge awards, the SEC specified that when there are no negative factors present, the award should be within the top third of the available award percentage. Additionally, a meritorious claim cannot result in an award below 10 percent under Dodd–Frank.<sup>8</sup>

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<sup>6</sup> *Id.*

<sup>7</sup> 138 S. Ct. 767 (2018).

<sup>8</sup> 15 U.S.C. § 78u-6(b)(1) (2010).

## **Observations and Potential Impact of Changes**

There were some observers who were concerned that the SEC's amendments would reduce the incentive for whistleblowers to come forward. We do not believe that will be the case. From a practical perspective, we believe meritorious whistleblowers will continue to come forward, and public companies and other market participants should anticipate that it will continue.

From a compliance perspective, public companies should continue to have robust compliance programs and hotlines to receive and address internal reports of potential wrongdoing before a whistleblower takes their case to the SEC.

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Alexander A. Ingoglia  
404.881.7863  
alex.ingoglia@alston.com

Susan E. Hurd  
404.881.7572  
susan.hurd@alston.com

David A. Brown  
202.239.3463  
dave.brown@alston.com

Matthew W. Mamak  
212.210.1256  
matthew.mamak@alston.com

Julie Mediamolle  
202.239.3702  
julie.mediamolle@alston.com

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777  
BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500  
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719  
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111  
DALLAS: Chase Tower ■ 2200 Ross Avenue ■ Suite 2300 ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899  
FORT WORTH: 3700 Hulen Street ■ Building 3 ■ Suite 150 ■ Fort Worth, Texas, USA, 76107 ■ 214.922.3400 ■ Fax: 214.922.3899  
LONDON: 5th Floor, Octagon Point, St. Paul's ■ 5 Cheapside ■ London, EC2V 6AA, UK ■ +44.0.20.3823.2225  
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100  
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444  
RALEIGH: 555 Fayetteville Street ■ Suite 600 ■ Raleigh, North Carolina, USA, 27601-3034 ■ 919.862.2200 ■ Fax: 919.862.2260  
SAN FRANCISCO: 560 Mission Street ■ Suite 2100 ■ San Francisco, California, USA, 94105-0912 ■ 415.243.1000 ■ Fax: 415.243.1001  
SILICON VALLEY: 950 Page Mill Road ■ Palo Alto, CA 94304-1012 ■ 650.838.2000 ■ Fax: 650.838.2001  
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333