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Whistleblowers: Best Practices in a New Regime

Tuesday, February 8, 2022

Course Materials

"**Whistleblowers: Best Practices in a New Regime**"

Tuesday, February 8, 2022

2:00 – 3:00 pm, Eastern [archive and transcript to follow]

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More than $1 billion has now been awarded under the SEC's whistleblower program -- and the Commission continues to announce record-setting awards. Companies need to get ahead of the new normal in light of the possibility that the SEC's current penalty posture signals a willingness to grant more awards, and that recent data and high-profile incidents show employees are more willing to submit tips. Hear from these experts on the latest best practices for whistleblower policies and procedures:

- **Zach Hafer,** Partner, Cooley
- **Susan Muck**, Partner, WilmerHale
- **Harris Mufson**, Partner, Gibson Dunn

Among other topics, this program will cover:

- Basics of Whistleblower Policies
- Whistleblower Rule Amendments
- Latest Trends from the SEC
- Cultivating a Compliant Corporate Culture
- Nuts & Bolts of Handling Whistleblower Complaints
- Whistleblower Complaint Documentation
- Communication with the Board
- Whistleblowers & ESG

“Whistleblowers: Best Practices in a New Regime”

Course Outline / Notes

1. Basics of Whistleblower Policies

2. Whistleblower Rule Amendments

3. Latest Trends from the SEC

4. Cultivating a Compliant Corporate Culture

5. Nuts & Bolts of Handling Whistleblower Complaints

6. Whistleblower Complaint Documentation

7. Communication with the Board

8. Whistleblowers and ESG

“Whistleblowers: Best Practices in a New Regime”

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Arnold & Porter

June 17, 2021

The SEC's Record-Breaking Whistleblower Award Run: Practical Considerations for Companies

Advisory

By Jane Norberg, Veronica E. Callahan, Michael D. Trager, Daniel M. Hawke, Joshua R. Martin, Stephanna F. Szotkowski, Sasha Zheng

After fiscal year (FY) 2020, when the Office of the Whistleblower (OWB) of the Securities and Exchange Commission (SEC or Commission) awarded a record-breaking $175 million to 39 individuals, FY 2021 has proven to be even more active. With more than three months still left, the Commission already has awarded approximately $370 million to whistleblowers, setting up the year to surpass FY 2020 for an all-time high. Notably, in just the last month, the Commission has awarded approximately $116 million in awards in nine SEC enforcement actions and two related actions brought by other agencies. This Advisory surveys the lay of the land regarding SEC whistleblower awards and identifies some practical suggestions for companies in anticipation of increased whistleblower activity.

Background

Formed in 2011, the OWB was established one year after the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) amended the Securities Exchange Act of 1934 (Exchange Act) by, among other things, adopting Section 21F. 15 U.S.C. § 78u-6. Section 21F, entitled "Securities Whistleblower Incentives and Protection," directs the Commission to make monetary awards to eligible individuals who voluntarily provide original information that leads to successful SEC enforcement actions resulting in monetary sanctions over $1 million, and successful related actions. Awards may range between 10% and 30% of the money collected. In addition to providing monetary awards to certain whistleblowers, Dodd-Frank and the Commission's implementing rules create confidentiality protections for whistleblower submissions and prohibit employers from retaliating against whistleblowers for providing information to the SEC. 17 C.F.R. §§ 240.21F-7; 15 U.S.C. § 78u-6(h)(1).

The Commission has relatively straightforward procedures for claiming a whistleblower award. Following a successful "Covered Action," which is defined as any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding $1 million, the OWB will post a "Notice of Covered Action" on the OWB website. 15 U.S.C. § 78u-6(a)(1); 17 C.F.R. §§ 240.21F-10(a). Within 90 calendar days of the Notice of Covered Action, a whistleblower must submit a claim in order to collect an award, 17 C.F.R. §§ 240.21F-10(a), and there are additional procedures for whistleblowers seeking to receive an award based on monetary sanctions collected from a "Related Action" brought by certain other agencies or regulators, 17 C.F.R. §§ 240.21F-11. OWB attorneys assess each claim and the eligibility of the claimant, including conferring with relevant investigative or other SEC staff. OWB attorneys then provide a recommendation to "Claims Review Staff" comprised of senior leaders in the Division of Enforcement and, in the case of a positive award recommendation or a contested denial, to the Commission. After consideration, the Commission issues Final Orders determining whistleblower award claims. These orders are usually heavily redacted, such that the name of the whistleblower and the Covered or Related Actions are not publicly disclosed.

Recent Awards and a Notable Trend

The OWB's activity in the first half of 2021 continues the uptick in awards seen in 2020. In May 2021 and halfway through June 2021 alone, the Commission issued awards to 19 individuals, totaling approximately $116 million. The SEC also is taking a liberal stance when it comes to interpreting provisions of the federal securities laws in a manner that appears to be designed to encourage whistleblowers to come forward.

In a recent Final Order issued on June 2, 2021, the Commission awarded approximately $23 million to two whistleblowers whose information and assistance led to successful SEC and related actions. One of the whistleblowers filed the application for award 18 days after the 90-day deadline, normally a fatal procedural defect. In the Final Order, the Commission noted that the mitigating circumstances asserted by the claimant did not rise to the level of circumstances beyond the claimant's control and, therefore, were not "extraordinary

circumstances" that might otherwise allow the Commission to waive the deadline under Rule 21F-8(a) of the Exchange Act. Despite this, the Commission determined to exercise its discretionary authority under Section 36(a) of the Exchange Act to waive the procedural defect and grant the whistleblower award. In doing so, the Commission noted that, based on the specific facts and circumstances of this case, "[s]trict application of the deadline would result in undue hardship to [the claimant], particularly in light of [the claimant's] significant contributions to the successful enforcement of the Covered Action and certain unique obstacles faced by [the claimant]." Given that the waiver of this deadline has been denied in the past, this rare use of Section 36(a) exemptive authority to waive the application filing deadline shows the value that the current Commission places on otherwise meritorious whistleblower tips.[1]

The Commission also showed a willingness to interpret Dodd-Frank and the SEC's implementing rules liberally to grant awards to whistleblowers in another high-value Final Order awarded on May 19, 2021. In the Final Order, the Commission awarded $28 million for a tip with a more tenuous nexus to the Covered Action—the whistleblower reported wrongdoing in one geographic region that resulted in investigations by the SEC and another agency, but the ultimate charges were based on conduct in another geographic region *not* reported by the whistleblower. The Final Order noted that, although "the Covered Action's and the Related Action's charges involved misconduct in geographical regions that were not the subject of the Claimant's information" and there was "not a strong nexus between the Claimant's information and the . . . charges," an award would nonetheless be granted that "appropriately recognizes Claimant's level of contribution to the Covered Action and Related Action." This award was one of the ten largest awards ever paid out by the Commission.

Of note, unlike the usual anonymous nature of whistleblower tips, purported counsel for the whistleblower in the May 19 Final Order has given public statements to news media claiming that the award was for information resulting in the 2018 settlements of Foreign Corrupt Practices Act (FCPA) charges against Panasonic Avionics Corporation (PAC), which makes entertainment and communications systems for aircraft, along with certain of its former executives. PAC ultimately paid more than $137 million to the DOJ, and its parent company paid more than $143 million to the SEC, in connection with these FCPA and related charges. If true, the public statements made by the whistleblower's counsel provide a rare public view into what is usually a confidential process.

Implications and Some Practical Considerations

In FY 2020, the Commission received more than 6,900 whistleblower tips, a 31% increase from FY 2018, the second-highest tip year. The high number of tips, the high value of awards, and the willingness of the SEC to liberally interpret the rules all indicate that the Commission views whistleblower tips as an important source of information in assessing wrongdoing in the markets. Credible whistleblower tips may serve as an increasing impetus to the opening of investigations by both the SEC and other regulators—and, given the start to FY 2021, the trend is likely to continue (if not strengthen) under the new administration.

In light of this, companies would be well-advised to anticipate the possibility of increased whistleblower activity and take proactive measures to ensure they comply with applicable law. While every situation is different, there are some practical considerations to bear in mind:

- **Risk Assessments.** Consider conducting risk assessments related to internal reporting structures to make sure that all reports—not just those going to an internal hotline—are captured, triaged, and investigated if appropriate. Use internal whistleblower information to get ahead of a potential problem with the regulators or law enforcement. Companies that are able to conduct thorough internal investigations showing a clear, robust response to an internal tip will be better able to effectively self-correct and have a defensible position if regulators or law enforcement get involved.
- **Annual Training.** Consider if annual training is appropriately robust and targeted to middle management to ensure that tips received outside of the employee hotline or formal reporting mechanisms are identified, logged, and triaged. This is particularly important given that 81% of SEC whistleblower awardees reported their concerns internally, including in many instances to their direct supervisor, before or at the same time as reporting to the Commission. If all tips are not identified and centrally reviewed, it is a lost opportunity for a company to self-correct an issue.
- **Internal Reporting Mechanisms in a Post-Covid World.** As more companies are pivoting back to an in-person workforce, consider a refresh on internal reporting mechanisms as well as related training. Record-breaking numbers of tips were reported to the SEC during the pandemic. This may have been because of a breakdown in internal reporting mechanisms for a remote workforce. Consider a fresh internal reporting campaign to refocus a returning workforce, whether it be full-time in the office, continuing remote, or some hybrid. The statistics show that the current mechanisms for internal reporting may not be effective anymore.
- **Anti-Retaliation Policies and Training.** Ensure that whistleblower anti-retaliation polices and training are up-to-date. Now is the time for companies to review anti-retaliation policies to ensure they are clear and concise. Annual training should be conducted to ensure that everyone understands what retaliation is and knows the steps that can and cannot be taken once someone reports internally or to the government. Zero tolerance policies that are advertised to the workforce can help employees get comfortable reporting internally rather than straight to the governmental authorities.

- **Domestic and International Policies.** Review and update both domestic and international policies. In light of the purported award in the PAC case, companies should be aware that whistleblower tips may arise from and with respect to any part of their business, including activity overseas. In FY 2020, 11% of whistleblower submissions to the Commission were submitted from non-US countries. Since the inception of the program, the SEC has received tips from whistleblowers in 130 countries. Properly and consistently implemented robust internal reporting mechanisms and whistleblower policies provides an additional safeguard for compliance with US and international laws and regulations.

Arnold & Porter is continuing to monitor developments in this area and plans to issue a series of important client advisories related to whistleblowing and best practices for companies. If you are seeking advice on how to mitigate risks in connection with whistleblower reporting and compliance, please reach out to any author of this Advisory or your regular Arnold & Porter contact.

[1] *See, e.g.*, Order Determining Whistleblower Award Claim, Release No. 91805 (May 10, 2021); Order Determining Whistleblower Award Claim, Release No. 89002 (June 4, 2020); Order Determining Whistleblower Award Claim, Release No. 85412 (March 26, 2019).

BakerHostetler

Alerts

SEC Begins Reversal of Trump Era Changes to Whistleblower Program

Alerts / August 17, 2021

The new Chairman of the Securities and Exchange Commission ("SEC"), Gary Gensler has wasted little time in revisiting some of the policies enacted under his predecessor. On August 2, 2021, Chairman Gensler issued a public statement calling on the staff of the SEC to propose potential changes to two whistleblower rules that the Commission had just amended in September 2020.[1] The amendments have drawn significant criticism for potentially discouraging whistleblowers from making reports. One of these 2020 amendments precludes the SEC in certain instances from making an award in related enforcement actions brought by other law-enforcement and regulatory authorities if a second, alternative whistleblower award program might also apply to the action. The other 2020 amendment at issue permits the SEC to consider the potential dollar amount of an award when making an award determination. As foreshadowing of the rulemaking to come, the SEC released a policy statement on August 5, 2021 that sets forth interim procedures that it will apply to whistleblowers during the period that the staff is preparing, and the Commission is considering, the changes called for by Chairman Gensler. [2] These interim procedures are designed to further the goal of encouraging whistleblowers to come forward to report violations of federal securities laws.

Over the past few years and particularly so far in 2021, responding to pandemic-related whistleblower tips,[3] there has been a dramatic uptick in whistleblower awards. The trends are very likely to continue under the leadership of new Chairman Gensler, who stated in his confirmation hearings that he intends to "examine whether and how the [SEC's whistleblower] program could be strengthened to ensure that misconduct within the remit of the SEC is identified, addressed and stopped."[4] According to a recent SEC press release, since the program's inception in 2010, it has paid out $956 million in total awards to 195 individuals.[5] FY 2020 was a record year – the program paid out approximately $175 million to 39 individuals, triple the number of individuals who were given awards in 2018.[6] The program also received over 6,900 whistleblower tips, a 31% increase from FY 2018, the second-highest tip year.[7] The 2021 FY is set to eclipse those numbers, already awarding approximately $377 million to 75 individuals,[8] including a $114 million payout to an individual, the largest in program history.[9]

Under the Dodd-Frank Act, qualified whistleblowers are entitled to a monetary award of 10%-30% of funds recovered by the SEC in a successful action that recovers greater than $1 million. Additionally, under the related-action provisions, when a whistleblower's disclosure to the SEC also leads to a successful enforcement action by another agency, the whistleblower is entitled to an additional award of 10%-30% of funds recovered in that action. On September 23, 2020, the SEC voted to adopt amendments to the rules governing its whistleblower programs, which, among other things, brought about changes to the rules implementing those two provisions.

One change explained that the SEC has discretion to consider the potential dollar amount of the final award payout as a factor in calculating the award, which would potentially allow it to lower whistleblower award amounts. The other stated that the agency may not pay an award for a related action if another agency's whistleblower program had the "more direct or relevant connection" to the related action. According to the SEC's recent policy update, this amendment serves to potentially limit awards, given that it would include situations where "the alternative whistleblower program has an award cap or award range that could disadvantage the particular claimant."[10] Both amendments have come under severe criticism for their potential to significantly limit whistleblower recovery and to disincentivize would-be tipsters.

As part of its new August 5th policy statement, the Commission clarified that it anticipates only using its discretion to consider final award amounts to raise awards, not to reduce them. Regarding related-action awards, the policy statement gives the agency the ability to use its exemptive authority to nullify the amendment limiting such awards if: (i) the alternative whistleblower program has an award cap or range that could disadvantage the particular whistleblower; or (ii) the SEC is aware or the whistleblower demonstrates a likelihood that a condition or exclusion would apply to his or her award claim under the alternative award program and the SEC determines that the whistleblower would likely obtain an award were he or she permitted to proceed under the SEC's program. Under other circumstances where the SEC determines that an alternative whistleblower program has a "more or direct connection" to the potential related action than the SEC's program does, whistleblowers may request an abeyance of their award claim for the duration of the "interim policy-review period" during which SEC staff will be continuing to review the two amendments.

Amid an already well-utilized SEC whistleblower program, these rollbacks will further incentivize individuals to come forward to the agency with reports of potential misconduct. Corporate compliance officers should act now to review their company's compliance programs to ensure that they create a culture of and have the procedures in place to encourage internal reporting. This includes reviewing whistleblower and anti-retaliation policies and confirming that they are sufficiently robust and clearly communicated to all employees. Compliance officers should also review their training programs and the manner in which they investigate whistleblower complaints. It is key that the company's internal policies for addressing whistleblower reports are well-defined and provide for prompt and thorough investigations of whistleblower complaints.

Authorship credit: Jonathan B. New, Patrick T. Campbell, Kayley B. Sullivan

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[1] Public Statement, Chair Gary Gensler, *Statement in Connection with the SEC's Whistleblower Program*, U.S. Sec. & Exch. Comm'n, (Aug. 2, 2021), available at https://www.sec.gov/news/public-statement/gensler-sec-whistleblower-program-2021-08-02.

[2] U.S. Sec. & Exch. Comm'n, Rel. No. 81207, *Procs. for the Comm'n's Use of Certain Auths. Under Rule 21F-3(B)(3) and Rule 21F-6 of the Secs. Exchange Act of 1934*, (Aug. 5, 2021), available at https://www.sec.gov/rules/policy/2021/34-92565.pdf.

[3] John J. Carney, Ryan A. Cates, Joseph C. Devine, Lauren P. Lyster, BakerHostetler, *Will the SEC's Record Whistleblower Awards and COVID-19 Lead to More Whistleblower Complaints?*, (May 15, 2020), available at https://www.bakerlaw.com/alerts/will-the-secs-record-whistleblower-awards-and-covid-19-lead-to-more-whistleblower-complaints; Ryan A. Cates, Joseph C. Devine, Lauren P. Lyster, BakerHostetler, *Whistleblower Complaints Are Skyrocketing Due to COVID-19*, (Sept. 28, 2020), available at https://www.bakerlaw.com/alerts/whistleblower-complaints-are-skyrocketing-due-to-covid-19.

[4] *Questions for the Honorable Gary Gensler, of Maryland, to be a Member of the Securities and Exchange Commission, from Senator Chuck Grassley*, available at https://whistleblowersblog.org/wp-content/uploads/2021/03/Senator-Grassley-questions-3.17.214.pdf.

[5] Press Release, *SEC Issues Nearly $6 Million in Whistleblower Awards, U.S. Sec. & Exch. Comm'n*, (Aug. 10, 2021), available at https://www.sec.gov/news/press-release/2021-149.

[6] Jonathan B. New, Patrick T. Campbell, and Lauren Lyster, *Developments in Federal Whistleblowing Programs: What Compliance Officers Need to Know*, 28 BUS. CRIMES BULLETIN, (June 2021), available at https://www.bakerlaw.com/webfiles/Litigation/2021/Articles/New_Campbell_Lyster_Whistleblower.pdf.

[7] *Id.*

[8] Press Release, *SEC Issues Nearly $6 Million in Whistleblower Awards*.

[9] Press Release, *SEC Issues Record $114 Million Whistleblower Award*, U.S. Sec. & Exch. Comm'n, (Oct. 22, 2020), available at https://www.sec.gov/news/press-release/2020-266.

[10] *Procs. for the Comm'n's Use of Certain Auths. Under Rule 21F-3(B)(3) and Rule 21F-6 of the Secs. Exchange Act of 1934*.

Related Professionals

- Patrick T. Campbell
- Jonathan B. New
- Kayley B. Sullivan

Arnold & Porter

September 20, 2021

At the Crossroads of ESG Disclosures and Whistleblowing: What Companies Need to Know Now (ESG Advisory Series, Part 5)

Advisory

By Robert C. Azarow, Veronica E. Callahan, Mark Epley, Ellen Kaye Fleishhacker, David F. Freeman, Jr., Sarah Grey, Daniel M. Hawke, Brian D. Israel, Teresa L. Johnson, Joshua R. Martin, Jane Norberg, Kathleen Reilly, Stephanna F. Szotkowski, Michael D. Trager, Andrew Varner, Erik Walsh, Charles Yi

This Advisory is the fifth in a series concerning environmental, social and governance (ESG) considerations for the financial services industry and other companies. As discussed in our prior ESG advisories (Parts I, II, III, and IV), these writings reflect the combined effort of the firm's Environmental Practice Group, Financial Services Group, and Securities Group, with insights from other practice areas at the firm. This installment in the series addresses issues related to both ESG-related disclosures and the whistleblower program of the US Securities and Exchange Commission (SEC or Commission), and it includes the viewpoints of our partner Jane Norberg, who is the former Chief of the SEC's Office of the Whistleblower.

* * * * *

On August 25, 2021, *The Wall Street Journal* reported that the SEC and the United States Attorney's Office for the Eastern District of New York are investigating greenwashing allegations made by the former head of sustainability of Deutsche Bank AG's asset-management arm, DWS Group (DWS), including allegations that DWS overstated how much it used sustainable investing criteria to manage its assets. DWS disclosed in its 2020 annual report that it invested more than half of its $900 billion in assets using a system called ESG integration, where companies are graded using ESG criteria. According to *The Wall Street Journal*, however, an internal assessment done a month earlier said that only a fraction of these assets applied the ESG integration process and that there was no quantifiable or verifiable ESG-integration for key DWS asset classes.

These allegations raise key considerations concerning the intersection of two high-priority matters for the SEC: (i) the adequacy and accuracy of ESG-related disclosures and (ii) the strengthening of the SEC's whistleblower rules to encourage whistleblowers to come forward. In this Advisory, we analyze this intersecting landscape and its implications and practical considerations.

Recent Signs of the SEC's Aggressive Approach to ESG-Related Misconduct

Since the 2020 presidential election, ESG investing and disclosure standards have repeatedly made financial news headlines, been the subject of many regulatory agency initiatives and newly-formed committees, and frequently served as a centerpiece of senior government officials' speeches.

Indeed, the SEC has signaled that it will aggressively investigate ESG-related misconduct using whistleblower tips. On March 4, 2021, the Commission announced the creation of the Climate and ESG Task Force in its Division of Enforcement, which is comprised of 22 enforcement attorneys and specialists who will analyze disclosure and compliance issues relating to "investment advisers' and funds' ESG strategies." The task force is charged with evaluating and pursuing whistleblower complaints on ESG-related issues. To highlight the SEC's interest in receiving these whistleblower complaints, the announcement included a link to the Commission's online portal which can be used to submit ESG-related tips, referrals, and complaints.

On April 9, 2021, the SEC's Division of Examinations issued a Risk Alert detailing staff observations from recent examinations of investment advisers, registered investment companies, and private funds engaged in ESG investing. These observations included "some instances of potentially misleading statements regarding ESG investing processes and representations regarding the adherence to global ESG frameworks" as well as "a lack of policies and procedures related to ESG investing; policies and procedures that did not appear to be reasonably designed to prevent violations of law, or that were not implemented; documentation of ESG-related investment decisions that

was weak or unclear; and compliance programs that did not appear to be reasonably designed to guard against inaccurate ESG-related disclosures and marketing materials," despite claims to the contrary.

On September 1, 2021, the Chair of the SEC, Gary Gensler, issued the Commission's most recent warning about ESG disclosures in prepared remarks made to the European Parliament Committee on Economic and Monetary Affairs. Chair Gensler stated that, " Many funds these days brand themselves as 'green,' 'sustainable,' 'low-carbon,' and so on. I've directed staff to review current practices and consider recommendations about whether fund managers should disclose the criteria and underlying data they use to market themselves as such."

Despite the SEC's aggressive enforcement posture on ESG disclosures, Gensler's recent remarks indicate that the SEC is still considering development of specific ESG disclosure requirements for ESG funds or funds that claim to incorporate ESG criteria into their investment strategies. Any enforcement action, therefore, would be based on existing, generally-applicable regulations that lack this specificity. For example, Rule 35d-1 under the Investment Company Act of 1940, the "Names Rule," requires a fund to invest at least 80% of its assets in the type of investment, industry, or geographic region suggested by its name. When applied to ESG funds and disclosures, there is significant ambiguity as to what is an ESG fund and what constitutes an ESG investment. As Commissioner Elad Roisman observed last year, "[i]n recent years, asset managers have proliferated in their creation of products labeled as 'ESG,' 'Green,' or 'Sustainable,'" but "there is no universal definition for any of these terms, and such products' investment philosophies and holdings can vary widely."

The SEC's Enhanced Use of Its Whistleblower Program as an Enforcement Tool

The SEC's Office of the Whistleblower (OWB) was formed in 2011, one year after the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) amended the Securities Exchange Act of 1934 by directing the SEC to pay monetary awards to eligible individuals who voluntarily provide original information leading to successful enforcement actions that result in monetary sanctions over $1 million and successful related actions. 15 U.S.C. § 78u-6. Awards range between 10% and 30% of the money collected. Dodd-Frank and the SEC's implementing rules include confidentiality protections for whistleblower submissions and prohibit employers from retaliating against whistleblowers for providing information to the SEC. 17 C.F.R. §§ 240.21F-7; 15 U.S.C. § 78u-6(h)(1).

In a prior Advisory, we analyzed how the SEC's fiscal year 2020 was a record-breaking year for the OWB in terms of whistleblower tips received and awards paid, and how fiscal year 2021 (which ends on September 30, 2021) will set new records. Moreover, on September 15, 2021, the SEC announced that the whistleblower program has now surpassed $1 billion in awards to individuals who provided information under the program since its inception. The number of tips, value of awards paid, and recent statements by Chair Gensler signaling his intent to strengthen the whistleblower rules underscore that the SEC views whistleblower tips as an important tool for the enforcement of the securities laws.

Convergence of the Two Landscapes: Implications and Practical Considerations

In light of these recent, converging ESG and whistleblower developments, there is likely to be an increase in internal and external whistleblower complaints concerning ESG disclosures and related issues. The SEC's focus on ESG-related funds and disclosures highlights the need for companies to take prompt action once they receive an internal report of potential misconduct regarding climate or other ESG disclosures. As a result, ESG-related funds, publicly traded companies, regulated entities, and other companies would be well-advised to consider the following:

- **Internal Whistleblower Communications.** Treat internal whistleblowers who report potential ESG disclosure misconduct in the same way as any other whistleblower who reports potential securities violations. Indeed, according to the SEC's 2020 Annual Report to Congress on the Whistleblower Program, 84% of SEC whistleblower awardees reported their concerns internally, in many cases to a direct supervisor, before or at the same time they reported out to the SEC. Companies should acknowledge whistleblowers and engage in appropriate communications if a whistleblower does not submit an internal report anonymously. A lack of communication following submission of an internal tip can result in misunderstandings and often a report out to a government agency.
- **Internal Reporting Framework.** Take steps to ensure that the current internal reporting framework for potential securities violations is sufficiently robust and flexible to identify, respond to, and investigate potential ESG disclosure misconduct. Companies that are able to conduct thorough internal investigations showing a clear, robust response to an internal tip will be better poised to effectively self-correct and have a defensible position if regulators or law enforcement later become involved.
- **Public Reporting Procedures.** Disclosure committees and audit committees of public companies should include ESG-related disclosure as an agenda item for discussion when developing, evaluating, and finalizing earnings releases, periodic reports, proxy statements, and other public disclosures. In particular, companies should recognize that the SEC is closely scrutinizing the use of generalities and should resist the temptation of "gilding the lily." ESG-related disclosures should have the same factual support as would be expected of all other public company disclosures.

- **ESG Policies, Procedures, and Internal Controls.** Consider conducting a risk assessment review of ESG policies, procedures, and internal controls. In particular, in light of the deficiencies noted in the SEC's Risk Alert, consider developing or reviewing current policies and procedures related to ESG investing and testing internal ESG-related controls for adequacy and proper functioning. Ensure that compliance programs are reasonably designed to capture inaccurate ESG-related disclosures or marketing materials.
- **Whistleblower Policies and Training.** Ensure that whistleblower policies and training are up-to-date. Review policies for clear mechanisms for internal reporting. To be effective, internal whistleblower policies should reflect a zero tolerance approach to retaliation so employees can feel comfortable reporting internally rather than externally in the first instance. Communicate the policy to your workforce. Target anti-retaliation training to middle management who are usually the first line recipients of tips from their direct reports.
- **Encouraging Internal Reporting for a Remote and Hybrid Workforce.** Consider a refresh on internal reporting campaigns for remote and hybrid workers to encourage and support internal reporting. Given the record numbers of whistleblower tips reported to the SEC during the pandemic, a fresh approach to internal reporting may be warranted. Provide clear reporting mechanisms that instill confidence, including anonymous reporting options.

Conclusion

Arnold & Porter's Financial Services and Securities Groups will continue to work with the Environmental Practice Group to monitor climate-related and other ESG developments in the financial services sector and to develop best practices for the firm's financial institution clients. If financial institutions or other companies are seeking advice on how to reduce risk related to whistleblowers or how to incorporate ESG factors—including climate-related considerations—into their business strategy, risk management, or disclosure processes, please contact any author of this Advisory or your regular Arnold & Porter contact.

**Andrew Johnson contributed to this Advisory. Mr. Johnson is a graduate of the University of California Hastings College of the Law and is employed at Arnold & Porter's Washington, DC office. Mr. Johnson is admitted only in California. He is not admitted to the practice of law in Washington, DC.*

Cooley

Whistleblower Complaints and Rewards Explode Worldwide

November 2021

What you need to know

Since the onset of the COVID-19 pandemic, the number of whistleblower complaints received by regulators has exploded on both sides of the Atlantic. On November 15, 2021, the US Securities and Exchange Commission (SEC) reported that it paid out more in whistleblower awards in fiscal year 2021 than in all prior years combined since the whistleblower program began in 2011. The agency announced that it paid out approximately $564 million to 108 individuals based on over 12,200 whistleblower tips – an approximately 76% increase in tips from fiscal year 2020. This comes after the agency reported a historic increase in the number of tips received in fiscal year 2020, including 6,900 whistleblower tips, which was the most it had ever received in a single fiscal year until that time. The trend is similar in Europe, with two notable whistleblower protection charities (Protect and WhistleB) reporting an increase of up to 40% in the number of whistleblowing complaints in 2020-21 when compared to previous years.

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COVID-19 itself is a major contributor to these growing whistleblower numbers. With many employees working from home, they may feel less connected to their employers and colleagues and more inclined to reach out to the authorities without first raising allegations to their employer (for example, by way of the confidential whistleblowing hotline maintained by the Financial Conduct Authority in the UK). In addition, whistleblowers may also find it easier to anonymously collect information relevant to their complaints when they have access to these materials from home.

Another factor is the exponentially growing size of financial incentives to blowing the whistle. In the past two years, for example, the SEC paid a $114 million award to a single whistleblower in October 2020 and a $110 million award

to a whistleblower in September 2021, as well as two $50 million awards paid out since the onset of the pandemic. With these awards, the program has now awarded more than $1.1 billion to whistleblowers since it began in 2011.

Expectations are that this trend will only accelerate in light of the new harmonized protection environment for whistleblowers in the European Union (see the EU Whistleblowing Directive due to be fully implemented by December 17, 2021). The legislation introduces new, broader protections to whistleblowers, not only during their working relationship with their employer, but also before they begin working and after they have left. While the UK is under no obligation to implement this new legislation, it is facing internal political pressure to pass legislation that broadly mirrors the rights and obligations contained within the directive.

In this environment of increased whistleblower complaints, it is vital that companies do two things well:

1. Be on the alert for whistleblowers and make sure they have an internal outlet for their complaints.
2. Have in place sound corporate governance policies and practices for handling complaints when they do arise.

Whistleblower hotlines

Well-designed whistleblower hotlines are critical for two reasons: Regulators in the US and the UK focus on them, and they encourage employees to report issues internally first, before reporting to a regulator. And the US Department of Justice (DOJ) corporate compliance program guidelines, the UK Bribery Act 2010 and the EU Whistleblowing Directive all make clear that regulators now expect companies to have strong whistleblower policies in place (with potentially serious inferences being drawn during an investigation in the absence of such policies). As such, effective whistleblower hotlines not only encourage internal reporting first – but may also help protect a company's position vis-à-vis regulators in the long run.

In evaluating a company's corporate governance framework, the DOJ considers an "efficient and trusted" whistleblower channel to be a "hallmark of a well-designed compliance program." In assessing the adequacy of a company's whistleblower channel, the first thing the agency asks is whether the company has an anonymous reporting mechanism such as a whistleblower hotline that is publicized to employees and which they feel comfortable using. Similarly, in the UK, the Department for Business, Energy & Industrial Strategy maintains a Code of Practice on whistleblowing, which notes that it is "good practice" for employers to "create an open, transparent and safe working environment where workers feel able to speak up" with "a facility for anonymous reporting." This is particularly important in the context of the Bribery Act 2010, under which it is a defense to an allegation of a failure to prevent bribery for an organization to demonstrate that it had "adequate procedures" in place designed to prevent such conduct. The UK Ministry of Justice's guidance makes it clear that whistleblowing policies and practice will be key elements to be assessed when determining whether a company has such "adequate procedures."

These days, the term "hotline" should be understood to refer to multiple avenues for submitting whistleblower complaints, including phone, email, text, mail and/or through a website, often managed by independent third-party providers. While there is no one-size-fits-all model for whistleblowing hotlines, a whistleblowing hotline should have several key features in order to promote good corporate governance. Among other things, a whistleblowing hotline should be:

- Toll-free, well publicized and accessible 24/7.
- Available with multilanguage support (as applicable).
- Anonymous, confidential and secure.

- Capable of escalating urgent matters to the executive level quickly (to the extent necessary).

Strategies for managing companies and other best practices

In addition to establishing and publicizing an anonymous whistleblower hotline, there are other best practices (outlined below) that companies should follow to handle whistleblower complaints to investigate properly, mitigate fall-out and be prepared for regulator inquiries.

Take whistleblower allegations seriously

All allegations should be appropriately investigated in order to determine what (if any) further action is required to correct the alleged misconduct. Resist the instinct to immediately question the veracity of the report or the motive of the whistleblower, and instead focus on the substance and seriousness of the complaint. Whistleblowers who are not taken seriously are more likely to report the allegations to regulators first without taking part in a company's internal investigation. In addition, while there are of course instances in which whistleblower complaints are ill-informed or conceived from bad motives, many are not. And an investigation that is compromised by skepticism about the whistleblower may not be objective and may compromise the company's ability to effectively respond, both internally and to regulators. To ensure that the allegations are viewed without skepticism, it will often be best practice for compliance, human resources or similarly situated departments – as opposed to the business chain of command – to bear principal responsibility for the investigation.

Know when to hire outside counsel and when to raise issues with auditors, the audit committee and/or board

Consulting with outside counsel early can ensure that the design of your whistleblower complaint investigation is sound, and the investigation is appropriately thorough. Depending on the significance of the matter, regulators may expect a thorough investigation conducted by external counsel, and may not view an internal investigation as independent. For example, complaints that rise to the level of misconduct by executives within the company, or relate to a company's financial reporting, may require external counsel and are best escalated quickly. Of course, retaining outside counsel can be particularly helpful when allegations relate to fraud or bribery. Not all whistleblower complaints will require the assistance of outside counsel, but an early assessment and consultation with counsel typically should be conducted.

Treat whistleblowers thoughtfully and respectfully, and stay in contact where possible

Treating whistleblowers with respect is not only key to a corporate culture that fosters openness and encourages those with complaints to report internally first, but it is also sound practice from an investigative standpoint, as it will encourage whistleblowers to remain communicative and provide as much detail and information about the allegation as possible.

Don't do anything that could be construed as retaliation or limiting communications between the whistleblower and regulators

In the US, the UK and the EU, whistleblower protections prohibit retaliation of any kind against a whistleblower. This includes explicit retaliation such as firing or demoting a whistleblower, as well as less-explicit retaliation such as changing a whistleblower's hours, excluding a whistleblower from training meetings that affect prospects for promotion, or even isolating or ostracizing the whistleblower.

Keep the whistleblower's identity confidential to the extent practicable

Knowing that confidentiality will be maintained to the maximum extent will encourage whistleblower use of a company's hotline and help avoid reporting outside of the company before first raising concerns internally. In addition, the fewer company officials and employees who know the whistleblower's identity or even the existence of

the whistleblower's complaint, the fewer opportunities for retaliation. Of course, there will be times that investigations require counsel and key company contacts to know the identity of the whistleblower in order to conduct an effective investigation.

Stay in contact with the whistleblower

If the whistleblower hasn't obtained outside counsel who won't allow such contact, interview and speak with the whistleblower as much as possible – and maintain ongoing contact throughout the investigation. This should include setting expectations with the whistleblower regarding how long an investigation might take, so that the time it takes to make a thorough inquiry isn't perceived as inattention to the complaint. While it won't be possible to share certain information with the whistleblower, keeping the whistleblower as informed as possible may prevent the whistleblower from reporting to the government out of a sense that the company is not taking the allegations seriously. This will better position the company to self-report if and when the time is right.

Consider whether – and when – to self-report whistleblower allegations

If the company uncovers potential wrongdoing while investigating a whistleblower allegation, it should consider with its attorneys whether and when to self-report the allegations to the relevant regulatory agency. Self-reporting – particularly if done early – may result in reduced penalties for wrongdoing. In many instances, if the above steps are followed, a whistleblower may feel heard and not inclined to report the alleged misconduct to the authorities at all.

Conclusion

In this environment of increased whistleblower complaints and scrutiny from regulators, all companies – even those that have not yet received whistleblower complaints – would benefit from conducting an internal review of their whistleblowing procedures and internal investigation capabilities to ensure they are appropriate for the size of the company and in line with current standards set by regulators. This will help the company be ready to respond appropriately if and when whistleblower complaints arise.

Notes

1. US Securities and Exchange Commission, "2021 Annual Report to Congress: Whistleblower Program," available at https://www.sec.gov/files/owb-2021-annual-report.pdf.

2. US Securities and Exchange Commission, "2020 Annual Report to Congress: Whistleblower Program," available at https://www.sec.gov/files/2020%20Annual%20Report_0.pdf.

3. Protect. "Our 2020 Impact Report – Record Number of Whistleblowers Supported," available at https://protect-advice.org.uk/our-2020-impact-report-record-number-of-whistleblowers-supported.

4. WhistleB. "Sharp Increase in Whistleblowers During Corona," available at https://whistleb.com/blog-news/sharp-increase-in-number-of-whistleblowers-during-corona.

5. US Securities and Exchange Commission, "Whistleblower Awards," available at https://www.sec.gov/page/whistleblower-100million.

6. US Securities and Exchange Commission, "2021 Annual Report to Congress: Whistleblower Program."

7. Directive (EU) 2019/1937. European Union, EUR-LEX, available at https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32019L1937

8. US Department of Justice (Criminal Division), "Evaluation of Corporate Compliance Programs"(updated June 2020), available at https://www.justice.gov/criminal-fraud/page/file/937501/download.

9. *Id.*

10. Department for Business, Energy & Industrial Strategy, "Whistleblowing: Guidance for Employers and Code of Practice," available at https://www.gov.uk/government/publications/whistleblowing-guidance-and-code-of-practice-for-employers.

11. See https://www.legislation.gov.uk/ukpga/2010/23/crossheading/failure-of-commercial-organisations-to-prevent-bribery.

12. Ministry of Justice, "The Bribery Act 2010 Guidance," available at https://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf.

13. See US Department of Labor, "Whistleblower Laws Enforced by OSHA," available at https://www.whistleblowers.gov; and the Employment Rights Act 1996 (as amended by the Public Interest Disclosure Act 1998), available at https://www.legislation.gov.uk/ukpga/1996/18/contents and https://www.legislation.gov.uk/ukpga/1998/23/contents.

GIBSON DUNN

November 3, 2021

NEW YORK EXPANDS WHISTLEBLOWER LAW

To Our Clients and Friends:

New York Governor Kathy Hochul recently signed a new law dramatically expanding protections for whistleblowers in New York. New York's whistleblower law (New York Labor Law Section 740) previously limited anti-retaliation protections to employees who raised concerns about "substantial and specific danger to the public health and safety" or "health care fraud". As outlined below, the amended law, which will go into effect on January 26, 2022, expands the scope of who is protected and what is deemed "protected activity" under Section 740. It also contains additional key changes and requirements for employers.

In sum, the amendments to Section 740:

- Broaden the categories of workers protected against retaliation;
- Expand the scope of protected activity entitling employees to anti-retaliation protection;
- Expand the definition of prohibited retaliatory action;
- Require employers to notify their employees of the whistleblower protections;
- Lengthen the statute of limitations for bringing a cause of action against an employer;
- Allow courts to order additional remedies; and
- Entitle plaintiffs to a jury trial.

Key Changes to NYLL Section 740

Below, we outline the key changes to New York's whistleblower law, effective January 26.

Expanding The Definition of "Employee" – The amendments expand the range of individuals protected from retaliation to include current and former employees as well as independent contractors.

Expanding Protected Activity – The amendments prohibit employers from retaliating against any employee because the employee:

a. discloses, or threatens to disclose to a supervisor or to a public body an activity, policy or practice of the employer that the *employee reasonably believes is in violation of law, rule or regulation*

or that the employee reasonably believes poses a substantial and specific danger to the public health or safety:

b. provides information to, or testifies before, any public body conducting an investigation, hearing or inquiry into such activity, policy or practice by such employer; or

c. objects to, or refuses to participate in any such activity, policy or practice.

Prior to the new amendments, the law required that, before disclosing violations to a public body, employees first report violations to their employer to afford employers a reasonable opportunity to correct the alleged violation. The new law merely requires employees make a "good faith" effort to notify their employer before disclosing the violation to a public body. Additionally, employer notification is not required for protection under the amended statute if the employee reasonably believes that reporting alleged wrongdoing to their employer will result in the destruction of evidence, other concealment, or harm to the employee, or if the employee reasonably believes that their supervisor is already aware of the practice and will not correct it.

Expanding Prohibited Retaliatory Action – Prior to the amendments, conduct constituting retaliatory action was limited to "discharge, suspension or demotion of an employee, or other adverse employment action taken against an employee in the terms and conditions of employment." Adverse action now also includes actions that would "adversely impact a former employee's current or future employment," including contacting immigration authorities or reporting the immigration status of employees or their family members.

Statute of Limitations – The new law expands the statute of limitations for filing a retaliation claim from one to two years.

Additional Remedies – Aggrieved plaintiffs are entitled to jury trials, and the amendments allow the recovery of front pay, civil penalties not to exceed $10,000, and punitive damages. Prevailing plaintiffs are also entitled injunctive relief, reinstatement, compensation for lost wages, benefits, and other remuneration, and reasonable costs, disbursements, and attorneys' fees. Notably though, if a court finds that a retaliation claim was brought "without basis in law or in fact," a court may award reasonable attorneys' fees and court costs and disbursements to the employer.

Employee Notification – Employers must post notice of the protections, rights, and obligations of employees under the law. Such notice should be posted conspicuously and in "accessible and well-lighted places." The New York Department of Labor will likely publish a model posting in advance of January 26.

Recommendations for Employers

In addition to complying with the new posting requirement, New York employers should consider steps to prepare for an uptick in internal complaints and potential claims. For example, employers may, as appropriate, consider revisiting their whistleblower and compliance policies, including opening up

additional channels for internal reporting of employee concerns. Employers may also consider additional training for managers on receiving and escalating whistleblower complaints, as appropriate.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Labor and Employment practice group, or the following authors:

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