



Investment Management Update

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*If you have any questions
about this Advisory,
please contact:*

RICHARD LEVAN
215.988.8316
rlevan@wiggin.com

CONOR MULLAN
215.988.8319
cmullan@wiggin.com

SEC Awards Million-Dollar Whistleblower Bounty to Compliance Professional

Last week, the U.S. Securities and Exchange Commission ("Commission" or "SEC") issued an order awarding as much as \$1.6 million to a "compliance officer" for information that helped the Commission resolve an enforcement action against his company. See SEC Rel. No. 74781 (April 22, 2015). This award was the first-ever award provided to a compliance officer and only the second such award provided to an employee with either internal audit or compliance responsibilities.

[1] As with all whistleblower awards, the identity of the whistleblower, the name of the company, the company's industry, and the nature of the misconduct were withheld from the public. Nonetheless, this award should serve as a reminder to investment advisers and all other companies subject to SEC jurisdiction that they should have adequate internal controls aimed at detecting misconduct and procedures for acting on internal whistleblower complaints.

The SEC's Whistleblower Program was adopted in 2011 pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Under Rule 21F of the Securities Exchange Act of 1934, which governs the SEC's Whistleblower Program, the SEC is required to pay awards to eligible whistleblowers who voluntarily provide the SEC with original information (i.e., information derived from the whistleblower's independent analysis) concerning any U.S. securities

law violations that leads to a successful enforcement action resulting in the recovery of more than \$1,000,000. Generally, employees whose principal duties involve compliance or internal audit responsibilities are ineligible for an award because their information is not obtained from their own independent analysis; uncovering misconduct and/or potential securities laws violations is their principal duty. See Rule 21F-4(b)(4)(iii)(B).[2]

There are, however, three exceptions to this general rule: (1) when the compliance professional believes that disclosure to the Commission is necessary to prevent substantial financial harm to the company or investors; (2) when the compliance professional believes that the company is engaging in conduct that will impede an investigation; or (3) when the compliance professional first reports the alleged violation internally and then waits at least 120 days before reporting it to the Commission. See Rule 21F-(b)(4)(v). According to the Commission's press release, the award provided to the compliance professional on April 22, 2015 was based on the first exception for reporting "misconduct after responsible management at the entity became aware of potentially impending harm to investors and failed to take steps to prevent it." This language also implies that the whistleblower first reported the misconduct internally, although it's not clear that he

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waited at least 120 days before alerting the Commission.

As noted above, this whistleblower award is the first-ever awarded to a compliance professional and we believe that such awards will continue to be extremely rare events. Nonetheless, the SEC's Order should serve as a reminder to investment advisers and other companies subject to SEC jurisdiction that all employees are potential whistleblowers and that the company should strengthen controls aimed at detecting and preventing misconduct, as well as procedures for acting on internal complaints. As a practical matter, most investment advisers' codes of ethics contain adequate policies and procedures for reporting misconduct, but seldom contain detailed information about how the recipient of the complaint should handle it. In the absence of such policies and procedures for responding to (and escalating) an internal

complaint, an adviser should consider: (1) revising its code of ethics; (2) creating separate written policies and procedures for, among other things, handling whistleblower complaints; and/or (3) training the person(s) designated to receive internal complaints on how to respond and escalate issues.

Please feel free to contact us if you have any questions regarding the SEC's Whistleblower Program or any related matter.

[1] See SEC Rel. No. 72947 (Aug. 29, 2014).

[2] This prohibition also applies to officers, directors, trustees and partners who receive information through a company's internal compliance program and employees of independent firms that have such responsibilities.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.