

AGENDA

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Five Questions Boards Must Ask About the Whistle-Blower Rule

By Diana Lloyd

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The SEC's new rule authorizing bounty payments to corporate whistle-blowers is giving directors pause. Boards are examining their companies' existing whistle-blower policies and considering the provision's likely consequences. *Agenda* asked **Diana Lloyd** about the questions boards should ask regarding the new rule. Lloyd is co-chair of the government enforcement and compliance practice group at **Choate, Hall & Stewart** in Boston. She has more than 20 years of experience representing Fortune 500 companies.

1. What impact will the new whistle-blower rules have on internal compliance programs?

Boards should direct companies to review their corporate compliance programs to ensure that the culture encourages employees to report suspected wrongdoing internally; that systems exist to handle internal reporting; and that mechanisms are in place to investigate allegations of misconduct promptly. An employee with an ax to grind may still contact the SEC to report wrongdoing that was previously investigated internally. However, companies will be in a much better position if they can demonstrate strong internal compliance programs.

2. How do the SEC's new whistle-blower rules change the landscape in the U.S.?

Since the standard for information that could entitle a whistle-blower to a lucrative award is extremely low, it creates a powerful economic incentive for individuals to run to the SEC at the slightest suggestion of wrongdoing. In some cases, the rules should help uncover real wrongdoing, but in many others, the result is likely to be a lot of wasted time and expense by the SEC and companies investigating meritless allegations.

3. Do the rules effectively address concerns about "a race to the bank," whereby employees ignore company policy and go directly to the SEC?

Boards have reason to be concerned about the SEC's decision not to require whistle-blowers to report their concerns internally first. With no incentive to report suspected violations of securities laws through a corporate compliance program, if the employee does not care about harm to the company, there will be greater interest in pursuing the potentially lucrative awards.

4. How can companies minimize potential liability once whistle-blowers have gone to the SEC?

There isn't a one-size-fits-all answer. If a whistle-blower has brought a bogus complaint, companies should cooperate promptly with the SEC and provide information demonstrating that the complaint lacks merit. Even in a situation where a violation of law has occurred, the company may be able to reduce its exposure by demonstrating the existence of a rigorous compliance program.

5. What long-term impact could these new rules have on fraud and governance in corporate America?

On the positive side, the rules may encourage stronger corporate compliance by incentivizing companies to strengthen their internal compliance programs. However, the likelihood of frivolous or trivial complaints is great, and the new rules are likely to prove costly for honestly run companies.