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For Whom the Whistle Blows

Advancing Corporate Compliance and Integrity
Efforts in the Era of Dodd-Frank

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Center for Corporate Ethics and Governance

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SUMMARY

In July 2010, President Barack Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, a lengthy statute that included a new mechanism for offering bounties to internal corporate “whistleblowers” who report instances of fraud to the SEC. Under the statute, such whistleblowers are entitled to an award (or “bounty”) of between 10 and 30 percent of any penalties or fees imposed in amounts greater than \$1 million. The SEC released a corresponding set of proposed whistleblower rules in November 2010 and, following a period of notice and comment, promulgated the final whistleblower rules on May 25, 2011. Perhaps the single most contentious feature of the new Dodd-Frank whistleblower regime is that the rules do *not* require that a corporate insider first make use of his or her company’s internal reporting channels as a prerequisite for access to the SEC and any potential award under Dodd-Frank.

The notions of Dodd-Frank awards and direct reporting to the SEC have been very controversial in the corporate community, raising concerns about opportunistic claims and the possibility that the new incentives could have the effect of sabotaging internal compliance in many organizations. Whistleblower advocates, on the other hand, have suggested that these fears are likely overblown and are contradicted by empirical data on analogous whistleblower litigation and claimants under the (longstanding) False Claims Act. The debate over the merits of the Dodd-Frank whistleblower scheme, and its likely impact on corporations, overshadows a deeper set of questions for policymakers and the corporate community—questions about how best to prevent corporate fraud and misconduct, how robust most companies’ internal compliance and reporting mechanisms truly are, and how best to reconcile internal reporting, compliance, and ethical corporate culture with the new reality of whistleblower awards under Dodd-Frank.

It was in this context that RAND convened a May 11, 2011, symposium, titled “For Whom the Whistle Blows: Corporate Whistleblowing, Federal Policy, and the Shifting Landscape of Corporate Compliance and Culture.” The aim of the symposium was to stimulate a broad conversation about the Dodd-Frank whistleblower provisions and about internal reporting and compliance oversight mechanisms within corporations. The symposium brought together a group of 20 senior thought leaders, drawing from the ranks of public company directors and executives, chief ethics and compliance officers (CECOs), and stakeholders from the government, industry, academic, and nonprofit sectors. Discussions focused on the probable impact of the new whistleblower rules on corporate America; the importance of internal compliance and reporting efforts to corporations, regulators, and employees alike; and concrete steps that could be taken to make organizational compliance and internal reporting mechanisms stronger in the era of Dodd-Frank.

Several major themes emerged from the symposium discussions. The first was the observation that employees are a prime resource for detecting corporate fraud and that they can

be a major asset to their own companies in that regard. This being said, it is often difficult to convince employees to come forward and report misconduct and fraud internally, in part because of concerns about confidentiality, the potential for management retaliation, and skepticism about whether management will act upon any reports received. These are problems with internal reporting that can and should be addressed, regardless of Dodd-Frank. A second general theme focused on ways to help deconflict internal reporting mechanisms and the Dodd-Frank whistleblower channel so that the former can be made maximally effective while use of the latter is minimized. The joint interests of the corporate community and the SEC are likely to be well served by this kind of “deconflicting,” to the extent reasonably practical. A third broad symposium theme highlighted the heightened incentive, in the era of Dodd-Frank, for companies to create an organizational culture in which employees can raise concerns safely within the organization. The goal is to make the internal reporting line the insider’s mechanism of choice. In this context, the group discussed the critical role of an empowered, senior-level chief compliance officer to oversee the compliance program and internal reporting system. In a related vein, the group also discussed the use of financial and non-financial incentives in connection with a variety of anti-fraud and corporate compliance goals.

INVITED REMARKS FROM FOUR PANELISTS

The initial session of the symposium was dedicated to invited remarks from four panelists who (respectively) represented the viewpoints of corporate defense counsel, whistleblower advocate, and CECO with regard to the impact and implications of the Dodd-Frank whistleblower rules. The speakers were Steven Pearlman, a partner at Seyfarth Shaw LLP; Stephen Kohn, executive director of the National Whistleblowers Center; Patrick Gnazzo, senior vice president and general manager for the U.S. public sector at CA Technologies (retired); and Joseph Murphy, public policy chair at the Society of Corporate Compliance and Ethics and Of Counsel at the Compliance Systems Legal Group (retired). Their remarks were based on invited white papers on the following topics (respectively): “New Whistleblower Policies and Incentives: A Paradigm Shift from ‘Oversight’ to ‘Insight,’” “The Impact of *Qui Tam* Whistleblower Rewards on Internal Compliance,” and “An Insider Perspective on Whistleblower Programs.” (The third paper was co-authored by Gnazzo and Murphy.) The three invited white papers were distributed to symposium participants in advance of the meeting on May 11 to set context and facilitate a dynamic discussion.

EXPLORING THE NEW WORLD ORDER: WHISTLEBLOWER CHALLENGES FOR CORPORATE MANAGEMENT AND GOVERNANCE

The second session of the symposium involved a moderated discussion of the challenges posed by the new whistleblower regime under Dodd-Frank, particularly the incentives for direct reporting of fraud by corporate insiders to the SEC. The session opened with some reflections on the problems that have long confronted internal corporate compliance and

reporting programs and that often cause the programs to fall short of their expected goals of preventing and detecting misconduct. The question was raised: How much difference will Dodd-Frank and the new whistleblower incentives truly make to internal compliance efforts? Notably, it was observed that boards and senior management already face some of the same basic problems in promoting effective internal compliance and reporting, regardless of the Dodd-Frank whistleblower rules. It was also observed that differences of opinion over the new whistleblower roles tie back, in part, to perceptions of how well current corporate compliance mechanisms are actually working. Critics of the rules tend to view internal compliance efforts as adequate but broadly threatened by the prospect of whistleblower bounties and direct reporting to the SEC, whereas advocates for the Dodd-Frank rules tend to view existing internal compliance efforts and reporting channels as inadequate or insubstantial in too many instances.

The session's opening remarks also underscored the importance of improving the ways in which companies manage their internal reporting mechanisms—encouraging adequate resourcing, board-level oversight, more consistent and professional investigation protocols, and more meaningful protection of internal whistleblowers from retaliation—all of which require strong, independent leadership in the role of the CECO. Participants noted that this is a key set of issues to consider in making internal corporate reporting more robust and in reducing the attractiveness of an external whistleblowing pathway for employees.

Some of the ensuing discussions touched on the specific role of boards in dealing with whistleblower issues, the responsibilities of the CECO and how that particular management role relates to whistleblower issues, and the connection between whistleblowing (whether internal or external) and corporate culture. The reality that corporate misbehavior and ethically dubious conduct remain serious problems in the United States and abroad, despite widespread awareness and recent scandals, was also a significant theme of conversation. Session participants generally agreed on several points:

- Boards of directors play an important role in reinforcing internal reporting mechanisms and ethical culture.
- Empowered leadership for internal reporting, in the form of a senior-level, experienced CECO, is vital to the success of compliance and ethics (C&E) programs and internal reporting mechanisms.
- Creating a culture in which internal reporting is valued—and in which those who report are protected—is critical to preventing and detecting misconduct internally.
- Financial and non-financial incentives could be used by corporations to make internal corporate reporting mechanisms more effective.
- From the perspective of the employee, trust in the system is a key motivator in coming forward and reporting internally.

CORPORATE INTEGRITY IN THE WAKE OF DODD-FRANK: HOW DO WE FORTIFY INTERNAL COMPLIANCE, REPORTING, AND CULTURE?

Participants in the final session of the symposium focused more deeply on the aim of reinforcing corporate compliance efforts and culture and on policy and practice interventions that could help companies accomplish this goal. Introductory remarks during this session observed that even if a corporation's compliance and internal reporting mechanisms initially work well, these efforts can erode over time (and through subsequent generations of management) when there is a lack of abiding institutional commitment behind them. Questions were raised about the best ways to use financial and non-financial incentives to support lasting C&E performance and about the potential for regulatory policies that might support managers in the CECO role in establishing a more aggressive anti-retaliatory posture. It was emphasized again that the ultimate strategy for strengthening internal reporting mechanisms involves embedding these mechanisms in a broader corporate "culture of integrity," in which employees recognize themselves as accountable for safeguarding the reputation of the company and in which they feel protected and encouraged in coming forward to report instances of wrongdoing or misconduct. Much of the discussion in this session touched on the public policy avenues for supporting stronger corporate culture and internal compliance efforts and for reconciling that support with the new external whistleblowing framework established under Dodd-Frank.

The major points of discussion and agreement during the session included the following:

- New requirements for C&E expertise on boards and on key board and executive committees should be considered.
- The SEC should publicize more regulatory data in support of strong compliance efforts and offer incentives to create a robust and independent CECO role.
- Tangible steps can be taken to reinforce C&E and internal reporting lines, such as addressing employees' fears about retaliation and ineffective follow-through.
- Internal reporting and external whistleblowing need not be viewed as antithetical and mutually exclusive.
- Ongoing dialogue between the compliance community and the SEC can help facilitate more effective internal and external reporting processes and, thus, better compliance efforts in the future.