
Whistleblowers May Rule

BY TOM LAUERMAN

Pending regulatory reform proposals would give “whistleblowers” unprecedented opportunity and incentive to make trouble for broker-dealers, investment advisers, investment companies and other persons who are subject to the federal securities laws.

Under the proposals, if original information voluntarily provided to the SEC by a whistleblower leads the SEC to bring an administrative or judicial action that results in monetary sanctions exceeding \$1 million, the SEC could reward the whistleblower with as much as 30% of the monetary sanctions resulting from the action (and any related actions). In order to be potentially eligible for such an award, a whistleblower need not be an officer or employee of the subject firm, but could instead be, for example, a service provider or any other person having knowledge of the firm’s affairs.

These proposals could have numerous perverse consequences, including:

- Individuals who could prevent, remedy, or promptly report improper conduct might instead delay, in hopes that the matter would ultimately ripen into a much more serious problem about which they could profitably inform the SEC.
- Where a whistleblower’s testimony is relied on to establish the substance of any violation, the potential reward would incentivize false testimony. And multiple whistleblowers could conspire to corroborate each others’ false testimony and be rewarded for doing so.
- Because the proposal would give the SEC broad discretion whether to make awards and in what amounts, the SEC would face the conflict of controlling the compensation of whistleblower-witnesses in proceedings to which the SEC is a party.
- Although the proposals would prohibit any award to a whistleblower who was criminally convicted in the matter, criminal securities law convictions are rare. It would appear possible that awards could be made to “whistleblowers” who themselves were culpable in the matter, though not criminally convicted.

These proposals, which are currently being considered by Congress as part of the proposed Investor Protection Act of 2009, have received far less critical attention than they deserve.

SEC Limits Affiliate Marketing

BY PATRICK LAVELLE

The SEC’s newly-adopted Regulation S-AM goes into effect June 1, 2010, which will limit the ability of certain financial firms to use for marketing purposes any consumer “Eligibility Information” received from the firms’ affiliates. The new restrictions will apply to “Covered Persons,” which include brokers, dealers, investment companies, investment advisers and transfer agents.

The SEC’s current privacy regulation (Regulation S-P) limits financial firms’ sharing of nonpublic personal financial information about a consumer with other persons, but generally permits such sharing among affiliates. Regulation S-AM will not change this, in that consumer Eligibility Information that is not used to market products or services may be freely shared among affiliates as permitted under Regulation S-P without complying with Regulation S-AM requirements.

Under Regulation S-AM, however, a Covered Person may use Eligibility Information received from an affiliate to make a marketing solicitation only if the consumer:

- is provided a “clear and conspicuous” notice of the information’s intended use;
- is provided a reasonable opportunity and method for opting-out of receiving marketing solicitations; and
- does not make such an “opt-out” request.

The notice required by Regulation S-AM may be combined with other disclosures, including the annual privacy notice required by Regulation S-P.

The scope of the Eligibility Information that is subject to Regulation S-AM is not entirely clear.

Under the applicable definitions, Eligibility Information generally includes information bearing on a consumer’s creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living that is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer’s eligibility for credit or insurance to be used primarily for personal, family or household purposes, employment purposes or other purposes as authorized by the Fair Credit Reporting Act. The SEC so far has declined to provide much guidance on the meaning of this definition.