

30 June 2020

Lynne Egan
Chair of the State Legislation Committee

Faith Anderson
Chair of the Whistleblower Protections/Awards Working Group

Re: NASAA Proposed Model Whistleblower Award and Protection Act

Dear Lynne and Faith,

CFA Institute¹ appreciates the opportunity to comment on NASAA's proposed model whistleblower award and protection act. CFA Institute supports NASAA efforts to establish a strong and clearly understood whistleblower rule that will encourage the reporting of high-quality information when such reporting is called for. A sound and easily understood whistleblower program can help to discourage certain behavior by some market participants. However, for a whistleblower program of this type to be effective, certain tensions must be balanced. First, the regulations must establish the proper process to sort out meritorious claims. Second, it must recognize the importance of honoring the internal compliance and reporting process in balancing the whistleblower incentives so as not to override what is a core corporate function. Third, the rule must offer legitimate whistleblower protection to those with the courage to step forward.

CFA Institute commented on this topic in 2011 in a letter to the SEC on their proposed whistleblower program, and it will be instructive to NASAA to review that comment letter.²

The Act

NASAA is seeking public comments on a proposed Model Whistleblower Award and Protection Act (the "Act"). The proposed Act would be adopted and applied on a state and local level and draws upon the whistleblower award provisions contained in Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the SEC's related rules in Regulation 21F, Indiana Code § 23-19-7, and Utah Code § 61-1-101 et. seq.

¹¹ CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 77 countries and territories.

² <https://www.cfainstitute.org/-/media/documents/comment-letter/2010-2014/20110118.ashx>

The intent of this legislation is to incentivize individuals who have knowledge of potential securities law violations to make reports to state regulators in the interest of investor protection. The Act provides not only for monetary awards to whistleblowers, but also protections for those who make whistleblower complaints, including an express cause of action against employers that retaliate against whistleblowers.

If adopted and implemented, the proposed Act would, in summary:

- provide a state's securities regulator with the authority to make monetary awards to whistleblowers based on the amount of monetary sanctions collected in the related administrative or judicial action;
- provide that the aggregate amount of awards made in connection with an administrative or judicial action shall be 10-30% of the monetary sanctions collected.
- Set forth certain non-exclusive factors to be considered in determining the amount of an award;
- Disqualify certain individuals from eligibility for a whistleblower award;
- Prohibit retaliation by an employer against a whistleblower;
- Create a cause of action and establish relief for whistleblowers that are retaliated against by their employers;
- Exempt information that would identify the whistleblower from public disclosure;
- Invalidate waivers of the rights and remedies available under the Act;
- Contain an optional bracketed provision granting rulemaking authority under the Act to the securities regulator.

Many of the provisions within the Act deal with definitions of terms, the authority to make a whistleblower award, and the amounts of whistleblower awards. CFA Institute has no disagreement with NASAA on any of these matters, though our main area of interest in this proposed Act deals with the whistleblower protections discussed in section 9 of the proposal.

Protection of whistleblower

(1) Prohibition against retaliation. No employer may terminate, discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner retaliate against, a whistleblower because of any lawful act done by the whistleblower:

- a. in providing information to the [Securities Division] in accordance with this Act;
- b. in initiating, testifying in, or assisting in any investigation or administrative or judicial action of the [Securities Administrator] or [Securities Division] based upon or related to such information; or
- c. in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.); the Securities Act of 1933 (15 U.S.C. 77a et seq.); the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.); 18 U.S.C. 1513(e); any other law, rule, or regulation subject to the jurisdiction of the Securities and Exchange Commission; or [the Securities Act of this State] or a rule adopted thereunder.

(2) Exceptions from protection against retaliation. Notwithstanding subsection (1) of this section, a whistleblower is not protected under this section if:

- a. the whistleblower knowingly [or recklessly] makes a false, fictitious, or fraudulent statement or misrepresentation;
- b. the whistleblower uses a false writing or document knowing that[, or with reckless disregard as to whether,] the writing or document contains false, fictitious, or fraudulent information; or
- c. the whistleblower knows that[, or has a reckless disregard as to whether,] the disclosure is of original information that is false or frivolous.

CFA Institute agrees with the whistleblower protections and exceptions proposed by NASAA. We believe these protections will encourage legitimate whistleblowers to come forward without the fear of retaliation if they have pertinent information of wrongdoing. We also feel that the exceptions that NASAA has detailed should discourage those without a legitimate whistleblowing claim.

Statute of Limitations

We agree with the statute of limitations set out in to proposed act. The proposed act states that an action may not be brought more than 6 years after the date on which the violation occurred, or more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the employee alleging a violation. We believe this time frame gives a potential whistleblower a reasonable amount of time to come forward with an accusation of wrongdoing.

Confidentiality

CFA Institute agrees with the confidentiality protections considered in the proposed Act. The Act as written states that information that could reasonably be expected to reveal the identity of a whistleblower is exempt from public disclosure. This does not limit the ability of the any person to present evidence to a grand jury or to share evidence with potential witnesses or defendants in the course of an ongoing criminal investigation.

Other Considerations

In defining the circumstance under which individuals can be eligible for whistleblower awards, we support including as “independent knowledge” that knowledge that is not direct, first-hand knowledge, but is instead learned from others, subject to the accuracy of the information, together with an exclusion for knowledge learned from publicly available sources. A whistleblower may not always receive firsthand knowledge of illegal activity but may instead learn of such activity from others. An exclusion of such “second-hand” sources may discourage whistleblowers with meaningful information from coming forward. However, there need to be protections to ensure that such an independent knowledge standard does not invite false

whistleblower claims from individuals who claim to have a whistleblower claim but are instead third parties with no indirect knowledge intent on causing problems for a firm, its employees and its investors.

We feel that the whistleblower process should work with a company's internal compliance mechanisms and should not be seen either as a substitute for or a way to circumvent a company's internal reporting structures. A potential whistleblower should receive credit with providing original information as of the date of their submission to any company legal, compliance, or audit position, thereby encouraging potential whistleblowers to work first and foremost through company channels.

CFA Institute believes that NASAA should ensure that no person may take any action to prevent a whistleblower from communicating directly with the NASAA. Such efforts would include trying to enforce, or threatening to enforce, a confidentiality agreement with respect to such communications. This approach continues to encourage whistleblowers to step forward to disclose potential violation in keeping with the underlying intent of the rule.

We therefore invite NASAA to discuss this and other related matters at your convenience. Should you have any questions about our positions, please do not hesitate to contact James Allen, CFA james.allen@cfainstitute.org, or Matt Orsagh at matt.orsagh@cfainstitute.org.

Sincerely,

/s/ Jim Allen
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