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New SEC Whistleblowing Rules: Impact on FCPA Compliance

Enhancing Internal Reporting Procedures and Meeting New Investigation and Disclosure Challenges

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*New SEC Whistleblower Rules:
Impact on FCPA Compliance*

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The Dodd-Frank Whistleblower Rules

Background

- The Dodd-Frank Act established a whistleblower program (Exchange Act Section 21F) that requires the SEC to pay awards to eligible whistleblowers for reporting securities law violations under certain circumstances.
 - Awards will be paid out of the Investor Protection Fund, which currently has a balance in excess of \$450 million.
- SEC implementing rules adopted May 25, 2011

General Framework

- Require payment of 10 to 30 percent of monetary sanctions obtained
 - To eligible whistleblowers
 - Who voluntarily provide
 - Original information about a possible violation of the federal securities laws (e.g. FCPA)
 - Leading to successful enforcement action with sanctions exceeding \$1 million

Bounty provisions: *who is eligible?*

- Almost anyone can be a Dodd-Frank whistleblower
- Can remain anonymous by reporting through counsel
- No exclusion for persons involved in misconduct, unless they are criminally convicted
 - But no amnesty for whistleblowers
- Excluded persons
 - Regulatory and law enforcement personnel
 - Independent public accountants (for information obtained in course of an audit)
 - Non-natural persons
 - Lawyers - *under most circumstances*
 - Compliance personnel - *under some circumstances*

What kind of information must be provided?

- “Original” information
 - *Not previously known to authorities*
- Must be provided “voluntarily”
 - *i.e., before the whistleblower or the whistleblower’s representative receives a request for information from the SEC, PCAOB, SRO, Congress, federal government, state attorney general or securities regulatory authority*
- Whistleblower is eligible for a bounty even if the information was obtained in violation of:
 - Privileges other than attorney-client
 - Civil law
 - Criminal law (unless convicted of violation)

What information does *not* qualify for a bounty?

- “Excluded” information
 - Information subject to attorney-client privilege
 - *Unless* “up the ladder” or ethics exception applies
 - Information received by compliance and internal audit personnel, officers, and supervisors as part of internal compliance process – unless:
 - Company doesn’t self-report within 120 days, or
 - “*Reasonable basis to believe*” that:
 - Company is engaged in conduct that will impede an investigation of the misconduct; or
 - Disclosure is necessary to prevent substantial injury to company or shareholders

Anti-retaliation provisions

- No retaliation permitted by employer if an employee qualifies as whistleblower
 - Employer may not discharge, demote, threaten or discriminate against whistleblower
 - SEC can bring enforcement action against the employer for retaliation
 - Whistleblower also has federal right of action to enforce this provision
 - Compare with SOX remedy of DOL action.

What Has Not Changed

- Dodd-Frank's whistleblower provisions do not require any new compliance program provisions.
 - Unlike other recent regulations, this rule does not require companies to implement new policies and procedures
 - Contrast with SOX Whistleblower Provisions
- At the same time, companies involved in any activities that might be subject to the federal securities laws may want to assure that they have done all that they can to encourage internal reporting of potential wrongdoing.

Tension with Corporate Compliance Efforts

- No requirement that employees first report concerns internally
 - SEC rule seeks to “not discourage” employees from first reporting to the company
 - SEC “may” (but need not) consider higher percentage awards for those who first report internally

Tension with Corporate Compliance Efforts

- Internal investigations
 - Attorney-client privileged information is generally secure – *but*:
 - Company personnel who learn of a potential FCPA issue by being questioned in an internal review can qualify for the bounty
 - Compliance, internal audit, supervisory personnel become eligible for bounties where company fails to report to SEC within 120 days

The Goal – Get Ahead of the Issue

- Proactive vs. reactive approaches
 - If a company is not the first to learn of potential FCPA violations, the chances now seem very much increased that the SEC will learn of the issues from a whistleblower.
 - This will have an impact on both FCPA internal investigations and voluntary disclosure decisions.



*Whistleblower Rule Impact on FCPA
Investigations and Disclosures*

FCPA Enforcement Trends

- Historic levels of FCPA enforcement continue against companies and individuals
- 40 DOJ and 31 SEC enforcement actions in 2010
- Over 100 companies under investigation
- More than half of recent DOJ enforcement actions triggered by voluntary disclosures
- Trend of multi-jurisdictional investigations and private litigation against companies and directors relating to FCPA issues continues unabated

Mandatory FCPA Disclosure Considerations

- Generally self-disclosure of a potential FCPA violation is not required
- However, disclosure may be legally required under certain circumstances
- Sarbanes-Oxley Act of 2002 may require disclosure of FCPA violations that preclude management from certifying the effectiveness of internal controls or that involve fraud
- 10A Report from Outside Auditors could require Audit Committee to disclose potential FCPA violations to the SEC

The Potential Benefits of Disclosure

- DOJ Memos on Prosecution of Business Organizations (US Attorneys' Manual)
 - “Timely and voluntary disclosure of wrongdoing”
- SEC: Seaboard Report (October 2001)
 - “Promptly, completely and effectively disclose the existence of misconduct”
- There are strong incentives to voluntarily disclose FCPA violations and cooperate in investigations by U.S. regulatory authorities

The Potential Benefits of Disclosure

- **U.S. Sentencing Guidelines Manual 8C2.5(g)(1)**

“If an organization (A) prior to the imminent threat of disclosure or government investigation; and (B) within a reasonably prompt time after becoming aware of the offense, reported the offense to appropriate authorities, fully cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, [it shall receive a 5 point reduction in its total culpability score].”

Potential Benefits of Disclosure

- There is some empirical evidence that voluntary disclosures result in lower fines
- Self-disclosure will make it more likely that DOJ/SEC will rely on the company's investigation
- Voluntary disclosure allows the company to present issues in the best possible light and to advocate for mitigating circumstances
- Self-disclosure provides an opportunity to focus the investigation on particular conduct and minimize disruption to other business operations

Risks of Voluntary Disclosure

- Risk of triggering comprehensive global investigation by SEC/DOJ (e.g. Avon Products)
- Potential for substantial penalties, disruption to business (e.g. compliance monitor), damage to reputation and parallel civil litigation and foreign investigations
- Possible waiver of privilege
- Potential loss of control over remediation efforts

Voluntary Disclosure Considerations

- Nature of conduct (e.g. amount of payments, level of employees, geographic scope)
- Jurisdictional considerations (e.g. U.S nexus for anti-bribery provision; consolidation for accounting provisions)
- Nature of control environment (e.g. systemic failure; lack of oversight)
- Feasibility of self-remediation
- Likelihood that will come to SEC/DOJ attention through other means (e.g. whistleblowers)

Dodd-Frank impact on “self-reporting” decisions

- Only the first person to report information to the SEC will be eligible for a bounty
- Companies may seek to report first to obtain cooperation credit
- *Changes the calculus of the self-reporting decision*
 - Greater chance that FCPA violations will come to SEC attention
 - Greater risk that whistleblower will report FCPA violations before the company does

Impact on Investigations and Disclosures

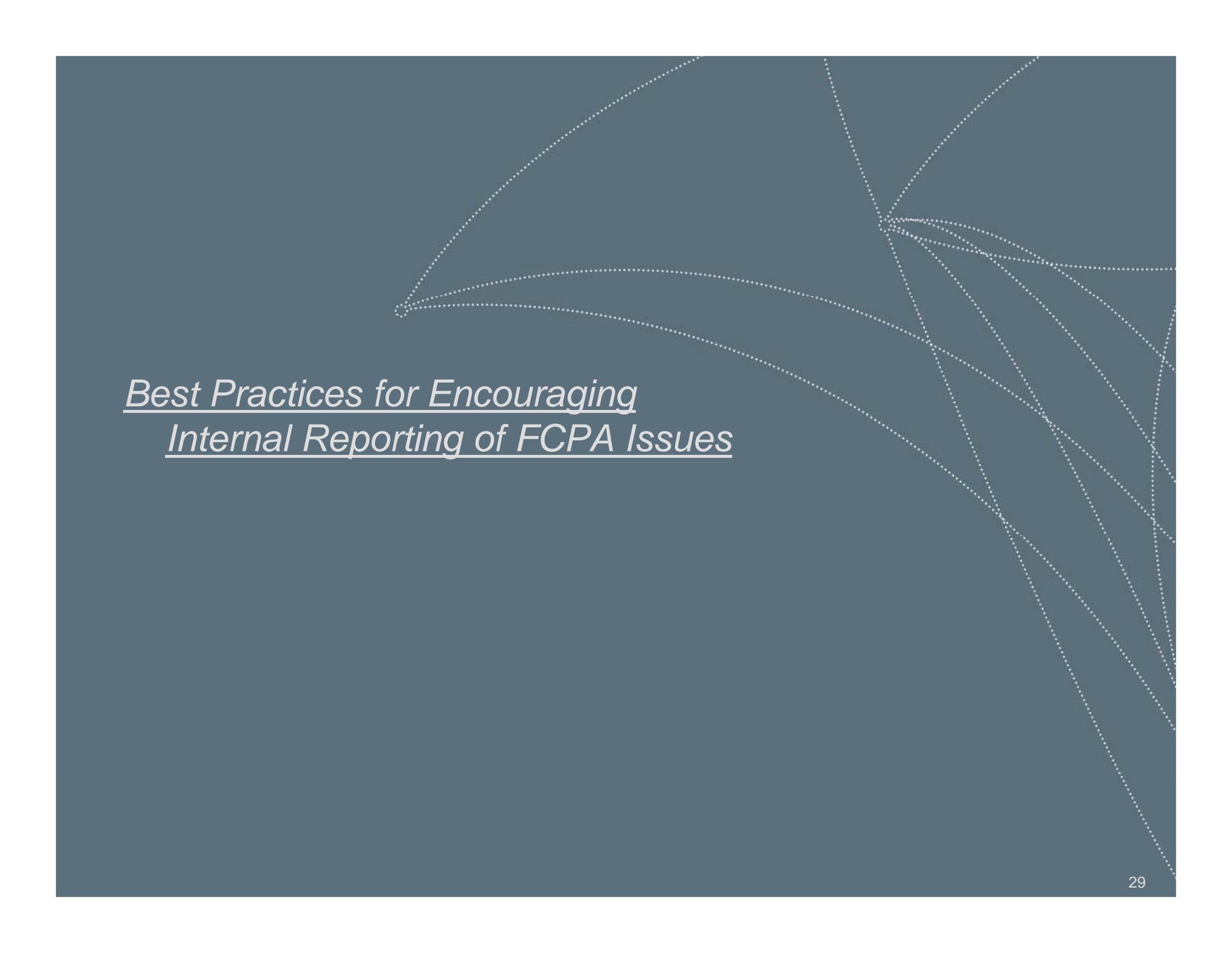
- Likely will increase number of FCPA internal investigations and self-disclosures
- Companies will have to make the voluntary disclosure decision within a compressed timeframe to account for whistleblower considerations
- Will impact how internal FCPA investigations are conducted (e.g. who is contacted, what information is shared and with whom, who is updated as to status and progress)

Be prepared to respond to SEC Enforcement

- SEC Enforcement Staff may contact companies about whistleblower reports
 - In most cases will offer companies the opportunity to investigate and report back
 - Significant advantages in cost and control
 - Staff will need to be confident that company will cooperate and conduct credible inquiry
 - Advance planning can position company to make an appropriate response

Responding to Internal Reports

- Act on any internal reports of FCPA issues quickly
 - Conduct an internal investigation of the issue
 - Depending on the magnitude of the issue and whether senior personnel may be implicated, consider having an independent third party conduct the investigation
 - Report findings up the chain
 - Consider reporting back to internal whistleblower the results of the investigation and corrective action taken, if any



*Best Practices for Encouraging
Internal Reporting of FCPA Issues*

Encouraging internal reporting

- Seek to maximize the possibility that the company will be the first to know of potential wrongdoing
- Promote the expectation that the company wants to know about potential wrongdoing
 - Appeal to shared values, like integrity
 - Remind personnel of the risks posed by illegal conduct
 - Explain the company's need to know of employee concerns (particularly in foreign jurisdictions following M&A transactions)

Encouraging internal reporting

- Require internal reporting in corporate policies
- Actively encourage reporting of genuine concerns – even if they turn out to be mistaken.
 - Provide clear instructions on how to report
 - Offer alternative ways to report
 - Describe what the company will do with reports
 - Prompt investigation by independent personnel
- Make clear that retaliation will not be tolerated (even though this concept may be unfamiliar in foreign jurisdictions)

Reinforcing the Message

- How to make your internal reporting regime more effective:
 - It all starts with the tone at the top
 - If management is not behind the mandate, the battle is already lost
 - Tell them how to report and make internal reporting easy (toll-free numbers, drop boxes and open channels)
 - Give people peace of mind – outline how reports will be handled
 - Remind them that the company will not retaliate

Reinforcing the Message

- How to make your internal reporting regime more effective:
 - Training of the rank and file and their supervisors
 - Win the hearts and minds and the rest will follow
 - a.k.a. the “eyes and ears” speech
 - Interviewing departing personnel
 - A last chance to get ahead of the issue
 - Consider local law issues
- Challenges of reinforcing these messages in foreign jurisdictions (particularly after acquisitions)

Internal Whistleblower Policy Will Not Cure All

- No policy, standing alone, is sufficient to ensure the success of a company's system for the reporting of potential wrongdoing.
 - At best, a policy can serve as a statement of principals and intentions that must be proven, again and again, by actions that meet those standards.

Enhance FCPA compliance systems

- Make systems more proactive / less passive
- Update periodically based on emerging risks and any changes in business model or geographic scope of operations
- Conduct periodic FCPA risk assessments
- Active monitoring of FCPA compliance by company and third-party agents
- Retrospective auditing of compliance (particularly following M&A transactions)

Reduce the risk of retaliation claims

- Limit the number of individuals aware of the identities of whistleblowers
- Do not seek to identify anonymous whistleblowers
- Provide training for managers at all levels
- Adhere to best practices for employee evaluations
 - Document fully and accurately
 - Review performance honestly and timely
- Exercise extra caution with employees who may use whistleblowing as an offensive strategy

Challenges of Encouraging Internal FCPA Reporting in China

- “Whistleblowing” familiar (post-1949 political movements), yet distinctive from usage in US context
- Post '49, ‘whistleblowing’ behaviors were often used offensively to attack enemies, not so much as a protective mechanism
- This overlays how reporting is used today
- “Hotlines” or other anonymous mechanisms for reporting concerns – useful, but potential for abuse

Contact Information

Questions?

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