Client Update
SEC Brings Two Enforcement Actions Against Employers for Taking Steps to Impede Whistleblower Activity

NEW YORK
Jyotin Hamid
jhamid@debevoise.com

Mary Beth Hogan
mbhogan@debevoise.com

WASHINGTON, D.C.
Julie M. Riewe
jriewe@debevoise.com

Jonathan R. Tuttle
jrtuttle@debevoise.com

Ada Fernandez Johnson
afjohnson@debevoise.com

Arian M. June
ajune@debevoise.com

Mark D. Flinn
mflinn@debevoise.com

Ryan M. Kusmin
rmkusmin@debevoise.com

The U.S. Securities and Exchange Commission ("SEC" or the "Commission") this week announced two enforcement actions against employers for taking steps to impede protected whistleblower activity. Both cases involved the use of separation agreements that required departing employees to waive their ability to recover whistleblower awards for reporting alleged misconduct to the SEC; the SEC also alleged that one of the firms took other actions to impede its employees from communicating with SEC staff. According to the Commission, such separation agreements and actions violate Section 21F of the Dodd-Frank Act and Exchange Act Rule 21F-17 by, among other things, "removing the critically important financial incentives" intended to encourage individuals to report possible securities law violations to the SEC.

JANUARY 19 SETTLEMENT ORDER

On January 19, 2017, a Seattle-based financial services company agreed to pay a $500,000 penalty to settle charges that it applied improper hedge accounting and took steps to impede whistleblower activity after the hedge accounting errors were discovered.[1] The company's treasurer also agreed to pay a $20,000 penalty to settle allegations that he caused the accounting violations.

The company publicly disclosed the accounting errors in its Form 10-Q for the third quarter of 2014, and received a voluntary document request from the SEC's Division of Enforcement in mid-2015. The SEC order states that the company assumed this request could have been prompted by a whistleblower complaint, and alleges that HomeStreet began taking steps to identify the presumed whistleblower and, in the process, impeded whistleblower activity in violation of Exchange Act Rule 21F-17. In particular, the SEC alleged that company

[1] *In the Matter of HomeStreet, Inc. and Darrell Van Amen*, Exchange Act Rel. No. 79844 (Jan. 19, 2017).

executives repeatedly asked two employees who had been close to the hedge accounting issue whether they were whistleblowers. The company also hesitated to honor an indemnification agreement for one of these employees, who had since left the company but was still responding to SEC requests. While the SEC's order states that Commission was unaware of any current or former employee who did not communicate directly with Commission staff about the company's hedge accounting errors, the Commission found that the company nonetheless "acted to impede individuals from communicating directly with the Commission staff about a possible securities law violation." Additionally, the SEC order states that one form of the company's separation agreements required departing employees to waive "any damages or monetary recovery" from "any government agency."

In accepting the company's settlement offer, the SEC considered certain remedial measures taken, including that the company disclosed its hedge accounting errors and revised its separation agreements to clearly state that its employees are entitled "to receive an award for information provided to any Government Agencies." The company also agreed to make reasonable efforts to notify former employees who signed the problematic severance agreements that the company does not prohibit former employees from reporting information to the SEC or from seeking and obtaining an SEC whistleblower award.

JANUARY 17 SETTLEMENT ORDER

On January 17, 2017, a New York-based asset manager agreed to pay a $340,000 penalty to settle allegations that it required more than 1,000 departing employees to sign separation agreements under which the employees could only receive severance payments if they agreed to "waive any right to recovery of incentives for reporting of misconduct, including, without limitation, under the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Sarbanes-Oxley Act of 2002."[2] According to the SEC order, the asset manager added this provision to its separation agreements in October 2011, two months after the SEC adopted Rule 21F-17, and the firm continued to use the provision until March 2016, when it was removed as part of a regular periodic review. The SEC order also notes that the asset manager's separation agreements did not prohibit departing employees from communicating with the Commission or other government agencies, and that the Commission is not aware of instances in which the agreements indirectly prevented such communications.

2 *In the Matter of BlackRock, Inc.*, Exchange Act Rel. No. 79804 (Jan. 17, 2017).

In accepting the settlement, the SEC considered the asset manager's voluntary decision to revise its separation agreements before the firm was contacted by the Commission. Additionally, the order recognizes certain remedial measures that the asset manager has taken, including the implementation of mandatory training sessions that explain employees' rights under the SEC's whistleblower program. The firm has also updated its code of ethics and other relevant agreements, policies, and procedures to further communicate these rights, and it agreed to notify former employees who signed the prior separation agreements that they are not prohibited from seeking or obtaining an SEC whistleblower award.

ANALYSIS

Section 21F of the Securities Exchange Act of 1934 ("Exchange Act") and rules promulgated thereunder provide whistleblower protections and incentives, including a bounty program for individuals that report original information to the SEC. One such rule, Exchange Act Rule 21F-17(a), specifically prohibits "any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement."[3] In the January 17 settlement order, the SEC alleged that the asset manager's prior separation agreements "undermine the purpose of Section 21F and Rule 21F-17(a), which is to 'encourag[e] individuals to report to the Commission' and violate Rule 21F-17(a) by impeding individuals from communicating directly with the Commission staff about possible securities law violations."

In August 2016, the SEC brought its first two enforcement actions—against BlueLinx Holdings, Inc. ("BlueLinx") and Health Net, Inc. ("Health Net")[4]—alleging violations of Rule 21F-17 based on separation agreements that prohibited former employees from collecting whistleblower awards. In both, the SEC alleged that the defendants' separation agreements required departing employees to waive their right to obtain whistleblower awards from the SEC and other federal agencies. Additionally, Health Net made such waivers a condition of receiving severance payments and other benefits from the company. As part of their settlements with the SEC, both BlueLinx and Health Net revised their

---

3 17 C.F.R. § 240.21F-17(a).

4 *In the Matter of BlueLinx Holdings, Inc.*, Exchange Act Release No. 78528 (Aug. 10, 2016); *In the Matter of Health Net, Inc.*, Exchange Act Release No. 78590 (Aug. 16, 2016). *See also* Debevoise & Plimpton LLP, Client Update: SEC Brings Action Against Employer for Agreements Requiring Employees to Waive Recovery if They Blow the Whistle (Aug. 11, 2016), *available at* http://www.debevoise.com/insights/publications/2016/08/sec-brings-action-against-employer-for-agreements.

severance agreements and agreed to pay civil penalties of $265,000 and $340,000, respectively. The companies also agreed to notify former employees who had signed the firms' prior agreements that they are not prohibited from seeking or obtaining a whistleblower award from the Commission.

Relatedly, in October 2016, the SEC's Office of Compliance Inspections and Examinations ("OCIE") published a risk alert notifying registered investment advisers and registered broker-dealers that OCIE exams will be focusing on violations of Rule 21F-17.[5] The risk alert specifically referred to the BlueLinx and Health Net enforcement actions described above, noting that the OCIE staff will be reviewing a variety of documents, including:

- Compliance manuals;
- Codes of ethics;
- Employment agreements; and
- Separation agreements.

The alert states that, in their review of these documents, OCIE staff will assess whether these documents restrict current or former employees' ability to communicate with the Commission.[6] OCIE's new focus on Rule 21F-17, coupled with this week's whistleblower enforcement actions, underscores the heightened scrutiny that asset managers should expect under this area of the whistleblower provisions.

KEY TAKE-AWAYS

This week's whistleblower actions are yet another reminder for employers to take the following actions to comply with the SEC's whistleblower rules:

- Avoid any activities that seek, or could be seen as seeking, to prevent or discourage whistleblowing complaints.
- Review all agreements with current and former employees to ensure that they do not contain provisions that can be read as prohibiting, discouraging

---

5 OCIE, SEC Risk Alert: Examining Whistleblower Rule Compliance (Oct. 24, 2016), *available at* http://www.sec.gov/ocie/announcement/ocie-2016-risk-alert-examining-whistleblower-rule-compliance.pdf.

6 *See* Debevoise & Plimpton LLP, Client Update: SEC Exams Focus on Whistleblower Compliance by Investment Advisers and Brokers (Oct. 26, 2016), *available at* http://www.debevoise.com/insights/publications/2016/10/sec-exams-focus-on-whistleblower-compliance.

or interfering with protected whistleblowing activities, including communication with the SEC and the collection of whistleblower awards. If prior agreements are found to contain such restrictions, firms should consult with counsel on the appropriate steps to address these agreements.

- Review confidentiality agreements, codes of conduct and compliance manuals for similar restrictive language.
- Review and amend personnel policies, employee handbooks, training materials, and other similar documents to ensure that employees clearly understand their rights under Dodd-Frank's whistleblower rules.

* * *

Please do not hesitate to contact us with any questions.