

Statement of the Investment Company Institute
Hearing on “Legislative Proposals to Address the Negative
Consequences of the Dodd-Frank Whistleblower Provisions”

Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives

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The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). The Institute seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of the Institute manage total assets of \$13.1 trillion and serve over 90 million shareholders.

The Institute has very serious concerns about the unintended consequences that are likely to result from the manner in which the U.S. Securities and Exchange Commission has designed its proposed whistleblower program under Section 922 of the Dodd-Frank Act. We are pleased that the Subcommittee is holding this hearing to explore these concerns in further detail and to consider legislation, such as that sponsored by Representative Grimm, to address them.

Our principal concern with the SEC’s proposal is that, fundamentally, it lacks any meaningful respect for internal compliance programs. While the Commission’s public comments and proposing release are replete with statements expressing the Commission’s concern with respecting internal compliance programs and the Commission’s interest in encouraging whistleblowers not to circumvent such programs, *there is absolutely nothing in the rules’ text that speaks to reporting through internal compliance programs*. We find this disconnect between the Commission’s public statements and its proposed rules to be very troubling.

This disconnect is particularly troubling for our members because, pursuant to Rule 38a-1 under the Investment Company Act of 1940, which was adopted in December 2003, *each registered investment company is required by law to have a robust compliance program to ensure compliance with the Federal securities laws*. The advisers that manage these funds are under similar obligations. These programs must: have extensive written policies and procedures; be reviewed at least annually to determine the effectiveness of the policies and procedures and any material compliance concerns; be overseen by a Chief Compliance Officer who reports to the fund’s trustees; and ensure that fund boards trustees are annually provided a written report on how the compliance program is functioning. We have very serious concerns about the Commission adopting a whistleblower program that both ignores the existence of such robust programs and permits all employees – including senior managers,

compliance professionals, and culpable individuals, among others – to first report any suspected violation of the Federal securities laws to the Commission. As noted in our comment letter to the Commission, we strongly believe that the ability of the funds to discover, whether through its internal whistleblower program as mandated by SOX or otherwise, and redress violations of the Federal securities laws is crucial to the success of these compliance programs.

The Institute’s comment letter to the Commission also expressed our serious misgivings with the proposed rules implicitly imposing upon all SEC registrants a duty to self-report all violations of the Federal securities laws. In the absence of any requirement under the Federal securities laws to report all violations of law, the Commission has long been interested in incentivizing such self reporting. However, rather than imposing a requirement directly, it has sought to impose it indirectly by making certain senior and compliance personnel eligible for a whistleblower reward *if the company fails to self-report the violation*. We find this backdoor method of imposing self-reporting on all SEC registrants to be very troubling.

We are also concerned with the profiteering that can be expected to occur from the SEC’s rules. As noted in our comment letter, lawyers have already launched websites, begun aggressive advertising campaigns, and are cold calling financial services employees to attract whistleblowers on the promises of riches to come.

The Commission’s rules are largely silent regarding the anti-retaliatory provisions in the law. As noted in our letter, that silence may lull some employees into thinking that, so long as they obtain whistleblower status under the Commission’s rules, they are immune from any adverse action on their employment (*e.g.*, demotion or firing) even when the conduct in question is unrelated to the reporting of information to the Commission.” Clarity about the precise protections afforded by whistleblower status is necessary for all parties.

All of these concerns are described more fully in our comment letter to the SEC, which is attached.

We are very pleased that the Subcommittee will be exploring these and other negative consequences of the Commission’s rules. We are also pleased that Representative Grimm has put forth a discussion draft bill that addresses the above concerns. This draft bill would: preserve the viability of internal reporting regimes by requiring whistleblowers, except in limited circumstances, to report wrongdoing through internal channels before reporting to the SEC; require the SEC to notify a registrant of a whistleblower’s allegations, except in limited circumstances, so the registrant can investigate and redress the alleged violations; prohibit whistleblowers who are involved in the misconduct from being rewarded for such misconduct; prohibit attorneys from entering into contingency fee arrangements with whistleblowers; and clarify the limits on the law’s anti-retaliatory provisions.

We support each of these reforms, which will go a long way towards addressing the serious adverse consequences that can be expected to flow from the Commission's proposed whistleblower rules. We thank the Subcommittee for holding this hearing and for the work it is doing to address these issues.