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WHISTLEBLOWERS—A CASE STUDY IN THE REGULATORY CYCLE FOR FINANCIAL SERVICES

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"Whistleblower—a person who informs on another or makes public disclosure of corruption or wrongdoing"[1]

ABSTRACT

The Securities and Exchange Commission and the Commodity Futures Trading Commission were directed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) to create whistleblower protection programs that reward informants with massive bounty payments. At the time of its passage, the Dodd-Frank Act was a highly controversial statute that was passed on partisan lines. Its whistleblowing authority was one of its "most contentious provisions." As the result of the 2016 elections, the Dodd-Frank Act has come under renewed attack in Congress and by the new Trump administration. The stage is being set for possible repeal of major parts of that legislation, including its whistleblowing provisions. The scope of this anti-retaliation prohibition has also just been narrowly interpreted by the Supreme Court. This Article shows why the Dodd-Frank whistleblowing authority was ill-considered, how its present application undercuts other regulatory programs that seek to prevent and deter violations, and proposes some reforms.

INTRODUCTION

The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) were directed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) to create whistleblower protection programs that reward informants with massive bounty payments.[2] At the time of its passage, the Dodd-Frank Act was a

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1. *Whistle-blower*, DICTIONARY.COM, http://www.dictionary.com/browse/whistle—blower (last visited Jan. 28, 2018). "The term 'whistleblower' originates from a practice of English constables, who would blow their whistles to inform other officers that help was needed." Timothy J. Fitzmaurice, Note, *The Scope of Protected Activity Under Section 806 of SOX*, 80 FORDHAM L. REV. 2041, 2046 (2012) (citation omitted).

2. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, §§ 748, 922, 124 Stat. 1380, 1381 (2010) (codified in 15 U.S.C. § 78n (2012)). The Dodd-Frank whistleblower programs seek to protect informants from retaliation by their employers when reporting violations of securities or commodities laws. They also authorize monetary awards to whistleblowers when they provide information that results in a successful prosecution, which assesses civil penalties from which the bounty can be paid. *See, e.g.*, Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Exchange Act

highly controversial statute that was passed on partisan lines.[3] Its whistleblowing authority was one of its "most contentious provisions."[4] As a result of the 2016 elections, the Dodd-Frank Act has come under renewed attack in Congress and by the new Trump administration.[5] The stage is being set for possible repeal of parts of that legislation, including its whistleblowing provisions.[6]

This process of regulation and deregulation is a now familiar part of the regulatory cycle for financial services, which operates as follows: (1) a financial crisis occurs; (2) Congress enacts legislation that supposedly corrects the regulatory flaws that precipitated the crisis; and (3) when the economy recovers, complaints of over-regulation lead to a roll back in regulation.[7] This Article advocates an alternative to this regulatory cycle that uses a more measured approach to the enactment of financial services legislation. It uses the whistleblowing provisions in the Dodd-Frank Act as a case study for demonstrating why this regulatory cycle is both ineffective and inefficient.

Section I of this Article describes the whistleblower programs mandated by the Dodd-Frank Act and the SEC and CFTC rules and cases implementing that authority. Section II then traces the creation and history of the financial regulatory cycle, using some illustrative examples of how that cycle played out in various financial service sectors. Section III shows how the Dodd-Frank whistleblowing authority is simply another iteration of those cycles and how its present application undercuts other regulatory programs that seek to prevent and deter violations. Finally, Section IV of the Article proposes reforms addressing the concerns raised by the SEC and CFTC whistleblowing programs.

Release No. 34-64545, 76 Fed. Reg. 34,300 (June 13, 2011), *available at* https://www.sec.gov/rules/final/2011/34-64545.pdf.

3. *See generally* Victoria Finkle, *Why the Battle Over Dodd-Frank Will Never End*, AM. BANKER (July 1, 2015, 12:21 PM), https://www.americanbanker.com/news/why-the-battle-over-dodd-frank-will-never-end (describing why controversy persists over that legislation).

4. *Divided U.S. SEC Approves Whistleblower Rule*, REUTERS (May 25, 2011, 11:43 AM), http://uk.reuters.com/article/sec-whistleblower-rule-idUKWEN365220110525.

5. President Trump has promised to do a "big number" on Dodd-Frank. Nathan Dean et al., *The Trump Era: Rolling Back Financial Regulation*, BLOOMBERG (May 9, 2017), https://www.bloomberg.com/professional/blog/trump-era-rolling-back-financial-regulation/.

6. *See How the Trump Administration May Impact the Oversight and Enforcement of Dodd-Frank's Whistleblower Provisions*, NAT'L L. F. (Mar. 6, 2017), http://nationallawforum.com/2017/03/06/trump-administration-may-impact-oversight-enforcement-dodd-franks-whistleblower-protections/ [hereinafter NATIONAL LAW FORUM].

7. *See* Charles Lane, *Republicans Begin Hearings to Peel Back Dodd-Frank*, NAT'L PUB. RADIO (Apr. 26, 2017, 5:03 AM), http://www.npr.org/2017/04/26/525675210/republicans-begin-hearings-to-peel-back-dodd-frank (describing this cycle of regulation and deregulation).

I. THE DODD-FRANK WHISTLEBLOWING AUTHORITY

A. SEC AND CFTC WHISTLEBLOWING RULES PROVE TO BE CONTROVERSIAL

Section 922 of the Dodd-Frank Act directed the SEC to create a whistleblowing program that protects and rewards employees who provide information regarding alleged securities law violations by public companies.[8] The SEC implemented that authority by adding a new Part 21F to its regulations.[9] Section 748 of Dodd-Frank Act granted the same authority to the CFTC.[10] The CFTC adopted a new Part 165 to its rules implementing that authority.[11] In adopting those rules, the CFTC "endeavored to harmonize its whistleblower rules with those of the SEC."[12]

The SEC's whistleblowing proposals were approved by a divided vote (3-2) of the SEC commissioners on May 25, 2011.[13] The vote by the CFTC commissioners on its whistleblowing rules was 4-1.[14] The divided votes at the SEC and CFTC were along party lines and reflected the partisan nature of the whistleblowing and other provisions in Dodd-Frank.[15] Indeed, the SEC whistleblower rules had "grown to become one of the most contentious

8. Section 922 of Dodd-Frank added a new Section 21F to the Securities Exchange Act of 1934 which contains the SEC whistleblowing authority. *See* Dodd-Frank Act § 922, 15 U.S.C. § 78u-6 (2012).

9. 17 C.F.R. § 240.21F-1 *et seq.* (2017). The SEC's Office of the Whistleblower provides significant information and details related to its whistleblower program. *Office of the Whistleblower*, U.S. SEC. & EXCHANGE COMMISSION, www.sec.gov/whistleblower/ (last modified Jan. 22, 2018). In support of its whistleblower programs, the SEC's Office of Compliance Inspections and Examinations issued a "Risk Alert" in October 2016, which stated that this Office will analyze and review internal whistleblower programs offered by broker-dealers and investment advisers. The Risk Alert warned that the SEC staff, in connection with its examinations and audits of SEC registrants, will evaluate compliance manuals, codes of ethics, employment agreements, and severance agreements for whistleblowing concerns. *See* SEC Off. of Compliance Inspections and Examinations, *Examining Whistleblower Rule Compliance*, SEC NAT'L EXAM PROGRAM RISK ALERT, Vol. VI, Iss. 1, Oct. 24, 2016. The CFTC has also provided guidance on its whistleblowing programs. *The Whistleblower Program*, U.S. COMMODITY FUTURES TRADING COMMISSION, https://whistleblower.gov (last visited Mar. 24, 2018); *see also* 17 C.F.R. § 165.

10. Section 748 of Dodd-Frank added this authority to the Commodity Exchange Act of 1936. Dodd-Frank Act § 748, 7 U.S.C. § 26 (2012).

11. 17 C.F.R. § 165.1 *et seq.* (2017).

12. Whistleblower Incentives and Protection, 76 Fed. Reg. 53,172 (Aug. 25, 2011) (codified at 17 C.F.R. pt. 165). For information on the CFTC's whistleblower program, visit its website at: www.cftc.gov and add "whistleblower" to the search window. *See generally* Lisa J. Banks, *The CFTC Whistleblower Practice Guide*, KATZ, MARSHALL & BANKS LLP (Feb. 2016), https://www.scribd.com/document/302888133/CFTC-Whistleblower-Practice-Guide (providing guidance on accessing the CFTC whistleblowing program).

13. *Divided U.S. SEC Approves Whistleblower Rule*, *supra* note 4. The statutes authorizing the appointment of SEC and CFTC Commissioners prohibit more than three members from the same political party from serving on those Commissions. *See* 15 U.S.C. § 78d(a); 7 U.S.C. § 2(a)(2)(A)(ii).

14. Whistleblower Incentives and Protection, 76 Fed. Reg. at 53,172.

15. *Id.*

provisions required under the Dodd-Frank Wall Street overhaul law."[16] Among other things, critics charged that the new rules would undercut employer internal compliance programs.[17] It is claimed that large monetary bounties provide employees with an incentive to keep their employers in the dark about ongoing violations, at least until the SEC acts, a process that could take years.[18]

B. SCOPE OF THE WHISTLEBLOWING RULES

The SEC and CFTC whistleblower rules define a "whistleblower" as a person "alone or jointly with others" who provides the SEC or CFTC with information that "relates to a possible violation" of the federal securities or commodities laws "including any rules or regulations thereunder[] that has occurred, is ongoing, or is about to occur."[19] The rules provide that the agencies will pay awards to whistleblowers who: (1) voluntarily provide the agencies; (2) with "original information"; (3) that leads to a successful federal court or administrative enforcement action; (4) in which the agency obtains monetary sanctions totaling more than $1,000,000.[20] In order to be eligible for a bounty, the "original information" provided to the SEC or CFTC must be information that is not available from publicly available sources and is "derived from [the whistleblower's] independent knowledge or independent analysis [that is] [n]ot already known to the Commission from any other source . . . ."[21] The information provided by the whistleblower must be "sufficiently specific, credible, and timely" to cause the agency staff to "commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination . . . ."[22]

The rules of the SEC and CFTC grant themselves considerable discretion to decide the percentage (between ten to thirty percent) of the amount of the bounty awarded to a whistleblower.[23] SEC and CFTC rules require the information provided by the whistleblower and the identity of the whistleblower to be kept confidential unless such disclosure is required in

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16. *Divided U.S. SEC Approves Whistleblower Rule*, *supra* note 4.

17. *Id.*

18. *See generally* Edward Wyatt, *Overcoming Dissenters, S.E.C. Adopts Revised Whistle-Blower Rules*, N.Y. TIMES (May 26, 2011), http://query.nytimes.com/gst/fullpage.html?res=9E00E0DC133AF935A15756C0A9679D8B63 (describing criticism of SEC whistleblower rules).

19. 17 C.F.R. §§ 240.21F-2(a) (2017); *see also* 17 C.F.R. § 165.2(p); *see also infra* Section D regarding the recent Supreme Court decision in *Digital Realty Trust, Inc. v. Somers*, 138 S. Ct. 767 (2018), which strictly defined the term "whistleblower."

20. 17 C.F.R. § 240.21F-3(a); *see also* 17 C.F.R. § 165.2 (similar provisions imposed by the CFTC).

21. 17 C.F.R. § 240.21F-4(b)(1); *see also* 17 C.F.R. § 165.2(g) (CFTC rule).

22. 17 C.F.R. § 240.21F-4(c); *see also* 17 C.F.R. § 165.2(i) (CFTC rule).

23. 17 C.F.R. § 240.21F-5; *see also* 17 C.F.R. § 165.8 (CFTC rule). SEC Rule 21F-6 sets forth the criteria that the SEC may consider in issuing an award. 17 C.F.R. § 240.21F-6; *see also* 17 C.F.R. § 165.9 (CFTC rule).

connection with a federal court or administrative action.[24] The SEC and CFTC whistleblower rules also provide for appeals from decisions made by the SEC and CFTC in connection with the granting or denying of an award.[25]

C. AGENCY ACTIONS ON WHISTLEBLOWING

The SEC whistleblower program has proved to be popular with tipsters. In fiscal year 2016, the SEC received over 4,200 whistleblower tips, a forty percent increase over the first year of the program which began in 2012.[26] By extrapolating these figures, it appears that the SEC has probably received over 10,000 tips since the implementation of its whistleblower program. By June 2017, the SEC had awarded over $175 million in bounties to whistleblowers.[27] Several of the SEC's bounty payments were in the millions of dollars, including awards of $83 million,[28] $30 million, $22 million, $20 million, $17 million and $4 million.[29]

The CFTC's whistleblower program has not been as generous or as popular as the one at the SEC. In fairness, although the whistleblower numbers at the CFTC pale in comparison to those at the SEC,[30] the CFTC's regulatory turf is much smaller than that of the SEC, which regulates large public companies, as well as exchanges, broker-dealers, and other financial services professionals whose counterparts are regulated by the CFTC.[31] The CFTC's first whistleblower bounty was not issued until May 2014, and the whistleblower in that case received a comparatively modest amount of $240,000.[32] Another CFTC whistleblower award was issued in 2016, in which only $50,000 was awarded.[33] However, on April 4, 2016, the CFTC issued a whistleblower award of over $10 million.[34]

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24. 17 C.F.R. § 240.21F-7; *see also* 17 C.F.R. § 165.4 (CFTC rule).

25. 17 C.F.R. §§ 240. 21F-9–10, 12–13; *see also* 17 C.F.R. § 165.13 (CFTC rule).

26. *See* SEC, 2016 ANNUAL REPORT TO CONGRESS ON THE DODD-FRANK WHISTLEBLOWER PROGRAM 1 (2016), https://www.sec.gov/whistleblower/reportspubs/annual-reports/owb-annual-report-2016.pdf [hereinafter SEC 2016 ANNUAL REPORT].

27. *Whistleblower Awards Over $150 Million*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/page/whistleblower-100million (last modified Jan. 23, 2017).

28. The SEC issued its most recent and largest award on March 19, 2018 worth $50 million being split with two persons and one receiving $33 million. See Press Release, SEC, SEC Announces Its Largest-Ever Whistleblower Awards (March 19, 2018), *available at* https://www.sec.gov/news/press-release/2018-44.

29. *See Whistleblower Awards Over $150 Million*, *supra* note 27.

30. *See supra* notes 27–29 and accompanying text.

31. The CFTC also strengthened its anti-retaliation protections for whistleblowers on May 22, 2017. *See* Press Release, CFTC, CFTC Strengthens Anti-Retaliation Protections for Whistleblowers and Enhances the Award Claims Review Process (May 22, 2017), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7559-17.

32. Press Release, CFTC, CFTC Issues First Whistleblower Award (May 20, 2014), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6933-14.

33. Press Release, CFTC, CFTC Announces Fourth Whistleblower Award (July 26, 2016), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7411-16.

34. Press Release, CFTC, CFTC Announces Whistleblower Award of More Than $10 Million (Apr. 4, 2016), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7351-16.

The SEC has otherwise demonstrated an aggressive approach to the enforcement of its whistleblower rules. For example, in *In re NeuStar, Inc.*, [35] the SEC accepted an offer of settlement from a public company in an enforcement action that was the result of disclosures made by a whistleblower. The SEC found that NeuStar had entered into voluntary severance agreements that prohibited employees leaving the company from whistleblowing to the SEC with respect to activities they observed during their employment.[36] The SEC noted that at least 246 NeuStar employees had signed such severance agreements.[37] The SEC's investigation prompted NeuStar to remove this provision from its severance agreements and to advise employees signing such agreements that they were not prohibited from communicating with the SEC. The respondent also agreed to pay a civil penalty of $180,000.[38]

The SEC took even stronger action in *In re SandRidge Energy*.[39] In that case, SandRidge Energy and twenty-four affiliates filed petitions for relief under Chapter 11 of the Bankruptcy Code on May 16, 2016.[40] The company then entered into separation agreements with approximately 546 employees, which stated in part that "a former employee may not . . . at any time in the future voluntarily contact or participate with any governmental agency in connection with any complaint or investigation pertaining to [SandRidge] . . . ."[41] The separation agreement also required employees to agree "not to make any independent use of or disclose to any other person or organization, including any governmental agency, any of [SandRidge's] confidential, proprietary information unless the employee obtained [SandRidge's] prior written consent" or to "defame, disparage or make statements or disparaging remarks which could embarrass or cause harm to SandRidge's name and reputation . . . ."[42] The SEC consent order required SandRidge to pay a fine of $1,400,000 to the SEC.[43]

35. NeuStar, Inc., Exchange Act Release No. 79593, 2016 WL 7335658 (Dec. 19, 2016).

36. These severance agreements stated: "I [employee] agree not to engage in any communication that disparages, denigrates, maligns or impugns NeuStar or its officers, directors, shareholders, investors, potential investors, partners . . . [to] . . . regulators (including but not limited to the Securities and Exchange Commission . . . .)." *Id.*

37. *Id.*

38. *Id.*

39. SandRidge Energy, Inc., Exchange Act Release No. 79607, 2016 WL 7368270 (Dec. 20, 2016).

40. *Id.*

41. *Id.*

42. *Id.*

43. There was a whistleblower in the *SandRidge* case but it is not known whether that person was given a monetary bounty since most such payments are confidential. *Id. NeuStar* and *SandRidge* were both settled in December 2016. *See supra* notes 35 and 39. Three other noteworthy whistleblower cases were settled by the SEC just a few months before *NeuStar* and *SandRidge*. *See* Health Net, Inc., Exchange Act Release No. 78590, 2016 WL 4474755 (Aug. 16, 2016); BlueLinx Holdings Inc., Exchange Act Release No. 78528, 2016 WL 4363864 (Aug. 10, 2016); KBR, Inc., Exchange Act Release No. 74619, 111 SEC Docket 917 (Apr. 1, 2015).

D. JUDICIAL DECISIONS ON SEC WHISTLEBLOWERS

Several courts have considered the scope and application of the SEC's Dodd-Frank whistleblowing rules. For example, the Second Circuit rejected extraterritorial application of those provisions.[44] Other courts have enforced pre-dispute arbitration agreements with respect to actions by whistleblowers.[45] An issue recently resolved by the Supreme Court was whether whistleblowers seeking Dodd-Frank protection were required to make an internal disclosure to their employers and an external disclosure to the SEC.[46] In other words, is it permissible to grant Dodd-Frank protection to a whistleblower who makes only one such disclosure, either internally to the employer or externally to the SEC? A split in the circuits had arisen over this reporting issue.

In *Asadi v. G.E. Energy (USA), LLC*,[47] the Fifth Circuit held that both internal and external disclosures are required in order for a whistleblower to be protected under Dodd-Frank.[48] In contrast, the Second Circuit in *Berman v. Neo@Ogilvy LLC*, deferred to SEC rules that interpreted the Dodd-Frank whistleblower authority[49] to protect a whistleblower who made disclosures internally to his employer but not externally to the SEC.[50] The Ninth Circuit followed the Second Circuit's approach in *Somers v. Digital Reality Trust, Inc.*[51] There, the Ninth Circuit held that the SEC's whistleblower rules had correctly implemented congressional intent to protect whistleblowers making internal disclosures as well as to those making disclosures to the SEC.[52] In essence, the Ninth Circuit supported the language from Sarbanes-Oxley Act of 2002 (SOX) that allowed for internal disclosures by a whistleblower to be sufficient to warrant protection.

On February 21, 2018, the Supreme Court reversed the Ninth Circuit's decision in *Somers* and required whistleblowers, in order to receive the anti-retaliation protections and any whistleblower awards, to make such disclosures, at a minimum, to the SEC.[53] In a unanimous decision, Justice

44. Meng-Lin v. Siemens AG, 763 F.3d 175 (2d Cir. 2014).

45. *See* John K. Lisman, Note, *Arbitration Agreement Arbitrage?: Statutory Discrepancy Leads to Third Circuit Victory for Dodd-Frank Whistleblower Defendants in Khazin v. TD Ameritrade Holding Corp.*, 60 VILL. L. REV. 753, 763–64 (2015) (describing these cases).

46. Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018).

47. Asadi v. G.E. Energy (USA), LLC, 720 F.3d 620 (5th Cir. 2013).

48. *Id.*

49. Berman v. Neo@Ogilvy LLC*,* 801 F.3d 145, 155 (2d Cir. 2015).

50. *Id.* at 153. SEC Rule 21F-4(c) provides for a disclosure either internally within the respective company or directly to the SEC. *See* 17 C.F.R. § 240.21F-4(c) (2017).

51. Somers v. Dig. Realty Tr., Inc., 850 F.3d 1045 (9th Cir. 2017), *cert. granted*, No. 16-1276, 2017 U.S. LEXIS 4190 (June 26, 2017).

52. *See* Ronald H. Filler, *Ask the Professor: What is the Impact of the Recent 9th Circuit Case of Paul Somers v. Digital Realty Trust, Inc. et al., on the Dodd-Frank's Anti-Retaliation Provision Involving Whistleblowers?*, 37 FUTURES & DERIVATIVES L. REP., June 2017, at 12 (describing that holding).

53. Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 772–73 (2018).

Ginsburg wrote that "Dodd-Frank delineates a more circumscribed class; it defines 'whistleblower' to means a person who provides 'information relating to a violation of the securities laws to the Commission.'"[54] Somers never made any such disclosures to the SEC, only internally. The Supreme Court emphasized the more recent whistleblower provision from the Dodd-Frank Act, stating that Section 78u-6 affords covered whistleblowers both incentives (e.g., the awards between ten to thirty percent of any monetary fines) and protections but, in order to receive such incentives and protections, the whistleblower is required to disclose the violation of the securities laws to the SEC.[55] The Court further disagreed with the SEC in adopting its Regulation 21F, which provided for two definitions of a "whistleblower."[56] Finally, the Supreme Court disagreed with the Ninth Circuit's reasoning that requiring a disclosure only to the SEC would narrow the third clause of §78u-6(h)(1)(A).[57] The Supreme Court held that the definition of a "whistleblower" unequivocally requires the whistleblower to make a disclosure to the SEC.[58]

This new Supreme Court decision will obviously affect important issues connected with the Dodd-Frank whistleblower provisions, as well as SEC internal compliance standards adopted under SOX.[59] Section 404 of SOX requires public companies to establish internal systems for employees to report potential violations to management so that the company can correct such problems.[60] The bounty system for whistleblowers under the Dodd-Frank Act threatens to undercut the effectiveness of the compliance programs under Section 404 that require public companies to spend billions of dollars annually to maintain. This is because the prospect of a large monetary reward encourages employees to not report potential violations to supervisors, thereby delaying corrective action.

II. THE FINANCIAL SERVICES REGULATORY CYCLE—SOME HISTORY

A. FINANCIAL PANICS IN THE UNITED STATES—THE FIRST 100 YEARS

History tells us that disruptive financial service practices are usually a triggering event that precedes most economic panics, recessions, and depressions. This phenomenon first appeared on Wall Street not long after

54. *Id.* (citing 15 U.S.C. § 78u-6(a)(6) (2012)).
55. *Id.* at 778.
56. *Id.* at 781–82.
57. *Id.*
58. *Id.* at 777.
59. The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, and 28 U.S.C.).
60. *Id.* at § 404 (codified at 15 U.S.C. § 7262 (2012)).

the U.S. government began operations under its then new Constitution. A panic in 1792 was triggered by the bankruptcy of William Duer, a former Assistant Treasury Secretary under Alexander Hamilton.[61] Duer had been massively speculating in government bonds and tried to corner the stock market.[62] He was bankrupted when that scheme fell apart, causing widespread hardship for his many creditors and disrupting the then unorganized and fledging stock markets in New York, Philadelphia, and Boston.[63] That failure led to the foundation of the New York Stock Exchange, which was created as a private institution that would police its members' conduct.[64]

Market downturns became commonplace in the stock markets after Duer's failure. The worst panics became recognized by a sobriquet, sort of like how we recognize hurricanes, except that panics or crashes were named by the year in which they occurred, instead of by a given name. The Panic of 1837, followed by a six-year economic depression, was one such event.[65] "Historians have traditionally attributed the Panic of 1837 to a real estate bubble and erratic American banking policy."[66] Twenty years later, the Panic of 1857 was touched off by the failure of the Ohio Life Insurance and Trust Company, a failure that was caused by embezzlements and speculative investment losses by its officers.[67] "The panic rippled outward as banks suspended gold payments, stocks plummeted, and thousands of businesses, including half of New York City's brokerages, went bankrupt."[68]

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61. *See* RON CHERNOW, ALEXANDER HAMILTON 383–84 (2004) (describing this background).

62. *Id.*

63. ROBERT E. WRIGHT & DAVID J. COWEN, FINANCIAL FOUNDING FATHERS: THE MEN WHO MADE AMERICA RICH 65–67 (2006).

64. *See* CHERNOW, *supra* note 61, at 383–84.

65. *See 1837: The Hard Times*, HARV. BUS. SCH. HIST. COLLECTIONS, https://www.library.hbs.edu/hc/crises/1837.html (last visited Aug. 2, 2017); *see also* BRAY HAMMOND, BANKS AND POLITICS IN AMERICA: FROM THE REVOLUTION TO THE CIVIL WAR 451–99 (1957) (describing that panic and its effects).

66. HAMMOND*, supra* note 65, at 451–99.

67. As one source notes:

> The financial institution had loaned $5 million to railroad builders, and had been swindled out of millions more by the manager of its New York branch. Unable to pay its extensive debt to Eastern bankers, Ohio Life was forced into bankruptcy. New York bankers began to panic for fear that they would not be able to meet their financial obligations, and shifted suddenly to hard credit policies. They demanded immediate payment on all mature loans, refusing to accept promissory notes from merchants and other debtors who were short on money. Depositors began to withdraw gold from banks, dropping gold reserves by $20 million by mid-September. Hopes for gold from California sunk on September 12 when the steamer *Central America*, with its $1.6 million in gold and 400 passengers, was lost at sea in a hurricane.

On This Day, N.Y TIMES, http://www.nytimes.com/learning/general/onthisday/harp/1024.html (last visited Aug. 2, 2017).

68. *Id.*

Unemployment "skyrocketed" and the effects of the panic spread to Europe.[69]

The Panic of 1873 followed the failure of Jay Cooke & Co., a brokerage firm that was bankrupted by railroad speculations.[70] That panic resulted in the failure of seventy-three New York Stock Exchange firms and the bankruptcy of 5,000 mercantile firms.[71] A depression followed that lasted for four years, leading to widespread and violent labor unrest. This panic became a turning point for governmental responses to panics and depressions.[72] Congress sought to prevent future panics through the adoption of legislation that sought to expand the money supply in order to spur inflation and reduce the value of debts;[73] President Ulysses S. Grant vetoed the legislation. Thereafter, legislation was adopted that sought the opposite result—a hard currency policy that would curb inflation.[74]

That legislation proved to be ineffective as demonstrated by the Panic of 1884, which was ignited by the failure of another high-profile brokerage firm, Grant & Ward.[75] Ironically, in light of his role in the Panic of 1873, former President and General, Ulysses S. Grant was a partner in that firm, which failed as a result of the fraudulent actions of another firm member.[76] Some 11,000 banks, as well as several brokerage firms, failed in the aftermath of this panic, and many banks faced "runs" from their depositors.[77]

Another severe panic occurred almost twenty years later. The Panic of 1893 was marked by the bankruptcy of the Reading Railroad, which was followed "by the failures of hundreds of banks and businesses dependent upon the Reading and other railroads. The stock market reacted with a dramatic plunge."[78] "The Panic of 1893 was one of the most severe financial crises in the history of the United States."[79]

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69. *Id.*; *see generally* KENNETH M. STAMPP, AMERICA IN 1857: A NATION ON THE BRINK 213–34 (1990) (describing the economic effects of this depression).

70. *See 1873: Off the Rails*, HARV. BUS. SCH. HIST. COLLECTIONS, https://www.library.hbs.edu/hc/crises/1873.html (last visited Aug. 2, 2017) (describing the causes of that panic). The leader of that firm, Jay Cooke, was famous for having successfully assumed responsibility for much of the funding of Union forces during the Civil War. *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, FROM CHRISTOPHER COLUMBUS TO THE ROBBER BARONS (1492-1900) 293 (2002) [hereinafter MARKHAM, FROM CHRISTOPHER COLUMBUS].

71. Jennifer 8. Lee, *New York and the Panic of 1873*, N.Y. TIMES (Oct. 14, 2008, 9:26 AM), https://cityroom.blogs.nytimes.com/2008/10/14/learning-lessons-from-the-panic-of-1873/.

72. *Id.*

73. Gary Richardson & Tim Sablik, *Banking Panics of the Gilded Age: 1863-1913*, FED. RES. HIST. (Dec. 4, 2015), https://www.federalreservehistory.org/essays/banking_panics_of_the_gilded_age.

74. *Id.*

75. MARKHAM, FROM CHRISTOPHER COLUMBUS, *supra* note 70, at 301.

76. *Id.* at 301–02.

77. *Id.* at 303.

78. *Panic of 1893*, U.S. HIST., http://www.u-s-history.com/pages/h792.html (last visited Aug. 2, 2017).

79. Richardson & Sablik, *supra* note 73.

B. FINANCIAL PANICS IN THE UNITED STATES IN THE TWENTIETH CENTURY

Panics became a pronounced feature of twentieth century economics. However, the first of those panics, the Panic of 1907, signaled a sea change from Congress' previous hands-off approach to most panics. The Panic of 1907 was triggered by "two minor speculators . . . [who] suffered huge losses in a failed attempt to corner the stock of United Copper, a copper mining company . . . . After the collapse of this corner, the banks associated with these men succumbed to runs by depositors . . . ."[80] This led to a crisis of faith in the banking system throughout the United States.[81]

Congress responded with a massive investigation of the stock markets. That investigation sought to determine whether the American economy was under the control of a "Money Trust" composed of the large Wall Street bankers.[82] Congress concluded that there was indeed such a cabal, which included J.P. Morgan & Co., and the predecessor firms to what is now Citigroup.[83] Although the stock markets were not regulated as a result of that crisis, "the panic transformed the way in which Americans viewed the banking system and the fundamental principles by which it was governed."[84] Indeed, "[t]he panic's impact is still felt today because it spurred the monetary reform movement that led to the establishment of the Federal Reserve System."[85]

The creation of the Federal Reserve System (the Fed) did nothing to prevent the next financial crisis, which occurred in October 1929, when the stock market imploded. In fact, the Fed's monetary policies were blamed for exacerbating the Stock Market Crash of 1929 and the ensuing Great Depression.[86] "In total, $25 billion—some $319 billion in today's dollars—was lost in the 1929 crash . . . . The market . . . then slid again, gliding swiftly and steadily with the rest of the country into the Great Depression."[87] "It is the longest and most severe depression experienced by the United States. Its

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80. John R. Moen & Ellis W. Tallman, *The Panic of 1907*, FED. RES. HIST. (Dec. 4, 2015), https://www.federalreservehistory.org/essays/panic_of_1907.

81. Lucy Chen et al., *The 1907 Crisis in Historical Perspective*, HARV. JOINT CTR. FOR HIST. & ECON., http://www.fas.harvard.edu/~histecon/crisis-next/1907/ (last visited Aug. 4, 2017).

82. *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR (1900-1970) 47–49 (2002) [hereinafter MARKHAM, FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR] (describing that investigation).

83. *Id.*

84. Chen et al., *supra* note 81.

85. Moen & Tallman, *supra* note 80.

86. *See, e.g.*, Timothy Cogley, *Monetary Policy and the Great Crash of 1929: A Bursting Bubble or Collapsing Fundamentals?*, FED. RES. BANK OF S.F. (Mar. 26, 1999), http://www.frbsf.org/economic-research/publications/economic-letter/1999/march/monetary-policy-and-the-great-crash-of-1929-a-bursting-bubble-or-collapsing-fundamentals/.

87. Claire Suddath, *The Crash of 1929*, TIME (Oct. 29, 2008), http://content.time.com/time/nation/article/0,8599,1854569,00.html.

social and cultural effects are staggering."[88] Some 1,350 banks failed in 1930 alone.[89]

Franklin Roosevelt won the presidency in 1932 as the Great Depression gained momentum. He ran for that post on a campaign largely based on his promise of economic legislation that would bring Wall Street under the control of the federal government and restore faith in the financial markets.[90] The result was the passage of a number of statutes that played a central role in the regulatory cycle that led to the passage of the Dodd-Frank Act of 2010. That "New Deal" legislation included the Glass-Steagall Act of 1933 restricting investment banking activities by commercial banks;[91] the Commodity Exchange Act of 1936 (CEA) that further regulated the commodity futures exchanges;[92] and the federal securities laws, including the Securities Exchange Act of 1934 that created the SEC and to which the Dodd-Frank whistleblower authority was added.[93]

C. REGULATORY CYCLE EXAMPLE 1: THE GLASS-STEAGALL ACT

Exhibit A at any future trial over whether there is such a thing as a financial regulatory cycle is the Glass-Steagall Act that was enacted in 1933.[94] That legislation prohibited commercial banks from, among other things, acting in the role of investment bankers by underwriting public securities offerings. The Glass-Steagall Act was widely criticized as over-regulation and was the subject of much commentary in the literature, both pro and con.[95] Those arguments need not be revisited here, but suffice it to

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88. *The 1930s*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/about/history/timeline/1930s.html (last updated Jan. 2, 2014).

89. Jim Luke, *Bank Failures: The 1920s and The Great Depression*, ECONPROPH (Oct. 26, 2009), https://econproph.com/2009/10/26/fdic-managing-the-crisis-the-fdic-and-rtc-experience/.

90. MARKHAM, FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR, *supra* note 82, at 165–72, 177–86.

91. The Glass-Steagall Act was a part of the Banking Act of 1933, ch. 89, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended at 12 U.S.C. § 227 (1988)).

92. Commodity Exchange Act of 1936, Pub. L. No. 74-675, 49 Stat. 1491.

93. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a *et seq.*). Other legislation extending the SEC's jurisdiction during the Roosevelt administration included the Trust Indenture Act of 1939, Pub. L. No. 76-253, 53 Stat. 1149 (codified as amended at 15 U.S.C. §§ 77aaa–bbbb) (regulating the administration of corporate bonds issued under trust indentures); the Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 789 (codified as amended at 15 U.S.C. §§ 80a-1–80a-64) (imposing prudential regulation on investment companies, including mutual funds); and the Investment Advisers Act of 1940, Pub. L. No. 76-768, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80b-1–80b-21) (regulating and registering investment advisors). Another piece of New Deal legislation enacted in this regulatory cycle was the Public Utility Holding Company Act of 1935, Pub. L. No. 74-333 (codified at 15 U.S.C. §§ 79–79z-6) (repealed 2005), which gave the SEC prudential control over holding company structure of public utilities. However, that legislation was repealed in 2005 by Title XII, Subtitle F of the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (codified in scattered sections of 42 U.S.C.).

94. Banking Act of 1933, ch. 89.

95. *See, e.g.*, Don More, *The Virtues of Glass-Steagall: An Argument Against Legislative Repeal*, 1991 COLUM. BUS. L. REV. 433, 433–34; Jonathan R. Macey, *Special Interest Groups*

say that the Glass-Steagall restrictions were gradually undermined over time through judicial challenges and administrative interpretations that eventually eviscerated the statute.[96] The Gramm-Leach-Bliley Act formally repealed Glass Steagall in 1999.[97] This completed one regulatory cycle, i.e., restrictive legislation following a crisis, followed by claims of over-regulation and then repeal.[98]

The Financial Crisis of 2008 renewed this particular regulatory cycle. Claims were then made that commercial banks had entered into high-risk business activities, such as managing hedge funds and proprietary trading, which contributed to their failures during the crisis.[99] Glass-Steagall style legislation was then enacted to meet those concerns. Section 619 of the Dodd-Frank Act required bank regulators to adopt the so-called Volcker Rule (named after its advocate, a former Fed chairman), which restricted their proprietary trading and hedge fund activities.[100]

The Volcker Rule legislation, and the agency rules implementing its provisions, quickly came under criticism as being either unworkable or

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Legislation and the Judicial Function: The Dilemma of Glass-Steagall, 33 EMORY L.J. 1, 1–2 (1984); Donald C. Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672, 675, 687–88 (1987); Bruce Rigelman, Note, *National Banks and the Brokerage Business: The Comptroller's New Reading of the Glass-Steagall Act*, 69 VA. L. REV. 1303, 1306, 1324–35 (1983).

96. *See* Jerry W. Markham, *The Subprime Crisis—A Test Match for the Bankers*, 12 U. PA. J. BUS. L. 1081, 1095–99 (2010) [hereinafter Markham, *The Subprime Crisis*] (describing that process).

97. Financial Services Modernization Act of 1999 (Gramm-Leach-Bliley), § 101, Pub. L. No. 106-102, 113 Stat. 1338, 1341 (codified as amended at 15 U.S.C. §§ 6801–09 (2006)).

98. Banking regulation is replete with other examples of the regulatory cycle. For example, Savings & Loan Associations (S&Ls) were intensively regulated during the Great Depression, including requirements limiting the amount of interest they could pay for deposits. Those restrictions prevented the S&Ls from effectively competing for deposits during the inflationary period that occurred in the 1970s. Congress then loosened interest rate and investment restrictions on the S&Ls, many of which engaged in reckless and sometimes fraudulent practices. This created a financial crisis, and Congress then tightened regulations causing many other S&Ls to fail. *See* LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANKING FINANCIAL SERVICE ACTIVITIES, CASES AND MATERIALS 95–113 (4th ed. 2011) (describing that regulatory cycle). In *United States v. Winstar Corp.*, 518 U.S. 839, 910 (1996), the Supreme Court imposed liability on the U.S. government for increasing previously lessened capital requirements for S&Ls during the S&L crisis.

Regulators have also gone through various iterations for commercial bank capital requirements. That effort is still a work in progress in the form of Basel I, II and III rules developed internationally for large banks. The Dodd-Frank Act included special leverage limitation provisions for systemically significant bank holding companies. *See* BROOME & MARKHAM, *supra* at 546–65 (describing that legislation and role of the Basel Committee in setting bank capital requirements). The Trump administration is reported to be considering changes in those Dodd-Frank Act provisions. *See* Dean et al., *supra* note 5 (describing proposals for such changes).

99. *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES: FROM THE SUBPRIME CRISIS TO THE GREAT RECESSION (2006-2009) (2005) [hereinafter MARKHAM, FROM THE SUBPRIME CRISIS TO THE GREAT RECESSION] (describing hedge fund losses).

100. 12 U.S.C. § 1851 (2012); *see Volcker Rule*, BOARD OF GOVERNORS OF THE FED. RES. SYS., https://www.federalreserve.gov/supervisionreg/volcker-rule.htm (last updated July 24, 2017) (describing the scope of that provision).

ineffective.[101] The election of President Donald Trump and the takeover of Congress by the Republicans in 2016 reopened the debate in Congress over that legislation.[102] At the direction of the new President, the Treasury Department announced that it is conducting a broad reexamination of the Dodd-Frank Act with a view of rolling back at least parts of that legislation.[103] The Volcker Rule is a primary target of that effort.[104] Ironically, President Trump has also declared that the Glass-Steagall Act should be revived in order to break up the larger banks.[105]

D. REGULATORY CYCLE EXAMPLE 2: THE COMMODITY EXCHANGE ACT

The CEA provides another example of the financial services regulatory cycle. The commodity futures markets were initially regulated by Congress in 1922 under the Grain Futures Act.[106] That legislation was the result of large-scale grain price manipulations that occurred after World War I.[107] The Grain Futures Act was only lightly applied and proved to be ineffective.[108] The regulatory cycle continued after the Stock Market Crash of 1929 and the onslaught of the Great Depression, during which agriculture prices dropped sharply. Blame was placed on the inadequacy of existing legislation to

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101. *See, e.g.*, Onnig Dombalagian, *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act: Proprietary Trading: Of Scourges, Scapegoats, and Scofflaws*, 81 U. CIN. L. REV. 387 (2012); Alison K. Gary, Note, *Creating a Future Economic Crisis: Political Failure and the Loopholes of the Volcker Rule*, 90 OR. L. REV. 1339, 1340 (2012); Andrew F. Tuch, *Financial Conglomerates and Information Barriers*, 39 J. CORP. L. 563, 566–67 (2014).

102. Ben Protess & Julie Hirschfeld Davis, *Trump Moves to Roll Back Obama Era Financial Regulations*, N.Y. TIMES (Feb. 3, 2017), https://www.nytimes.com/2017/02/03/business/dealbook/trump-congress-financial-regulations.html.

103. The Treasury Department issued an initial report in June 2017 that considers changes needed in the regulation of the bank depository system. U.S. DEPT. OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS: REPORT TO PRESIDENT DONALD J. TRUMP (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf. The Department will be considering the need to curb other aspects of Dodd-Frank in future reports. *Id.* at 4. At about the same time, the House of Representatives approved legislation seeking repeal of parts of the Dodd-Frank Act affecting large banks. Alan Rappeport, *Bill to Erase Some Dodd-Frank Banking Rules Passes in House*, N.Y. TIMES (June 8, 2017), https://www.nytimes.com/2017/06/08/business/dealbook/house-financial-regulations-dodd-frank.html.

104. Lisa Lambert, *U.S. Regulators Look at Volcker Rule, A Sign They Hear Wall Street*, REUTERS (May 8, 2017, 7:31 PM), http://www.reuters.com/article/us-usa-banks-trading-idUSKBN1842H8.

105. Dean et al., *supra* note 5.

106. The Grain Futures Act, Pub. L. No. 67-331, 42 Stat. 998 (1922) (codified as amended in scattered sections of 7 U.S.C.).

107. *See* Jerry W. Markham, *The Manipulation of Commodity Futures Prices—The Unprosecutable Crime*, 8 YALE J. ON REG. 281, 292–302 (1991) [hereinafter Markham, *The Manipulation of Commodity Futures Prices*] (describing that legislation and its failure).

108. *Id.*

prevent market manipulators from accentuating those losses.[109] The result was the CEA.[110]

The cycle of regulation and deregulation soon began anew after widespread speculation and phenomenal increases in commodity prices in the 1970s led to a demand for more regulation. Congress responded with the Commodity Futures Trading Commission Act of 1974.[111] That legislation created the CFTC and added intrusive regulation over the commodity exchanges and their participants.[112] That legislation quickly became the subject of criticism that it was over-regulating the commodity markets. Among other things, critics claimed that the CEA was impairing the development of swaps and other economically desirable over-the-counter derivative instruments.[113]

Interestingly, the Stock Market Crash of 1987 resulted in no significant legislative response even though the stock market had dropped farther in relative and absolute terms than was the case in 1929.[114] This was probably because the market quickly recovered and the economy was not seriously damaged. Nevertheless, numerous reports by government agencies and others sought additional legislation.[115] Instead of additional regulation, Congress responded to concerns that regulation would impair the growth of the swaps market by deregulating the swaps markets in 1992.[116] Congress further loosened CFTC regulation of swaps when it enacted the Commodity Futures Modernization Act of 2000 (CFMA).[117]

This regulatory exemption spurred the growth of credit default swaps, which played a large role in the Financial Crisis in 2008 and resulted in large

109. JERRY W. MARKHAM, THE HISTORY OF COMMODITY FUTURES TRADING AND ITS REGULATION 12–16 (1987) [hereinafter MARKHAM, THE HISTORY OF COMMODITY FUTURES] (describing that background).

110. The Commodity Exchange Act of 1936, Pub. L. No. 74-675, 49 Stat. 1491 (codified as amended in scattered sections of 7 U.S.C.). *See* Markham, *The Manipulation of Commodity Futures Prices*, *supra* note 107 (describing the background of that legislation).

111. Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (codified as amended at 7 U.S.C. §§ 1–22 (1976)).

112. *See* MARKHAM, THE HISTORY OF COMMODITY FUTURES, *supra* note 109, at 48–80 (describing this background and the scope of the CFTC legislation).

113. *See* Jerry W. Markham, *Regulation of Hybrid Instruments Under the Commodity Exchange Act - Alternatives Are Needed*, 1990 COLUM. BUS. L. REV. 1, 1–59 (1990).

114. Jerry W. Markham & Rita McCloy Stephanz, *The Stock Market Crash of 1987—The United States Looks at New Recommendations*, 76 GEO. L.J. 1993, 2008 (1988) (describing those studies and lack of legislative response to that crash).

115. *See id.* (describing those studies and lack of legislative response to that crash).

116. Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590 (codified as amended at 7 U.S.C. §§ 6a, 6(c)–(d)).

117. Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (codified as amended in scattered sections of 7 U.S.C.); *see also* RONALD H. FILLER & JERRY MARKHAM, REGULATION OF DERIVATIVE FINANCIAL INSTRUMENTS (SWAPS, OPTIONS AND FUTURES) 267–81 (2014) (describing the CFMA).

losses to Wall Street firms.[118] Indeed, much of the blame was placed on trading abuses in swap contracts, particularly credit default swaps.[119] Dodd-Frank then repealed the CFMA's exemptions for swaps and intensively regulated those instruments.[120] The SEC has only reluctantly acted under that authority and is still (seven years later) writing rules that would implement major portions of that legislation.[121] The new CFTC chairman appointed by the Trump administration quickly announced that he would be moving to cut back that agency's existing Dodd-Frank swap rules, signaling that the regulatory cycle will continue.[122]

E. REGULATORY CYCLE EXAMPLE 3: SEC CAPITAL REQUIREMENTS

The effectiveness of the "New Deal" legislation that created the SEC has long been a matter of some debate. The SEC has asserted that the federal securities laws restored confidence in the securities markets, which had been undermined by the speculation that led up to the Stock Market Crash of 1929.[123] However, critics note that the stock market did not recover its 1929 high until twenty-five years later, in November 1954.[124] Critics also contend that the stock market resumed its growth, not because of the creation of the

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118. *See* Markham, *The Subprime Crisis*, *supra* note 96, at 1124–30 (describing the growth of credit default swaps and losses sustained from those instruments during the Financial Crisis).

119. Critics supporting Dodd-Frank claimed that the failure to regulate swaps and other over-the-counter derivatives was a leading causal factor in the Financial Crisis of 2008, and that their demands for regulation of those instruments had been shouted down before the crisis. *See* Brooksley E. Born, *Lessons Not Learned-The Derivatives Market and Continued Risks: A Conversation with Brooksley E. Born and Joseph A. Grundfest*, STAN. LAW. (June 7, 2013), https://law.stanford.edu/stanford-lawyer/articles/lessons-not-learned-the-derivatives-%E2%80%A8market-and-%E2%80%A9continued-risks/ (describing those claims); *see also* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, FROM ENRON ERA SCANDALS TO THE SUBPRIME CRISIS (2004-2006) 429–618 (2011) (describing the Financial Crisis of 2008 and the role of credit default swaps in that event).

120. Wall Street Transparency and Accountability Act of 2010, Pub. L. No. 111-203, title VII, 124 Stat. 1641 (codified as amended at 15 U.S.C. §§ 8301–8344 (2012)).

121. *See* Jerry W. Markham, *Regulation of Swap and Other Over-The-Counter Derivative Contracts*, BNA Securities Practice Portfolio Series No. 263 (2014) (describing the SEC and CFTC swap regulation programs under Dodd-Frank).

122. Gabriel T. Rubin, *CFTC Chairman Readies Revamp of Swaps Rules*, WALL ST. J. (Aug. 11, 2017, 8:04 AM), https://www.wsj.com/articles/cftc-chairman-readies-swaps-rules-revamp-1502445602.

123. For example, the SEC's website states that those statutes were "designed to restore investor confidence in our capital markets by providing investors and the markets with more reliable information and clear rules of honest dealing." *What We Do*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/Article/whatwedo.html (last modified June 10, 2013).

124. Gary Richardson et al., *Stock Market Crash of 1929*, FED. RES. HIST. (Nov. 22, 2013), https://www.federalreservehistory.org/essays/stock_market_crash_of_1929.

SEC, but because the breakout of the war in Europe restarted the American economy, which continued its upward course after the war.[125]

The SEC tried to burnish its role as an aggressive and high-profile business conduct law enforcement regulator by making insider trading a crime in the 1960s.[126] However, the agency was widely criticized after Wall Street nearly collapsed in 1969 in the wake of a "paperwork crises" that "brought our Nation's securities market to its knees."[127] That crisis was the result of the fact that brokerage firms regulated by the SEC were unable to handle the paperwork generated by increased trading volumes. Between 1968 and 1970, some 100 New York Stock Exchange (NYSE) firms that were regulated by the SEC failed.[128] Those failures were blamed largely on the lack of an SEC enforced minimum capital requirement.[129]

The SEC previously abandoned its own capital requirements in deference to NYSE capital requirements for it member firms.[130] That deregulatory effort by the SEC was widely criticized and resulted in numerous amendments to the Securities Exchange Act of 1934 after the paperwork crisis.[131] Among other things, that legislation required the SEC to adopt and enforce a net capital rule for all registered broker-dealers.[132] The SEC then became a more intrusive regulator, but dissatisfaction with that role gave rise

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125. *See* Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking the Federal Securities Laws*, 28 N.C.J. INT'L L. & COM. REG. 725, 740–41 (2003) [hereinafter Markham, *Rethinking the Federal Securities Laws*] (describing that recovery).

126. Before the SEC acted in 1961, insider trading was not treated as a violation of federal law or state law. In a leading case decided in 1933, a year before the SEC was created, a state high court held there was no private right of action for insider trading on an exchange. *Compare* Goodwin v. Agassiz, 186 N.E. 659, 661 (Mass. 1933), *with* Strong v. Repide, 213 U.S. 419 (1909) (holding that there may be insider liability for failure to disclose in certain rare and special circumstances). The Securities Exchange Act of 1934, which formed the SEC, contained only a narrow prohibition on insider trading that barred insiders from making short-term profits on their company's stock, but did not prohibit insiders from profiting from company stock held more than six months. *See* 15 U.S.C. § 78(p) (2012). Instead of a statutory prohibition, the SEC simply developed the crime of insider trading a quarter of a century later through an administrative decision that was issued in connection with the settlement of a case that was not tried or subject to appeal. *In re* Cady Roberts & Co., 40 S.E.C. 907, 911 (1961).

127. *Securities Processing Act: Hearings on H.R. 14567, H.R. 14826 & S. 3876 Before the Subcomm. on Commerce & Fin. of the H. Comm. on Interstate & Foreign Commerce*, 92nd Cong. 1 (1972).

128. *See* MARKHAM, FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR, *supra* note 82, at 362–66 (describing the paperwork crisis). The value of the stock market was cut in half in the wake of that event. *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS: FROM ENRON TO REFORM 390 (2005) [hereinafter MARKHAM, FROM ENRON TO REFORM].

129. MARKHAM, FROM J.P. MORGAN TO THE INSTITUTIONAL INVESTOR, *supra* note 82, at 362–66.

130. SEC, STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS & DEALERS 7 (1971).

131. JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES, FROM ENRON ERA SCANDALS TO THE SUBPRIME CRISIS (2004-2006) 159–62 (2011) (describing the paperwork crisis and reforms).

132. Securities Act Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97; *see also* 17 C.F.R. § 240.15c3-1 (the rule adopted by the SEC under that authority).

to calls for "deregulation" during the administration of President Ronald Reagan.[133]

The SEC and other financial services regulators responded by easing regulations during Ronald Reagan's two terms in office, and that of George H.W. Bush.[134] Those deregulatory efforts continued into the run up to the Financial Crisis of 2008. Among other things, the SEC eased capital requirements for the large investment banks, allowing them to use their own models to assess what a safe level of capital should be for their individual risk profiles.[135] The large firms allowed to use this reduced capital approach included Bear Stearns, Merrill Lynch, Lehman Brothers, Goldman Sachs and Morgan Stanley.[136] During the Financial Crisis of 2008, those firms all failed, were rescued by other financial institutions, or converted to bank holding company status. Their breakdowns were blamed on the SEC's deregulatory efforts.[137] In response, the Dodd-Frank Act imposed almost complete regulatory control over large financial institutions that are deemed to be "systemically important financial institutions."[138] This was done through the creation of a super-regulator, the Financial Stability Oversight Council, that is tasked with designating such institutions.[139] The 2016 elections set the stage for a renewal of this regulation/deregulation cycle. President Trump has sought to jumpstart that effort through an executive order directing the Treasury Department to review that authority for possible repeal or limitation.[140]

III. THE REGULATORY CYCLE FOR WHISTLEBLOWERS

A. THE SARBANES-OXLEY ACT OF 2002

SOX forms the backdrop for the whistleblower regulatory cycle and the provisions in the Dodd-Frank Act.[141] SOX was adopted by Congress in

133. *See* JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES: FROM THE AGE OF DERIVATIVES INTO THE NEW MILLENNIUM (1970-2001) 95–97 (2002) (describing deregulation efforts under the Reagan administration).

134. *See id.*

135. *See* MARKHAM, FROM THE SUBPRIME CRISIS TO THE GREAT RECESSION, *supra* note 99, at 714–15 (describing that action).

136. *See id.*

137. *See id.*

138. Michael S. Gibson, Director, Division of Banking Supervision and Regulation, Testimony before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, Washington, D.C.: Systemically Important Financial Institutions and the Dodd-Frank Act (May 16, 2012), *available at* https://www.federalreserve.gov/newsevents/testimony/gibson20120516a.htm.

139. *See id.*

140. Jim Puzzanghera, *Trump Targets Dodd-Frank Rules Designed to Wall Off Risky Banks*, L.A. TIMES (Apr. 21, 2017, 12:30 PM), http://www.latimes.com/business/la-fi-trump-financial-regulation-20170421-story.html.

141. *See* The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, and 28 U.S.C.).

response to the disclosure of widespread accounting fraud at Enron, WorldCom, and other large public companies.[142] Those accounting scandals involved massive manipulations of the accounting disclosures that are the most basic premise of the federal securities laws—full and accurate disclosures of the financial statements of public companies.[143] Congress responded to those scandals by enacting SOX, which created a quasi-government body, the Public Company Accounting Oversight Board (PCAOB) to oversee public company auditors.[144] Another provision in SOX, the now infamous Section 404, required public companies to strengthen their internal accounting controls and required managers to certify the adequacy of those controls.[145] The controls mandated by SOX were criticized as costing public companies $5.5 billion annually in additional costs with little positive showing that those controls were in any way effective.[146] Those and other provisions in SOX were said to be ill-thought out, resulting in "quack corporate governance" requirements[147] and a reflection of what was described as "Sudden Acute Regulatory Syndrome."[148]

Another provision in SOX provided whistleblowing protection to employees of public companies that report violations of the federal securities laws. SOX made it illegal for public companies to "discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee" for engaging in protected whistleblowing activities.[149] This provision was designed to protect employees who reported fraudulent actions to government regulators, as well as internally within their own company.[150] The enactment of the SOX whistleblower provision was a reflection of the fame given to whistleblowers at Enron and at WorldCom Inc. They had protested improper accounting actions at their companies and were named "Persons of the Year" by *Time* magazine.[151] Interestingly, neither the Enron nor the WorldCom whistleblowers were fired from their jobs, and they did

142. *See* Markham, *Rethinking the Federal Securities Laws*, *supra* note 125, at 740–41 (describing the scandals that led to the enactment of SOX).

143. *See* MARKHAM, FROM SUBPRIME CRISIS TO THE GREAT RECESSION, *supra* note 99 (describing that breakdown in full disclosure).

144. *About the PCAOB*, PUB. COMPANY ACCT. OVERSIGHT BOARD, https://pcaobus.org/About (last visited June 15, 2017).

145. MARKHAM, FROM ENRON TO REFORM, *supra* note 128, at 467 (describing those controls and their costs).

146. *Id.*

147. *See* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

148. Larry E. Ribstein, *Sarbox: The Road to Nirvana*, 2004 MICH. ST. L. REV. 279, 293 (2004).

149. 15 U.S.C. § 1514A(a) (2012).

150. Samuel Leifer, Note, *Protecting Whistleblower Protections in the Dodd-Frank Act*, 113 MICH. L. REV. 121, 126–27 (2014).

151. *See The Whistleblowers: 2002*, TIME, http://content.time.com/time/specials/packages/article/0,28804,2019712_2019710_2019677,00.html (last visited June 18, 2017).

not blow a whistle at the SEC. Rather, they expressed their concerns only internally.[152]

In any event, the SOX whistleblowing protections proved to be ineffective. "Empirical research suggests that SOX's whistleblower protections have neither effectively encouraged whistleblowers nor consistently rewarded them for their whistleblowing actions."[153] The reasons for that failure are manifold, but one of SOX's shortcomings was the assignment of its whistleblowing enforcement powers to the Occupational Safety and Health Administration (OSHA) in the Department of Labor. Only a very small percentage of SOX whistleblower claims adjudicated by OSHA were successful.[154] This was said to be because "[t]he Sarbanes-Oxley Act had long been construed narrowly by the U.S. Department of Labor and the courts, leaving many employees uncovered or burdened with proof requirements that favored defendants."[155]

The assignment of enforcement of the SOX whistleblower provisions to OSHA was, in all events, faulty because the hearing officers at OSHA who were considering SOX whistleblower claims were ill-suited for this role. They did not have the expertise to judge, in light of the complexity of the federal securities laws and arcane accounting standards, whether a whistleblower was disclosing an actual violation of the securities laws or its effect on the company's stock price.[156] In addition, OSHA hearing officers had no subpoena power to investigate claims that a discharge was related to an employee's objections to fraudulent accounting or other illegal activities.[157] The purposes of the SOX whistleblowing authority were further thwarted because that statute only protected claims brought by employees within ninety days of their termination.[158] SOX's whistleblower remedies were also criticized as being too restrictive because they were limited to "reinstatement with the same seniority, back pay with interest, and compensation for special damages" that may have resulted from any litigation brought by the employee.[159]

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152. *See* MARKHAM, FROM ENRON TO REFORM, *supra* note 128, at 76–78, 344–45, 352 (describing the actions of these whistleblowers).

153. Leifer, *supra* note 150, at 128.

154. Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 WM. & MARY L. REV. 65, 67 (2007).

155. Jonathan Ben-Asher, New Developments in Whistleblower Cases Under Sarbanes-Oxley and Dodd-Frank, American Bar Association Section of Labor and Employment Law Annual Meeting Boston 1, 6 (Aug. 2014), *available at* https://www.americanbar.org/content/dam/aba/events/labor_law/am/2014/3c_ben-asher.authcheckdam.pdf; *see also* Moberly, *supra* note 154 (describing shortcomings of the SOX whistleblower provisions).

156. *See* MARKHAM, FROM ENRON TO REFORM, *supra* note 128, at 456 (describing those deficiencies).

157. *Id.*

158. *Id.*

159. Leifer, *supra* note 150, at 127; *see also* Asadi v. G.E. Energy (USA), LLC, 720 F.3d 620, 623 (5th Cir. 2013) (describing other differences in whistleblower claims brought under SOX versus those under Dodd-Frank, including differing statutes of limitations).

B. THE DODD-FRANK WHISTLEBLOWING PROVISIONS RESTART THE REGULATORY CYCLE

SOX added the initial whistleblower requirement in 2002 in the hope that it would protect and encourage employees to report uncorrected violative activities that, if unchecked, could blossom and trigger a financial crisis. However, SOX failed to prevent the Financial Crisis of 2008. Dodd-Frank proponents claimed that this was because the SOX whistleblower provisions were too limited in scope, had been too narrowly applied by OSHA, and did not contain provisions for whistleblower payments.[160] "The financial crisis in 2008 provides the most vivid case study of this [whistleblowing] failure, as corporate officers, government regulators, and law enforcement agencies ignored the warnings of employees who tried to report problems in the subprime mortgage industry."[161]

Despite those claimed shortcomings, the SEC still received tips from informants. Indeed, the problem was not a lack of tips. Rather, the SEC was not receptive to such assistance. For example, the agency had been tipped several times on what was perhaps the largest fraud in all-financial history. Bernie Madoff was able to carry out that fraud for several years before his exposure despite some very credible whistleblower claims.[162] Those whistleblowers pointed out that it was impossible for Madoff to have made the returns he claimed from his purported investment programs for his clients.[163] Ignoring that failure on the part of the SEC, Congress doubled-down on whistleblowing by granting the SEC and CFTC whistleblower powers and by adding the bounty feature in Dodd-Frank.[164] The whistleblower provisions of Dodd-Frank are now caught up in the next phase of the regulatory cycle, i.e., deregulation. The Trump administration has thus identified those provisions as a probable target for future review and cutback.[165]

IV. SOUND POLICY, NOT REGULATORY CYCLES, SHOULD DICTATE THE ENACTMENT OF LEGISLATION

The ongoing review of the SEC and CFTC whistleblower programs should include consideration of at least two policy questions. First, is such a

160. *See generally* Richard Moberly, *Sarbanes-Oxley's Whistleblowing Provisions: Ten Years Later*, 64 S.C. L. REV. 1 (2012) (describing those shortcomings).

161. *Id.* at 4; *see also* Markham, *The Subprime Crisis*, *supra* note 96 (describing the role of subprime mortgages in the Financial Crisis of 2008).

162. *See* SEC OFF. OF INVESTIGATIONS, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME: PUBLIC VERSION 61–88 (Aug. 31, 2009), *available at* https://www.sec.gov/files/oig-509.pdf (describing SEC failures in following up on whistleblowing tips about the Madoff Ponzi scheme).

163. *Id.*

164. *See* Wyatt, *supra* note 18 (noting that the Dodd-Frank whistleblower provisions were partially the result of the Madoff scandal).

165. NATIONAL LAW FORUM, *supra* note 6.

bounty program sound public policy, and second, is whistleblowing effective? The following discussion addresses those questions.

A. WHISTLEBLOWING AS POLICY—SOME HISTORY

Whistleblowing has not always been viewed as a commendable act or good policy.[166] Indeed, whistleblowers have historically been viewed with much disdain, especially where a bounty is paid for betraying superiors.[167] Disreputable whistleblowers have also betrayed their employers, including their own government, on political, rather than monetary grounds, but their motivation is still suspect.[168] Totalitarian societies are also usually associated with suppressing basic freedoms through repressive acts against dissidents exposed by government informants.[169] Whistleblowing in the form of press leaks has also been a popular political act on the part of government officials. They leak information in order to undermine government policy or to float administration proposals in order to test the political winds.[170] Whistleblowing through such leaks is controversial—some persons supporting and some opposing. Whatever the case, monetary rewards in the form of bounties are not given to these whistleblowers. To the contrary, unauthorized leakers may lose their government jobs or even be subject to prosecution for improper disclosure of classified information.[171]

166. Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899, 1901 (2007) ("Whistleblowers, who traditionally have been considered tattletales and otherwise viewed with suspicion, have recently enjoyed a distinct rise in popularity.").

167. Perhaps the most infamous whistleblower was Judas Iscariot, who betrayed Christ for thirty pieces of silver. *Judas Iscariot*, ENCYCLOPAEDIA BRITANNICA, https://www.britannica.com/biography/Judas-Iscariot (last visited June 16, 2017).

168. For example, Julius and Ethel Rosenberg, two politically motivated Soviet Union sympathizers, were executed for exposing the secret of the atom bomb to that evil empire. *See* GEOFFREY PERRET, EISENHOWER 443–44 (1999) (describing the execution of the Rosenbergs). More recently, an employee of a government contractor to the NSA, Edward Snowden, leaked a mass of secret government documents to the press. He became a fugitive from justice and was provided asylum in Russia. *See generally* Edward J. Epstein, *Why President Obama Can't Pardon Edward Snowden*, NEWSWEEK (Jan. 5, 2017, 7:00 AM) http://www.newsweek.com/why-obama-wont-pardon-edward-snowden-nsa-538632. The book and movie *The Informant* documented the role of a corporate informant the government used to break a price-fixing scheme, only to discover that the informant had been committing fraud on a fairly massive scale. *See* KURT EICHENWALD, THE INFORMANT (2001); *see also* THE INFORMANT (Warner Brothers Co. 2009).

169. *See generally* AVIEZER TUCKER, THE LEGACIES OF TOTALITARIANISM: A THEORETICAL FRAMEWORK 89 (2015) (describing the use of informants in the Soviet Union to suppress dissent).

170. "Deep Throat's" role in bringing down the Nixon administration is now legend. *See* CARL BERNSTEIN & BOB WOODWARD, ALL THE PRESIDENT'S MEN *passim* (1974) (describing that informant). This form of whistleblowing was most recently demonstrated by leaks from officials in the intelligence community who are seeking to cripple the Trump administration. Even the fired Director of the FBI, James Comey, joined the host of leakers. *See Comey Testimony: Highlights of the Hearing*, N.Y. TIMES (June 8, 2017), https://www.nytimes.com/2017/06/08/us/politics/james-comey-testimony-hearing.html?_r=0.

171. *See* 18 U.S.C. § 798 (2012) (imposing criminal liability for leaking classified information).

In another context, criminal law enforcement authorities have long rewarded "snitches" for providing damaging information about their crime bosses. Such information is useful, even necessary, for effective law enforcement. Nevertheless, these whistleblowers are generally depicted as being despicable and untrustworthy. Unlike SEC and CFTC whistleblowers, these organized crime informants are not lionized for betraying even the most detestable mobsters. Such informants are usually paid only small amounts of money as a bounty, given sentence reductions for their own crimes, or in extreme cases, given admission to a witness protection program for their protection from retaliation. Even so, the government has not been entirely successful in protecting its informants. "Close to 700 witnesses and informants . . . have been threatened, wounded or killed over a recent three-year period, a survey found."[172]

An exception to the traditional model of offering small amounts for betraying crime bosses is the large bounties offered for terrorists. "The Rewards for Justice program, run by the U.S. State Department's Bureau of Diplomatic Security, has paid out more than $100 million to over 60 people since it was created in 1984."[173] However, even large bounties paid for whistleblowing on the vilest terrorists are not always effective. For example, the U.S. government offered a bounty of $25 million for the apprehension of Osama bin Laden, but he was not captured and killed until nearly a decade after that reward was offered.[174] Even then, apparently, no one qualified for a bounty in his takedown.[175]

Another change in the governmental approach to whistleblowers occurred in 1986 when the False Claims Act was amended to allow the payment of bounties to third parties exposing efforts to defraud the government.[176] Formerly, that legislation sought only to protect whistleblowers from retaliation by their employers. The 1986 amendments went further by authorizing rewards in the form of bounties to whistleblowers uncovering fraudulent government contractor claims, regardless of whether the whistleblower was subjected to adverse action by their employer.[177] This became the model for the Dodd-Frank whistleblower provisions.

172. Jacob Gershman, *Why Life for 'Snitches' Has Never Been More Dangerous*, WALL ST. J. (June 20, 2017, 8:00 AM), https://www.wsj.com/articles/criminals-subvert-online-court-records-to-expose-snitches-1497960000.

173. Ben Rooney, *Who Gets Bin Laden's $25 Million Bounty?*, CNN MONEY (May 2, 2011, 6:24 PM), http://money.cnn.com/2011/05/02/news/osama_bin_laden_reward/index.htm.

174. Matthew Cole, *U.S. Will Not Pay $25 Million Osama Bin Laden Reward, Say Officials*, ABC NEWS (May 19, 2011), http://abcnews.go.com/Blotter/osama-bin-laden-reward-paid/story?id=13633236.

175. *Id.*

176. 31 U.S.C. §§ 3729–33 (1988).

177. *See* Elletta Sangrey Callahan & Terry Morehead Dworkin, *Do Good and Get Rich: Financial Incentives for Whistleblowing and the False Claims Act*, 37 VILL. L. REV. 273, 273–74 (1992) (describing that change in approach to whistleblowing).

B. DODD-FRANK WHISTLEBLOWERS AND PUBLIC POLICY

1. Is Whistleblowing Justified on Monetary Grounds?

In contrast to the typical criminal snitch, whistleblowers in public companies and at firms otherwise regulated by the SEC and CFTC, have been given hero status in the press and richly rewarded for exposing their employers. "While our society still attaches many negative stigmas to whistleblowers, several recent corporate scandals have instigated a shift in perspective towards acceptance of and even praise for whistleblowers . . . ."[178] Nevertheless, these whistleblowing programs have their critics. Whistleblowing under SOX has been equated with insider trading by one scholar.[179] Another critic charged that, "[i]n effect, the Dodd-Frank Act's whistleblower laws transform corporate corruption into a 'gold mine' by giving individuals the opportunity to reap enormous benefits from reporting alleged violations."[180]

The effectiveness of the SEC whistleblower program may be judged in light of its successes or lack thereof. In fiscal year 2016, the SEC received over 4,200 whistleblower tips, a forty percent increase over the first year of the program, which began in 2012.[181] By extrapolating these figures, it appears that the SEC has probably received over 10,000 tips since the implementation of its whistleblower program. However, between 2012 and 2016, the SEC considered only some ninety-nine whistleblower claims for possible bounties.[182] Of that number, sixty-four bounty claims were denied by the SEC and only thirty-five awards were granted.[183] This small number of successful whistleblower claims appears to mirror the statistical success of a lottery. It also pales in comparison to the fact that the SEC brought nearly 550 enforcement actions during that same period that were independent of any whistleblower assistance.[184]

178. Christina Pellino, Note, *Don't Whistle While You Work—Unless You Whistle to the SEC*, 46 SETON HALL L. REV. 911, 915–16 (2016).

179. Macey, *supra* note 166, at 1901 ("Whistleblowers, who traditionally have been considered tattletales and otherwise viewed with suspicion, have recently enjoyed a distinct rise in popularity.").

180. Jenny Lee, Note, *Corporate Corruption & the New Gold Mine: How the Dodd-Frank Act Overincentivizes Whistleblowing*, 77 BROOK. L. REV. 303, 305 (2011).

181. *See* SEC 2016 ANNUAL REPORT, *supra* note 26.

182. *See Final Orders of the Commission*, U.S. SEC. & EXCHANGE COMMISSION, OFF. OF THE WHISTLEBLOWER, www.sec.gov/about/offices/owb/owb-final-orders.shtml (last modified Aug. 25, 2017). By May 2017, the number of SEC awards to whistleblowers increased to a still paltry forty-three individuals. *Whistle-Blower Collects Nearly $4M from SEC*, 49 SEC. REG. & L. REP. (BNA) 688 (May 1, 2017).

183. *See Final Orders of the Commission*, *supra* note 182.

184. *See* Press Release, SEC, SEC Announces Enforcement Results for FY 2016 (Oct. 11, 2016), *available at* https://www.sec.gov/news/pressrelease/2016-212.html [hereinafter SEC 2016 Press Release].

This raises the question of whether the game is worth the candle, as is the case for other governmental tipster programs. For example, the Bank Secrecy Act requires financial services institutions to file suspicious activity reports (SARs) with the government that disclose business activities on the part of the institutions' private clients that might be illegal.[185] In 2014, over 1.7 million SARs were filed by reporting financial services firms reporting suspicious business activities by their clients.[186] Those reports were accessible to over 380 local, state, and federal law enforcement agencies.[187] It is unknown how many prosecutions resulted from this massive invasion of privacy, but that number appears to be extremely small in comparison to the number of reports filed. There is also some disturbing data available from another mandatory whistleblowing requirement, i.e., the filing of currency reports for transactions in excess of $10,000. One press report asserted that this mandatory informant program resulted in the filing of over 77 million currency reports between 1987 and 1996.[188] Yet, only 580 convictions out of 77 million filed reports were obtained from all of those filings.[189] This massive invasion of privacy of the private financial information of clients of financial institutions has also proved expensive because such reports take some time to complete.[190]

The SEC whistleblower program has resulted in the recovery of a large sum of fines, i.e., more than $953 million in financial remedies were obtained in those whistleblower-induced enforcement actions.[191] From that amount, over $150 million in whistleblower payments were made, an award allocation averaging about fifteen percent of the fines levied in those actions.[192] The SEC has asserted that it believes "that the continued payment of significant awards . . . will continue to incentivize company insiders, market participants, and others with knowledge of potential securities law violations to come forward and report their information to the agency."[193] Some perspective is needed in assessing the validity of the SEC claims of success for its whistleblowing program. The total recovery amount is only about five percent of the total disgorgement and penalties ordered in all SEC

185. *See* JERRY W. MARKHAM & THOMAS LEE HAZEN, BROKER DEALER OPERATIONS UNDER SECURITIES AND COMMODITIES LAW: FINANCIAL RESPONSIBILITIES, CREDIT REGULATION, AND CUSTOMER PROTECTION Ch. 7 (2016) (describing these and other money laundering enforcement tools). This is a mandatory whistleblowing program that does not make bounty payments. However, financial service firms are incentivized to file these reports because they will be sanctioned for failing to do so. *Id.* (describing these and other money laundering enforcement tools).

186. FINCEN, SAR STATS TECHNICAL BULLETIN 2 (Oct. 2015).

187. *Id.* at 1.

188. Richard W. Rahn, *Financial Privacy in Peril*, WALL ST. J., June 1, 1999, at A22.

189. *Id.*

190. Duncan E. Alford, *Anti-Money Laundering Regulations: A Burden on Financial Institutions*, 19 N.C.J. INT'L L. & COM. REG. 437, 457 (1994).

191. *Whistleblower Awards Over $150 Million*, *supra* note 27.

192. *Id.*

193. *Id.*

enforcement actions from 2012 to 2016.[194] The remedies in non-whistleblower actions averaged over $4 billion per year between 2014 and 2016,[195] and over $3 billion per year in 2012 and 2013.[196] The whistleblowing recoveries are thus only a small portion of the SEC's enforcement program, and the awards went only to a small number of recipients. Query, should the SEC issue a greater number of awards from claims provided by whistleblowers, or should the SEC be more definitive in disclosing that only a very small number of whistleblower filed claims will result in an award?

Moreover, while the large absolute numbers for SEC enforcement recoveries from both whistleblowing and independent actions might sound impressive, without more, their usefulness in measuring the value of whistleblowing is subject to criticism. This is because most of the SEC's fines and remedies are gathered through settlements in which the settling party neither admits nor denies the SEC's charges.[197] In the wake of the Financial Crisis of 2008, public companies, financial services firms in particular, were assaulted by enforcement actions brought by the SEC, CFTC, and a host of other regulators.[198] The costs of settlements imposed by regulators in those actions just for the sixteen largest banks, which are public companies, collectively totaled more than $320 billion by the end of 2016.[199]

194. *See, e.g.*, Press Release, SEC, SEC Announces Enforcement Results for FY 2013 (Dec. 17, 2013), *available at* https://www.sec.gov/news/press-release/2013-264 [hereinafter SEC 2013 Press Release]; *see also* SEC 2016 Press Release, *supra* note 184.

195. *See* SEC 2016 Press Release, *supra* note 184.

196. *See* SEC 2013 Press Release, *supra* note 194.

197. The SEC also gathers monies assessed in proceedings conducted before its administrative law judges (ALJs). In those proceedings, the SEC acts as the complainant, the SEC staff as prosecutor, the SEC ALJ as judge and jury, and the SEC conducts the appellate review from the decisions of its ALJs to which the courts defer when an appeal is taken from the agency. *See* Jerry W. Markham, *Regulating the U.S. Treasury Market*, 100 MARQ. L. REV. 185, 225–27 (2016) (proposing restrictions on such internal agency administrative proceedings).

198. *See* Jerry W. Markham, *Regulating the "Too Big to Jail" Financial Institutions*, 83 BROOK. L. REV. 517 (2018) [hereinafter Markham, *Too Big to Jail*] (describing these actions). The regulators demanding those settlements were numerous state, federal and foreign authorities including the Department of Justice, SEC, CFTC, Office of the Comptroller of the Currency, Federal Reserve Board (Fed), Federal Deposit Insurance Corporation, Treasury Department, Financial Crimes Enforcement Network, Federal Housing Finance Agency, National Credit Union Administration, Department of Housing and Urban Development, Federal Trade Commission, Federal Energy Regulatory Commission, Office of Foreign Assets Control, and Department of Labor. State attorney general wolf packs, from forty-nine states, plus the District of Columbia, and various local municipal prosecutors and state pension fund administrators also participated in many of these settlements. Particularly active at the state level were attorneys general from New York and the New York Superintendent of Financial Services. Foreign regulators demanding settlements included the UK Financial Conduct Authority and regulators from Switzerland, Netherlands and the European Union. *Id.* at 517–18.

199. Ben McLannahan, *Banks' Post-Crisis Legal Costs Hit $300bn*, FIN. TIMES (June 7, 2015), https://www.ft.com/content/debe3f58-0bd8-11e5-a06e-00144feabdc0; Karen Friefeld, Arno Schuetze & Kathrin Jones, *Deutsche Bank Agrees to $7.2 Billion Mortgage Settlement with U.S.*, REUTERS (Dec. 23, 2016), http://www.reuters.com/article/us-deutsche-bank-mortgages-settlement-idUSKBN14C041; *World's Biggest Banks Fined $321 Billion Since Financial Crisis*, 49 SEC. REG. & L. REP. (BNA) 395 (Mar. 6, 2017). In addition to those payments, the targeted firms had to pay

Yet, no executives at those firms were charged with a crime.[200] Even in cases where lower-level employees were charged, the Department of Justice has had a remarkable lack of success in contested cases.[201]

These huge settlements were forced because the large public companies targeted for SEC enforcement actions receive little sympathy in the courts or in SEC administrative proceedings.[202] These institutions also do not want to gamble on the collateral estoppel effects of a successful SEC enforcement in the class action suits that inevitably piggy-back on the SEC cases.[203] Those companies also do not want to have their executives charged with violations by the government, in proceedings where anti-Wall Street bias is feared, and not unlikely.[204] Consequently, claims of success based on whistleblower recoveries must be tempered with this element of coercion from the government, which raises several questions. With the new Supreme Court decision in *Somers*, which clearly requires a whistleblower to file a claim directly with the SEC, will whistleblowers stop filing any internal claims now and only file them directly with the SEC? How will this decision impact public companies that have strong internal compliance and reporting regimes? Will this decision adversely affect their efforts to try and do the right thing? Will such companies continue to adopt policies that encourage their employees to report internally but still not retaliate against them if they only report any such law violations to the SEC?

2. Are Bounties Inconsistent with the Internal Risk Controls Mandated by SOX?

The integrity of the whistleblower bounty programs is fairly criticized on other grounds in assessing whether a rollback of Dodd-Frank in this area is appropriate. Whistleblowers are now being offered bounties that sometimes amount to millions of dollars. Instead of protecting whistleblowers from retaliation by management, this bounty system gives every employee with a grudge against their employer a strong motive to exact a lucrative revenge. Employees of public companies dismissed for performance failures also have a strong motive to claim a violation in order to retain their job and receive a large reward. This raises the issue of how public companies can be protected from whistleblower claims that have no merit or that are based on bad

billions of dollars in attorney fees in response to the investigations that led to those payments. They were also forced to pay for "corporate monitors" selected by the government, that were often required to be employed by the settling party to oversee corporate management in its compliance efforts.

200. Markham, *Too Big to Jail*, *supra* note 198, at 518–19.

201. *Id.*

202. *Id.* at 575–76.

203. *See generally* MARKHAM, FROM ENRON TO REFORM, *supra* note 128 (describing class action abuses and concerns for public companies).

204. *See* Markham, *Too Big to Jail*, *supra* note 198 (describing these reasons for SEC and other financial services regulatory fines).

motives. Query, should such frivolous claims be subject to a fine, as each such claim can be quite costly for the SEC to research, or does the public interest test permit any and all claims regardless of their merits?

These whistleblowing powers of the SEC and CFTC will also be assessed by critics in the context of a larger picture that includes the massive compliance costs imposed on public companies by government regulations. The inclusion of whistleblower authority to the already intrusive financial regulatory arsenal will be claimed by critics to be just another part of a continuing effort to impose multiple layers of regulations that intrude into every aspect of company management.

The harshest critics contend that the SEC whistleblower program is inconsistent with the provisions of Section 404 of SOX that mandate extensive internal risk controls.[205] In order to meet the requirements of Section 404, employees are required to periodically certify whether they are aware of any violations. If so, they must report them to their supervisors. Lower-level supervisors then report up through the management chain until those concerns reach appropriate senior managers and even the board of directors.[206] The apparent goal of this reporting system is to assure early detection and correction of violations, so as to limit its effects on shareholders and victims of any fraud. This system also apparently seeks to encourage early self-reporting of those violations by a company to the SEC, where "cooperation" with the government will result in the reduction of penalties that are ultimately borne by shareholders.

The SOX anti-retaliation provision covers employees who report fraud not only to the SEC, but also to any other federal agency, Congress, or an internal supervisor of the employer.[207] If Section 404 mandates are to be effective, both should be required. That is, employees should be required to first report possible violations to their employer. If no action is taken, the employee should then be allowed to report the violations to the SEC or CFTC without fear of retaliation or harassment. If retaliatory action is taken against employees, they could seek redress through a private action. That approach is consistent with the goals of SOX Section 404 and will remove the motivation of employees for not reporting violations or delaying reports in hopes that the severity of the violations will result in the receipt of a large monetary bounty from the SEC.

3. Whistleblowing vs. Internal Reporting

Internal and external reporting requirements for whistleblowers sought to further Section 404's goals of effective internal controls for identifying and reporting violations. However, this begs the question of whether

205. *See Divided U.S. SEC Approves Whistleblower Rule*, *supra* note 4.
206. *See generally* Romano, *supra* note 147 (critiquing the goal of Section 404 of SOX).
207. Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767, 778 (2018).

whistleblowers should be given a lottery size payout for exposing what they are, in any event, required by law to report to their employer under Section 404. One or the other of these mandates need to go, and Section 404 should not be excluded as the appropriate target if the whistleblower award program is not repealed or limited. Query, will the recent Supreme Court decision in *Somers* significantly reduce any internal reporting in the future?

The SEC is regarded by those seeking deregulation to be a particularly intrusive regulator. It requires every public company to report to it quarterly on financial results and other matters that affect the company. SOX Section 404 deepened that intrusion by deputizing public companies as investigators for the SEC at great expense to the shareholders of public companies. That requirement and other SEC intrusions did nothing to prevent the Financial Crisis of 2008. Consequently, it is hard to justify the massive expenses associated with that program, particularly if the whistleblower provisions are retained.

This self-deputization approach to regulation has been expanded in other ways. Among other things, Dodd-Frank requires public companies to act as surrogates in pushing various political agendas. For example, Dodd-Frank requires disclosures by public companies on whether they are trafficking in conflict minerals.[208] Another politically-motivated requirement in Dodd-Frank is that public companies publish in their SEC filings a ratio that compares management compensation to that of their average workers.[209] Efforts have also been conducted by the SEC to inject itself into the highly charged debate over climate change by requiring disclosures detailing how the operations of public companies are being affected by global warming.[210] The SEC's whistleblowing program in combination with Section 404 of SOX simply adds fuel to the debate over whether that agency has far exceeded its original mandate of providing disclosures describing its financial status and market risks through the expansion of required disclosures into political debates over the role of business in society.

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208. According to widespread leaks, the Trump administration is considering rescinding a rule adopted by the SEC pursuant to Dodd-Frank that requires conflict minerals disclosures. It is unclear whether these leaks are whistleblowing or authorized disclosures made to test the political winds on this issue. Sarah N. Lynch & Emily Stephenson, *White House Plans Directive Targeting 'Conflict Minerals' Rule Sources*, REUTERS (Feb. 8. 2017), http://www.reuters.com/article/us-usa-trump-conflictminerals-idUSKBN15N06N.

209. *See generally* Press Release, SEC, SEC Adopts Rule for Pay Ratio Disclosure (Aug. 5, 2015), *available at* https://www.sec.gov/news/pressrelease/2015-160.html; *see also* Jerry W. Markham, *Excessive Executive Compensation—Why Bother?*, 2 J. BUS. & TECH. L. 277 (2007) (describing the ineffectiveness and futility of the SEC's efforts to regulate executive compensation).

210. *See generally* Press Release, SEC, SEC Issues Interpretive Guidance on Disclosure Related to Business or Legal Developments Regarding Climate Change (Jan. 27, 2010), *available at* https://www.sec.gov/news/press/2010/2010-15.htm.

CONCLUSION

While the SEC has been by far the more aggressive regulatory agency in connection with whistleblower programs in the post-Dodd-Frank era, it is expected that both the SEC and the CFTC will continue to highlight and support their respective whistleblower programs. In considering the rollback of Dodd-Frank, Congress will be weighing the value of those programs against their effects in undermining the self-policing required by Section 404 of SOX. If SOX Section 404 is to be maintained, any continued whistleblower programs should require employees to first bring potential law violations to the attention of senior management. Such incentives may allow early self-correction, reduction of harmful effects from violations, and amelioration of punitive enforcement penalties. It will be interesting to see how the SEC, or even the CFTC, changes its whistleblower programs in light of the new Supreme Court decision in *Somers*.