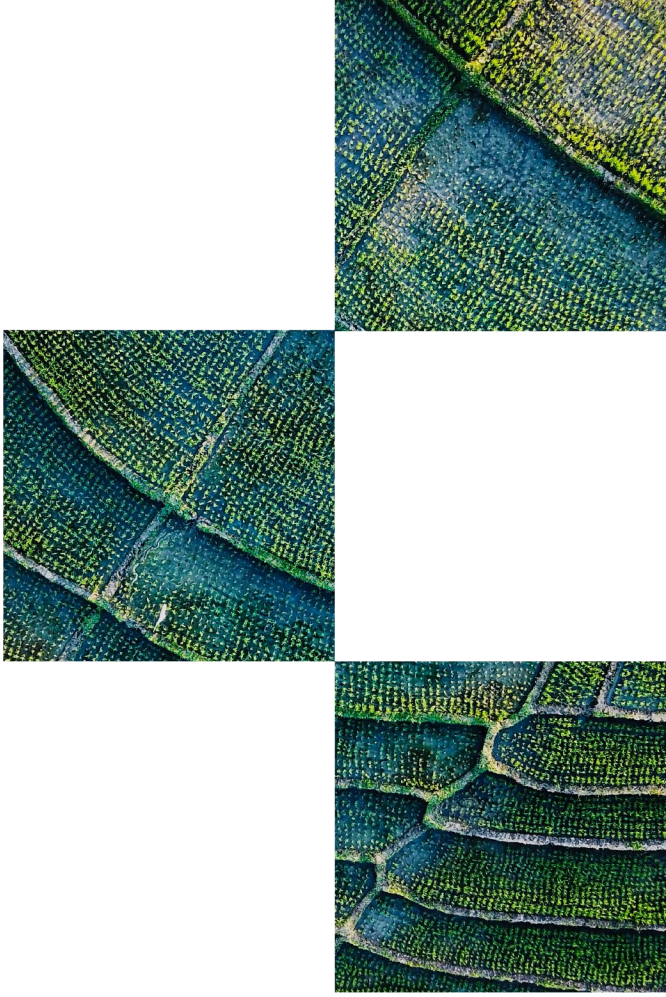
SCHULTE ROTH + ZABEL



ALERT

SEC Focus on Confidentiality Provisions and the Whistleblower Protection Rule

June 6, 2024

ALERT

SEC Focus on Confidentiality Provisions and the Whistleblower Protection Rule

June 6, 2024

The US Securities and Exchange Commission ("SEC") Division of Enforcement is conducting a review of private fund advisers regarding issues concerning the whistleblower protections under the SEC's whistleblower protection rule, Rule 21F-17 ("Rule") under the Securities Exchange Act of 1934. Private fund advisers should consider reviewing the language in their agreements and policies and consider any appropriate next steps.

In addition to this review, the SEC, through enforcement actions (including significant penalties), examinations and statements by SEC staff, has continued to emphasize whistleblower protections under the Rule. The Rule prohibits parties, including private fund advisers, from taking any action to prevent an individual from contacting the SEC directly to report a possible securities law violation. Rule 21F-17, which became effective in 2011, states:

> *"[no] person may take any action to impede an individual from communicating directly with the [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications."*

Historically, SEC enforcement actions under the Rule focused on the employment context. Recently, however, the SEC and its staff, in an enforcement action, examinations and speeches, have made clear that it is their view that the Rule is not limited to employees or former employees but applies to any individual, regardless of that person's relationship to the source of information. They also have stated a view that the SEC does not need to demonstrate that any individual actually was impeded by the relevant provision in order to pursue an enforcement action. In a January enforcement action, the SEC focused on confidentiality language used by a subsidiary of an investment bank in release agreements with certain investment advisory clients and brokerage customers, finding that such language improperly impeded the clients from communicating with the SEC. Although that case involved retail clients, the Co-Chief of the SEC Enforcement Division's Asset Management Unit stated that "[i]nvestors, whether retail or otherwise, must be free to report complaints to the SEC without any interference."[1] In announcing that enforcement action, the Director of Enforcement specified that "[w]hether it's in your employment contracts, settlement agreements *or elsewhere*, you simply cannot include provisions that prevent individuals from contacting the SEC with evidence of wrongdoing." (emphasis added)[2]

In its enforcement actions, the SEC has found confidentiality language to violate Rule 21F-17, among other things, where the language:

- Creates an outright prohibition on communicating with the SEC;

---

[1] *See* SEC Press Release: J.P. Morgan to Pay $18 Million for Violating Whistleblower Protection Rule (Jan. 16, 2024), available here.

[2] *Id.*

- Requires an individual to provide notice to the counterparty before communicating with any third party or the government;
- Prohibits or limits a person from collecting any reward/bounty when providing information to the government;
- Is contained elsewhere in a document or internal policies and is inconsistent with "carveout" language contained in a confidentiality provision; or
- Suggests or implies that a person is limited from voluntarily providing information to the SEC.

In recent months, both the Division of Enforcement and the Division of Examinations have focused on potential violations of the Rule by private fund advisers.

Considerations for Private Fund Advisers

The SEC's Whistleblower Program is very active – it received a record-setting 18,000+ tips in 2023 and awarded millions to whistleblowers, including a single award of over $279 million to one whistleblower. To protect its program, the SEC has been aggressively pursuing actions that might chill an individual's ability to communicate with the SEC. To that end, there have been more than 20 enforcement actions on the specific issue of confidentiality language that the SEC believes violates Rule 21F-17. At the same time, the current review by Enforcement of private fund advisers is consistent with the Enforcement Director's comments last year that the private funds industry continues to be a "substantive priority area" for the SEC's enforcement agenda.[3] Given these factors, fund advisers should consider steps to address scrutiny of their confidentiality provisions under Rule 21F-17.

- *Consider Reviewing Agreements For Language That May Be Viewed as Restricting or Limiting Individuals From Communicating With the SEC or other Authorities.* Based on the SEC's enforcement actions and statements, particular provisions to look for are those that could be viewed as:
  - Prohibiting any and all disclosures of confidential information, without any exception for voluntary communications with the SEC concerning possible securities laws violations;
  - Prohibiting employees or former employees from voluntarily communicating with the SEC or other authorities regarding possible violations of law or from recovering a SEC whistleblower award;
  - Requiring an employee to notify and/or obtain consent from the fund manager prior to disclosing confidential information; and
  - Conditioning employee post-termination payments on representations to the fund adviser that the employee did not file a complaint or commence a proceeding with the SEC.
- *Consider Carveout Language Within Agreements to Address Rule 21F-17 Prohibitions*. Fund advisers should consider including "carveout" language to limit provisions restricting third-party communications or the sharing of information. Such language can specifically address permissible communications. Historically, fund manager agreements outside of the employment context – such as limited partner agreements – typically have not contained

[3] *See* Schulte *Alert*: SEC Enforcement Director Highlights Focus on Private Funds (May 25, 2023), available here.

such carveout language, but now fund managers should consider expanding their review to non-employment agreements.

- *Consider Whether the SEC Might Expect Lookbacks and Remedial Action With Respect to Certain Existing Agreements*. The SEC has faulted parties for failing to remediate or take steps to address "historical" language contained in prior agreements in certain circumstances.
- *Be Mindful of Varying Employment Law Considerations*. Fund advisers should consult with employment counsel in reviewing employment-related agreements given overlap and specificity in city and state regulatory and employment law.

Authored by *Michael S. Didiuk*, *Peter D. Greene*, *Daniel F. Hunter*, *John P. Nowak*, *Martin Schmelkin*, *Max Garfield* and *Cody A. Lind*.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors

SCHULTE ROTH + ZABEL

Schulte Roth & Zabel
New York | Washington DC | London
srz.com