



SIPA

SMALL INVESTOR PROTECTION ASSOCIATION

A Voice for Small Investors
Seeking Truth and Justice

Via email

April 21, 2015

SIPA Comment Letter

OSC Staff Consultation Paper 15-401: Proposed Framework for an OSC Whistleblower Program

http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20150203_15-401_whistleblower-program.htm

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The Small Investor Protection Association is pleased to provide comments on the proposed whistleblower program.

The Small Investor Protection Association (SIPA - www.sipa.ca) was founded in 1998 and is registered in Ontario as a national non-profit organization.

In 2004 SIPA hand delivered a copy of our unsolicited report *[“The Small Investors’ Perspective of Investor Protection in Canada”](#)* to the OSC Chair David Brown, who read the report and later said it precipitated his arranging the Town Hall Meeting in 2005. This report states on Page 52:

Whistleblower legislation proposed subsequent to the Fraser Report must extend beyond the federal government and apply to provincial and municipal governments, corporations, the investment industry and the regulators. By empowering Canadians to tell the truth without fear of reprisals and negative consequences our government can make the world a better place in which to live. This would assist regulators in carrying out their function.

At the same time the Government should establish a new agency or authority that is charged with consumer/investor protection that would work in conjunction with the regulatory agencies, whether they are provincial or federal. It should be independent from industry and industry regulators that are populated with industry participants. It should be controlled by individuals that are not from the investment industry and that have a consumer oriented background. It could be similar to the New York Attorney General’s Office



Bureau of Investment Protection or could be patterned after the new Authority in Quebec.

Law enforcement agencies depend upon whistleblowing to help them in resolving crimes that would be otherwise insoluble. The Canadian Government has recognized the need for legislation to protect whistleblowers but it applies only to Government.

Canadians are losing billions of dollars of their life savings each year resulting in traumatized victims who suffer the life-altering event of losing their life savings due to industry fraud and wrongdoing at an age where it is too late to start over. Their mistake was to trust the industry and believe that regulators would protect them against the risks of fraud and wrongdoing.

It seems the Quebec authority has recognized the issues and revised their regulatory system while TROC is either unwilling or unable to effect change that would protect the ordinary Canadian investor.

The issue of whistleblowing is not new. It has been studied, discussed and reported on for many years. The SIPA Report of 2004 reported on the need for legislation. In June 2008 the SIPA Sentinel reported:

"Canada lacks whistleblower protection legislation so those who are brave enough to come forward and tell the truth will not ultimately pay the price. Lost job and lost career are only a part of it. Our laws and courts seem more supportive of the white collar criminals who perpetrate frauds than the victims of these frauds. Its time for Canadians to speak up and call for updated legislation to protect those who will come forward to tell them the truth and reward them for doing so"

Although the OSC has been considering whistleblowing for some considerable time the delays result in evermore Canadians losing their life savings due to widespread industry wrongdoing that seems to escape detection. There is no doubt that proper whistleblowing legislation will result in enforcers becoming more effective in detecting wrongdoing.

Canadians have been subjected to life altering loss of savings due to systemic practices of wrongdoing by an industry that enables commission driven sales persons to gain Canadians trust by allowing them to use unregulated business titles of "Financial Advisor" and "Vice President". This facilitates the sale of products paying the highest commissions with higher risk than is appropriate and the use of leverage by various means for investors who can not afford the risks associated with such strategies.

This problem is ever increasing with the move from defined benefit pension plans to defined contribution pension plans. This will result in more Canadians becoming responsible for investment performance to protect their pensions. Canadians will



turn to “Financial Advisors” not knowing that they are commission driven sales persons with no legal requirement to look after clients’ best interests. This is why fiduciary duty is becoming ever more important.

Inevitably there are those in the industry who will find ways to circumvent the rules and regulations and cause extreme investor loss. The implementation of a whistleblower strategy should help to improve investor protection provided by regulators.

There have been endless surveys and reports that substantiate the comments made by SIPA to the OSC for the past decade. The OSC Town Hall Event provided public evidence of the desperate need for change when approximately 500 people attended the event and many witnesses came forward to speak out.

In an attempt to help the OSC in their protracted deliberations the SIPA Advisory Committee led by Ken Kivenko prepared the following information that should assist the OSC as they approach initiating action on this important issue.

The **CSA Investor Index**

http://www.msc.gov.mb.ca/about_msc/csa_inv_index_oct_2006.pdf provides interesting stats on fraud • More than one-in-three Canadians has been approached with a fraudulent investment. • An estimated 900,000 Canadians have been victims of financial fraud. • While two thirds of the cases involve \$5,000 or less, 12% involve \$25,000 or more. • 70% of the time, no money is recovered from scams. • Despite this level of fraud attempts and experience, only 51% believe they are just as likely to be a victim as anyone else and only 47% believe fraud is common. • Only 14% of fraud attempts are reported to authorities. Any regulatory actions that reduce harm to small investors are welcomed.

SIPA realizes how extremely difficult it is to detect, investigate, and prosecute serious white collar crime without insider information or assistance from knowledgeable individuals. Canadian companies are filled with many honest people who want to do the right thing. Often, they fear being blacklisted and retaliation. With the incentives and planned protections of the proposed OSC Whistleblower Program, their downside risk would be significantly limited. We fully support the initiative as it will help to make the Canadian securities marketplace safer for investors. A whistleblowing program is an important investor protection tool – one that will encourage those with robust information to come forward and report illegal activities and practices.

Canadian corporations are not required by the OSC to have an internal whistleblowing policy and system. There may be those that argue that the OSC program will short circuit internal corporate programs. The numbers speak for themselves. There have been books written about the ineffectiveness of internal hotlines and the adverse impact on the lives of whistleblowers - the results are



ugly. The recent CBC case demonstrates that even a reputable Crown Corporation was unable to deal with a very serious misconduct problem.

See also The Harvard Law School Forum on Corporate Governance and Financial Regulation **Elements of an Effective Whistleblower Hotline document** <http://blogs.law.harvard.edu/corpgov/2014/10/25/elements-of-an-effective-whistleblower-hotline/> . It defines the criteria for a trusted hotline. We are told that few corporate programs meet these criteria and several employee surveys suggest that no matter how robust the program, fear dominates potential whistleblowers in Canada.

On the other hand, there is strong evidence the SEC whistleblower program has been successful:

1. **Dodd Frank Whistleblower Program: Report to Congress**

<http://www.kkc.com/wp-content/uploads/2014/11/SECannual-report-2014.pdf> The SEC experience suggests that financial rewards are a powerful incentive for whistleblowers to come forward.

2. **Study shows whistleblower complaints lead to increased penalties and likelihood of enforcement** - Lexology

An academic study The Impact of Whistleblowers on Financial Misrepresentation Enforcement Actions http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2506418 first reported by the [WSJ](#), concludes that, in regulatory enforcement actions brought by the SEC and DOJ alleging financial misrepresentation, employee whistleblowers have a consequential impact on regulatory outcomes, increasing the size of penalties, length of prison sentences and duration of the actions. In addition, whistleblower complaints were found to significantly increase the likelihood of an enforcement action.

<http://www.lexology.com/library/detail.aspx?g=49f83aeb-168b-4b98-97db-7e99cd1732c7>

It is our opinion that Livent, Bre-X, Atlas Freezer , FMF , Hollinger, YBM Magnex, Sino-Forest, and countless other scandals would have been uncovered earlier if a robust WB program had been in place.

Financial incentives are a key success factor of the SEC program.

Presented below are our comments, observations and questions:

What is definition of a “Whistleblower”? Under the proposal, we understand a whistleblower to be any individual who provides information to the OSC regarding a possible violation of the securities laws that has occurred, is ongoing or that is about to occur, i.e. employee, agent, or someone outside the company who provides relevant information may be a whistleblower. We assume this would also



include Company Officers. It is not clear to us why a WB must be an individual. Muddy Waters LLC, published a June, 2011 research report alleging Sino-Forest Corp. is a "fraud" and a "multibillion-dollar Ponzi scheme". Subsequently, the OSC decided to proceed with the case. In any event, it is very important to carefully define an eligible "whistleblower" as applicable to the program.

Who is eligible? There are different types of persons who can be whistleblowers and therefore covered by the proposed policy. These persons can be broadly classified as internal (employees, contract workers, etc.) or external (suppliers, customers, members of the public etc.). We assume that the program covers "outsiders"/third parties under certain conditions but we would not normally consider a Company's external auditor eligible. We are uncertain if a pension fund, forensic accountant, hedge fund or a research firm (Muddy Waters, a research firm, is credited with exposing anomalies in Sino-Forest disclosure which ultimately led the OSC to initiate an enforcement action) should be eligible whistleblowers although they presumably have the resources, analytical skills and insight to early detect deviant practices, unusual trading patterns and accounting anomalies and thus could be a rich source of valuable information.

Whistleblowers should be able to receive awards where the enforcement outcome is significant or full compensation is made to investors, rather than just monetary penalties. The reward scale could be adjusted to reflect this case.

The Reward schedule is light We believe that the reward schedule may be a little light – it is well below SEC levels. An award to an eligible whistleblower (WB) of up to 15% of total monetary sanctions (including the amount of administrative penalties and disgorgement.) imposed in a s.127 administrative proceeding or a payment agreed to in a settlement before the Commission where imposed sanctions or settlement payments are more than \$1,000,000, exclusive of costs may not be adequate to bring WB' forward. The maximum amount of \$1,500,000 may be adequate but one must note that WB's suffer a life altering event. They may find it difficult if not impossible to gain future employment

It should be noted that Canadians are just as interested in seeing lawbreakers put in jail as fined. This suggests whistleblowers should be rewarded even if no fine is ever collected. Just having an increased number of eyeballs can itself lead to a decrease in financial fraud which is a key goal of the Securities Act. If the reward is taxed as ordinary income, we definitely believe the amounts are too low.

We add parenthetically that Canadians are increasingly disturbed that even in those rare cases when fraudsters are convicted, sentences are light, "white collar jails" are too comfortable and parole conditions an affront to their sensibilities and sense of justice.



A Guidebook for WB's will be required The SEC Whistleblower Program Handbook is a good model. With its [anonymous reporting, employment protections, and monetary awards](#), the SEC Whistleblower Program is revolutionizing the way the securities laws are enforced and has inspired whistleblowers from all walks of life to break their silence and report a wide variety of significant securities violations to the SEC. The SEC Whistleblower Program Handbook is designed to educate potential whistleblowers and other interested parties regarding the many policies and procedures that govern this important investor protection program. <http://www.secwhistlebloweradvocate.com/resources/sec-whistleblower-program-handbook> WB's run many personal risks so they need to be well informed before they take even the first step.

WB protection is a key success factor so the OSC will need to ensure such protection is provided to the maximum extent practicable. The OSC should be prepared to prosecute entities that constrain and intimidate WB's through confidentiality or employment agreements.

Changes may need to be made to Ontario Employment Standards Act While Anti-retaliation protections must be available to both individuals who report possible violations of the Securities Act" up the ladder" through their employer's internal compliance reporting system and individuals who report directly to the OSC, more protective actions may be required than amendments to the Ontario Securities Act.

What is the intended use of increased (anticipated) fine proceeds? Will the money be used to further investor protection/education, fund more investor research, reduce the OSC's operating budget or be turned over to the Ontario Govt. as general revenues?

When is a complaint a whistle blow? SIPA has pointed out to the OSC that certain mutual fund companies were paying trailer commission payments intended to provide advice to discount brokers who are prohibited from providing advice. We view this as a serious governance issue resulting in the leakage of tens of millions of dollars of investor assets. Program documentation should make it clear to prospective whistleblowers as to how to report an issue to the OSC so as not to lose their rights to an award. We also recommend that the OSC review its own approach to complaint handling and follow-up with complainants as opportunities for detection of serious wrongdoing may be missed.

The eligibility criteria for information provided by a whistleblower must lead to a Statement of Allegations issued by Staff. We believe this will give the program a jump start. It could be amended later depending on experience. In the short term, Ontarians want to see a more aggressive approach in dealing with white collar crime.



WB's should not have to report to the corporation before filing with the

OSC - WB's should not be required to report misconduct to their organizations' internal compliance programs in order to be eligible for a whistleblower award. There may well be cases (Bre-X?) where the risk of physical harm as well as employment and other sanctions (blacklisting) would make it too risky to use an internal hotline system. This is true especially where the wrongdoing is at the very top of the organization.

Culprits should be eligible for reward - Individuals culpable in the conduct being reported should be eligible for a whistleblower award dependent on their role in the wrongdoing. Those in law enforcement are well aware of the value of such a policy.

While the thrust of the OSC appears to be focused on corporations (accounting miss-statements, insider trading, market manipulation etc.), the investment field is littered with huge fiascos. These include the great mutual fund market timing scandal which cost investors over \$200 million that was ultimately recovered by OSC actions. Portus is another example as are cases involving leveraging, Ponzi schemes (Earl Jones) and the infamous Ian Thow/ Berkshire episode. A Whistleblowing program might well have caught these nightmares before they could become huge. It is clear to us that the MFDA and IIROC whistleblower programs have not been fruitful because they do not offer financial incentives. The OSC program will rectify this deficiency. We are glad to see that Registrant misconduct wherein dealers who aren't dealing fairly, honestly and in good faith with clients; are breaching their KYC and suitability obligations; are providing misleading or false information; and/or aren't identifying and disclosing conflicts of interest are covered by the program.

An August 2012 survey by The American Association of Individual Investors revealed some very interesting results. A sizeable number of financial services professionals said they have either observed, have firsthand knowledge of or feel pressured to engage in unlawful or unethical behavior. The survey was conducted by Labaton Sucharow, a law firm that specializes in protecting and advocating for Securities and Exchange Commission (SEC) whistleblowers. The firm asked 500 senior-level finance professionals in the United States and the United Kingdom (mostly in New York and London) about ethics and illegal activity in the financial services industry. Among the survey's findings were:

§ 24% of respondents believed rules may have to be broken in order to be successful;

§ 30% felt pressure to compromise ethical standards or violate the law as the result of their compensation or bonus plan; 23% also felt other pressures to compromise ethical standards or violate the law;



§ 26% of respondents said they have observed or had firsthand knowledge of wrongdoing in the marketplace; 12% believed it was likely that staff in their company have engaged in unethical or illegal activity;

§ Just 41% said staff within their own organization had “definitely not” engaged in unethical or illegal conduct to be successful;

§ 16% of respondents admitted to being fairly likely to engage in insider trading if they could get away with it; only 55% of respondents said they would definitely not engage in insider trading if they could make \$10 million with no risk of getting arrested;

§ 14% feared their employers would retaliate if faced with a report of wrongdoing in the workplace; only 35% felt certain their employer would not retaliate; and

§ 94% of respondents would be willing to be a whistleblower for the SEC if they were given anonymity, employment protections and a monetary award, but just 44% were aware that the SEC had such a program. Ref *Bad behaviour in the financial industry* <http://www.aaii.com/journal/article/bad-behavior-in-survey-financial-industry?adv=yes>

Give reasons for Award denial - In a section of the OSC’s whistleblower consultation paper titled “Process for Determining Whistleblower Awards,” the OSC states:

“The commission would, in its discretion, approve, reject or modify the amount to the recommended award and, if applicable, authorize payment. The OSC would not give reasons for its determination.” While there’s nothing unusual about the OSC giving itself total discretion on whether an award’s granted, and for how much, we question the OSC’s remark that it won’t explain its decisions. It is a fundamental principle of administrative law to give reasons for such judgments.

Related recommendations:

Give OBSI back its systemic issues investigation mandate - We believe that there is a relationship between complaints and organized wrongdoing. Systemic issues such as excessive fees, KYC adulteration / signature forgery and unmonitored Outside Business Activities need a much better system than we have today. OBSI can serve as an early warning system for serious systemic misconduct.

Ensure IIROC complaints system is more diligent in investigating complaints - Too many complaints are dismissed too early and the complaint system is geared more to investigating individuals rather than dealers/issuers. Market misconduct issues may persist and become more pervasive if there is less of



a regulatory focus on alleged [trading rule] violations. A more robust system might help expose serious pattern issues that are not now being fully investigated.

In conclusion, SIPA supports the OSC whistleblowing initiative. Investment fraud is serious and in many cases is a life-altering event for small investors. With senior demographics being what they are, the OSC initiative could not be timelier as research and statistical evidence has shown that seniors are a large and growing vulnerable segment of Ontario society. See **Fraudsters take aim at Baby Boomers**: University of Toronto (2007)

[http://sites.utoronto.ca/difa/PDF/Research_Projects/DIFA2007-Fraudsters Take Aim at the Baby Boomers.pdf](http://sites.utoronto.ca/difa/PDF/Research_Projects/DIFA2007-Fraudsters_Take_Aim_at_the_Baby_Boomers.pdf)

Enforcement is a key component in the fraud prevention /investor protection system and whistleblowing is an invaluable tool. In the United States, the chances of having a penalty over \$1 million are infinitely greater than they are in Canada because they enforce rules more seriously, and have tougher penalties.

The OSC needs more resources to track the activities of companies that raise money in Canada, but operate largely offshore, under the direction of non-Canadians. Canadian stock markets shouldn't welcome these listings.

It is important however to also work on [fraud prevention activities](#). The Small Investor Protection Association have argued for over a decade that better national data about financial fraud would help regulators decide where to target their actions, and would help alert the public about fraud risks. Knowing how much fraud is going on out there would really bring investor and political attention to the issue. The fact there's no measure that gets attention and is publicly available means it doesn't really resonate with Canadians that there is a significant amount of fraud that is going on in the markets. We urge the OSC/ CSA to establish a central database with key statistics and estimated dollar losses.

Additionally, our sense is that the Exempt market in Ontario is too lightly regulated. The statistics indicate that more resources need to be applied. Ref **Welcome to Canada's exempt market: Exclusive, anything goes investments — but play at your own risk**

<http://business.financialpost.com/2013/06/15/welcome-to-canadas-exempt-market-exclusive-anything-goes-investments-but-play-at-your-own-risk/>

We also wish to stress that the initiative must be integrated and harmonized with other regulatory initiatives such as fraud prevention, investor "Streetproofing", TSX listing requirements, reverse takeover rules ("backdoor listings"), zombie listings on the TSX-V, market monitoring including advertising, seminars and cyberspace, auditor oversight, underwriter due diligence obligations in IPO's, the responsibilities of "gatekeepers", the role of bond rating firms and the OSC's own process for granting regulatory exemptions. We recommend better communications between



IIROC, the MFDA and OBSI with the OSC when serious wrongdoing is suspected or observed.

SIPA agrees to public posting of this Comment Letter.

We would be pleased to discuss our comments and recommendations with you in more detail at your convenience.

Sincerely,

Stan Buell,
President



REFERENCES

PwC 2014 Global Economic Crime Survey

<http://www.pwc.lu/en/fraud-prevention-detection/global-economic-crime-survey.jhtml>

2013 Canadian Securities Regulators' Enforcement Report Highlights Fraud

http://www.lautorite.gc.ca/en/press-releases-2013-conso.html_2013_canadian-securities-regulators-enforcement-report-highlights-fraud21-02-2013-11-0.html

Auditors need to do a much better job [http://www.cpab-](http://www.cpab-ccrc.ca/EN/content/Auditing_in_Foreign_Jurisdictions_FINAL.pdf)

[ccrc.ca/EN/content/Auditing_in_Foreign_Jurisdictions_FINAL.pdf](http://www.cpab-ccrc.ca/EN/content/Auditing_in_Foreign_Jurisdictions_FINAL.pdf) "The Canadian Public Accountability Board is disappointed by the results of its review. In too many instances, auditors did not properly apply procedures that would be considered fundamental in Canada, such as maintaining control over the confirmation process. CPAB's findings indicate that auditors often did not appropriately identify and assess the risks of material misstatement in the financial statements, through a sufficient understanding of the entity and its environment. CPAB also found a lack of professional skepticism when auditors were confronted with evidence that should have raised red flags regarding potential fraud risk.

Stock market swindles galore in Canada

<http://rabble.ca/blogs/bloggers/progressive-economics-forum/2012/04/stock-market-swindles-galore-canada>

A Decade of Financial Scandals

http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm_Final-0222.pdf Cases include Norburg, Earl Jones, Ian Thow, Portus, Triglobal and Fulcrum.

THE AFTERMATH OF BRE-X: THE INDUSTRY'S REACTION TO THE DECISION AND THE LESSONS WE ALL HAVE LEARNED

http://www.groiaco.com/pdf/The_Aftermath_of_Bre-X_Mar_4-08.pdf

2007 CSA Investor Study: Understanding the Social Impacts of Investment Fraud

The key focus of this study was to understand the impact of investor fraud beyond the financial loss endured by victims. Victims of fraud and their friends and family were asked to share their perceptions on the social impact of investment fraud. The study also explored the experiences of victims of both attempted and actual fraud. The results of this study showed that the first casualty of fraud is the victim's trust in other people, in the financial markets and investments in general. We also learned that the effects of financial fraud go well



beyond the victim's pocket book, causing negative impacts to health and social relationships. For more information on the results of this survey and how investment fraud affects Canadians: [View the Executive Summary](#) [while the study refers to fraud, losses due to flawed financial advice or negligence have the same impact on victims]

Regulators risk creating policies based on anecdotal, incomplete information, report warns

Major participants and regulators should work together to create an "exempt market data repository", suggests a new report produced by the University of Calgary's School of Public Policy. This collection of data would include information on different industries within the exempt market, the size of an issuer and whether it is a reporting issuer or not. The repository should also provide details on the size of each issue, the types of security, the intended use of the capital, the liquidity and duration of the security as well as requiring notification of redemptions. It is the absence of this data that is making regulators' efforts to make rules in this space problematic, according to the report entitled [*The exempt market in Canada: empirics, observations and recommendations*](#).

A New Look at Reporting Fraud: By Exchange

[Douglas J. Cumming](#) York University - Schulich School of Business and Sofia Johan - (October 15, 2011)

Abstract: Statistics reporting litigated cases of fraud on an exchange-by-exchange basis are not readily available to investors. This paper introduces data from three countries with multiple exchanges with different listing standards, – Canada, the United Kingdom and the United States – to show litigated cases of fraud significantly vary by country, and the different exchanges within the country. Comparisons are also made to Brazil, China and Germany to assess out-of-sample inferences. The data examined suggest listing standards have a strong influence over the nature of observed fraud by securities commissions within the United States; by contrast, outside the United States there appears to be a comparative lack of enforcement. The data also suggest policy implications for the ways in which fraud ought to be reported to improve investor knowledge, market transparency and market quality.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1949458

SEC Announces First Whistleblower Action Regarding Confidentiality Agreement Restrictions <http://www.natlawreview.com/article/sec-announces-first-whistleblower-action-regarding-confidentiality-agreement-restric>

Whistleblowers Against Fraud Discusses the SEC's Decision to Reward a Corporate Officer <http://www.sys-con.com/node/3319110>