



Canadian Foundation *for*
Advancement *of* Investor Rights

May 4, 2015

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Sent by email to: comments@osc.gov.on.ca

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

FAIR Canada is pleased to offer comments to the Ontario Securities Commission (“OSC”) regarding its proposed whistleblower program that is set out in OSC Staff Consultation Paper 15-401 (the “Consultation Paper”).

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. Executive Summary

- 1.1 FAIR Canada is supportive of the OSC instituting a whistleblower program as a properly designed whistleblower program will help combat fraud and other wrongdoing, thereby helping the OSC to fulfill its mandate to protect investors and foster fair and efficient capital markets and confidence in those markets. Such a program will help the OSC to discover and put a stop to wrongdoing early and quickly and thereby minimize investor losses.
- 1.2 FAIR Canada is strongly supportive of the payment of financial incentives to eligible whistleblowers. We also strongly support the inclusion of robust confidentiality protections for all whistleblowers and the inclusion anti-retaliation measures. FAIR Canada believes that such provisions are needed in order to address, as much as possible, the severe repercussions whistleblowers face when they come forward. Those repercussions negatively impact their careers, their reputations, their financial well-being, their health and their family relationships. In consideration of this fact, it is not sufficient to expect individuals to simply “do the right thing”.
- 1.3 FAIR Canada believes that the whistleblower program should allow each whistleblower to decide what route is best to pursue – internal reporting of the wrongdoing or reporting externally to the OSC – while providing incentives for the whistleblower to report internally (rather than requiring it). FAIR Canada believes that the United States’ Dodd-Frank Whistleblower Program struck the appropriate balance between encouraging whistleblowers to pursue the route of internal compliance when appropriate while also allowing the whistleblower to decide to report matters externally. As set out below in section 3, this approach should foster improved internal compliance and internal reporting/addressing of wrongdoing as well as improved enforcement and deterrence of wrongdoing by the securities regulator. FAIR Canada recommends that the OSC structure its program in a similar manner.

- 1.4 FAIR Canada believes that how the program is structured, resourced and funded will be very important to its success. We make a number of recommendations which we hope will result in more robust enforcement and higher rates of collection of fines. The whistleblower program needs to be adequately funded, have sufficient resources and expertise and needs to be supported at the highest levels. Emphasis should be placed on transparency as to the number and types of complaints it receives, the number of whistleblower tips it obtains, the number of investigations it pursues and the number of enforcement outcomes it obtains (with and without financial payments). Structures that put an emphasis on meaningful disclosure and transparency of the enforcement process should lead to better accountability, both of the whistleblower program and enforcement generally.

2. The Need for a Whistleblower Program

- 2.1 The SEC's Dodd-Frank Whistleblower Program has had a significant impact on the SEC's investigations according to the SEC's Chair Mary Jo White.¹ Whistleblowers have helped the SEC's Enforcement Division identify more possible fraud and other violations and do so earlier than otherwise would have been possible. The SEC has received over 3000 tips for each of the three fiscal years the program has been in operation² and many were of "high quality and extremely useful". The Chair has called the program "enormously successful" and has publically stated that it "has yielded very significant information on very serious securities fraud" that would have been "very difficult to detect" without the whistleblower.³
- 2.2 The academic literature suggests that whistleblowers play a key role in uncovering fraud and that they provide some of the most important information about corporate fraud.⁴ According to one study, "[w]histleblowing is the single most effective way to detect fraud," and "[o]ver 40% of fraud detection results from whistleblower tips".⁵ The 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program indicates the most common complaint categories reported by whistleblowers included Corporate Disclosures and Financials, Offering Fraud, and Manipulation.⁶ As noted in the Consultation Paper, "[t]hese types of cases involve

¹ Mary Jo White, "A Few Things Directors Should Know About the SEC" (Address to Stanford University Rock Center for Corporate Governance at Stanford, California, June 23, 2014) available online at: <http://www.sec.gov/News/Speech/Detail/Speech/1370542148863>.

² See the SEC's 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program, at page 20, available online at <http://www.sec.gov/about/offices/owb/annual-report-2014.pdf>.

³ Barbara Shecter, "SEC chair Mary Jo White praises 'enormously successful' whistleblower program" *Financial Post* (October 16, 2014) available online at: <http://business.financialpost.com/news/fp-street/sec-chair-mary-jo-white-praises-enormously-successful-whistleblower-program>.

⁴ See for example, Nancy M. Modesitt, "Why Whistleblowers Lose: An Empirical and Qualitative Analysis of State Court Cases" 62 Kan. L. R. 1 (October 2013) at page 166, available online at

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2499630 and Jennifer Pacella, "Inside or Out? The Dodd-Frank Whistleblower Program's Anti-Retaliation Protections for Internal Reporting, 86 Temp. L. R. Summer 2014 (October 2013) at page 37, available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2320229.

⁵ Jennifer Pacella, at page 37, quoting Geoffrey Christopher Rapp, "States of Pay: Emerging Trends in State Whistleblower County Schemes", 54 S. Tex. L. Rev. 53, (2012) at 108.

⁶ 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program, at page 21. In fact, whistleblowers used the category of "other" the most frequently as they thought that their information did not fit into any allegation category that is listed on the questionnaire.

sophisticated players, raise complex issues, and are difficult to uncover without the assistance of a whistleblower.”⁷

- 2.3 The importance of whistleblower programs, and in particular the protection of whistleblowers, was identified as one of the high priority areas in the G20’s global anticorruption agenda.⁸ Whistleblower protection, according to the OECD, is essential to encourage the reporting of misconduct, fraud and corruption.⁹ The introduction of a whistleblower program in Ontario that includes the protection of whistleblowers (which should include financial incentives to compensate for financial and other harms whistleblowers face) will help further the G20 global anti-corruption agenda.
- 2.4 In contrast, in the U.K., the Financial Conduct Authority and the Bank of England’s Prudential Regulation Authority have noted that “...the Government have concluded that financial incentives should not be introduced as an integral part of the whistleblowing framework” and have not made it a part of their proposed framework. Their approach observes that UK policy norms are different to those in the US and do not agree with paying significant sums to high-income individuals for fulfilling a “public duty”. Remarkably, they come to the opposite conclusion to the SEC noting that, from their research into the impact of financial incentives on encouraging whistleblowing in the US, “[T]he research showed that introducing financial incentives for whistleblowers would be unlikely to increase the number or quality of the disclosures we receive from them.”¹⁰
- 2.5 In Canada, paying whistleblowers has already been introduced by the Canada Revenue Agency’s Offshore Tax Informant Program. FAIR Canada believes that the policy norm in Canada appears to support payment to whistleblowers and believes that the evidence from the SEC supports the efficacy of financial incentives and, therefore, supports their introduction.
- 2.6 Instituting a whistleblower program in Ontario should similarly result in earlier detection of securities violations and increased deterrence of potential future violations. This should result in increased investor protection and a more efficient allocation of investment (since monies will not be diverted away from legitimate, productive uses). The increase in deterrence should result in increasing the level of confidence in Ontario’s securities markets. Thus, a whistleblower program will further the mandate of the OSC.
- 2.7 FAIR Canada is of the view that the efficiency and effectiveness of an enforcement program should not be assessed solely or even primarily by how quickly matters are dealt with, but rather on how much investor harm is being avoided, how much fraud and wrongdoing is being

⁷ OSC Staff Consultation Paper 15-401: Proposed Framework for an OSC Whistleblower Program, February 3, 2015, at page 1, available online at http://www.osc.gov.on.ca/documents/en/Securities-Category1/rule_20150203_15-401_whistleblower-program.pdf.

⁸ G20 Anti-Corruption Action Plan Protection of Whistleblowers, “Study on Whistleblower Protection Frameworks, Compendium of Best Practices and Guiding Principles for Legislation” at page 2, available online at <http://www.oecd.org/daf/anti-bribery/48972967.pdf>.

⁹ G20 Anti-Corruption Act Plan, at page 4.

¹⁰ Prudential Regulation Authority, “Financial Incentives for Whistleblowers” (July 2014) at page 1, 3 and 5, available online at: <https://www.fca.org.uk/your-fca/documents/financial-incentives-for-whistleblowers>.

uncovered, and how much of a deterrent effect the enforcement action is engendering. The OSC in its Consultation Paper states that its Enforcement Branch has a number of initiatives aimed at resolving enforcement matters more quickly and effectively, including no-contest settlements, a clarified process for self-reporting and enhanced public disclosure of credit granted for cooperation. Resolving enforcement matters more quickly does not assist the OSC beyond possibly realizing some amount of efficiency gains for the OSC from an administrative resources standpoint. The real question is whether instituting a given enforcement program such as the proposed whistleblower program will help protect investors and help foster fair and efficient markets and confidence in those markets. FAIR Canada believes that it will, and therefore implementing a whistleblower program will further the mandate of the OSC.

- 2.8 While the adoption of such a program will lead to a greater amount of information being received by the OSC, and therefore, greater resources and systems to appropriately receive and assess the information¹¹, such costs need to be weighed against the ability to have more effective enforcement (i.e., greater detection and halting of wrongdoing that otherwise would not be discovered) and the deterrent effect it may have in discouraging future violations. FAIR Canada believes that a properly instituted program's benefits will outweigh the costs.

The Fate of Whistleblowers

- 2.9 Those who uncover potential corporate wrongdoing face real risks in disclosing that information to their employer. Whistleblowers face the following risks: dismissal from their job; difficulty in finding a new job in the same or similar field given their "reputation"; possible legal claims in order to deter the whistleblower from speaking out (i.e., claims for breach of confidentiality or libel); allegations regarding the whistleblower's personal or professional integrity or attacks on their character which serve to discredit the whistleblower's reputation; and the resulting risks to the whistleblower's mental and physical health, which can also impact on the whistleblower's family relationships. Time and again honest behavior by whistleblowers is not rewarded but rather is punished under the current system.
- 2.10 Recent studies suggest that employees who blow the whistle suffer as a result. For example, the study by Richard Moberly found that the Sarbanes-Oxley Act ("SOX") failed to protect whistleblowers from reprisals by the employer and employees rarely succeeded with their claims for damages resulting from such retaliation¹².
- 2.11 Another study, which looked at whistle-blowing in corporations from the period 1996 to 2004 and examined who blows the whistle on corporate frauds, revealed that "[i]n 82 per cent of cases with named employees, the individual alleges that they were fired, quit under duress or had significantly altered responsibilities as a result of bringing the fraud to light. Many of them

¹¹ See, for example, "The Impact of Whistleblowers on Financial Misrepresentation Enforcement Actions" where in they estimated that 85% of whistleblower complaints are either frivolous or not pursued by regulators. Andrew C. Call *et al.* "The Impact of Whistleblowers on Financial Misrepresentation Enforcement Actions", (December 9, 2014) at page 33, available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2506418.

¹²Richard Moberly, "Sarbanes-Oxley's Whistleblower Provisions: Ten Years Later" 64 S. C. Law Rev 1 (2012) pp 1-54 at page 22.

are quoted saying, “If I had to do it over again, I wouldn’t.”¹³ Employees were often forced to switch from the industry in which they worked and where they lived in order to avoid harassment. This same study found that after the introduction of SOX, employee whistleblowing decreased from 18 to 13 percent, suggesting that SOX’s protections for whistleblowers did not increase the employee’s incentives to come forward with cases of fraud. The authors propose the following possible explanations: “One possible explanation is that the rules which strengthen the protection of the whistleblowers’ current jobs offer only a small reward relative to the extensive ostracism whistleblowers face. Additionally, just because jobs are protected does not mean that career advancements in the firm are not impacted by whistle-blowing. Another explanation could be that job protection is of no use if the firm goes bankrupt after the revelation of fraud.”¹⁴ The paper concludes that employees “seem to lose outright from whistle-blowing”¹⁵ and suggests as a solution the use of monetary awards to create a greater incentive for employees to report wrongdoing.

- 2.12 It should also be noted that even regulators can hamper the success of whistleblowers’ efforts by failing to react positively to whistleblowers. This could be due to political pressure felt by regulators or through lack of resources for the investigation of whistleblower allegations.¹⁶ We address this issue further below in Section 3, “D”, under “Program Structure”.
- 2.13 Studies have also found that in addition to impediments whistleblowers face in getting a positive response from the company or from a regulatory agency, they routinely encounter problems succeeding in court. The above-noted study by Moberly found that very few employee claims arising from SOX whistle-blowing succeeded before the Occupational Safety and Health Administration (1.8%) and such claims succeeded only 6.5% of the time before an administrative law judge.¹⁷ A separate study by Professor Modesitt found that whistleblowers in state court cases appear to prevail at a rate that is only somewhat higher than the rate of SOX whistleblowers and at a rate well below that of tort plaintiffs. Professor Modesitt posits that courts do not view whistleblowers favorably. She concludes: “The research suggests that courts are denying claims based on employer-favorable legal standards as well as by considering the evidence in a light favorable to the employer...Review and analysis of the current causation legal standards that state courts across the country apply is necessary to determine whether this is a broad problem or one limited to the jurisdictions represented in the study.”¹⁸
- 2.14 Inability to prove causation was the largest single reason that whistleblowers lost their case in the Modesitt study – a short time period between the plaintiff blowing the whistle and the termination of his or her employment was not sufficient to establish a causal connection between the termination and the protected activity, nor was it sufficient to show temporal

¹³ Alexander Dyck, Adair Morse & Luigi Zingales, “Who Blows the Whistle on Corporate Fraud?”, 65 J. Finance, 2240-2245. Also available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=891482 at page

¹⁴ Dyck, at page 28.

¹⁵ Dyck, at page 28.

¹⁶ Modesitt, at page 168 to 169.

¹⁷ Moberly, at page 28.

¹⁸ Modesitt, at page 194.

proximity coupled with a strong motive to fire an employee so long as the employer provided evidence of employee misbehavior on the job.¹⁹

- 2.15 Given the experience of whistleblowers and their treatment by employers and the legal system, it is necessary to design a whistleblower program that addresses the systemic issues that have been identified, that encourages whistleblowers to continue coming forward to prevent wrongdoing, and that compensates them adequately for their actions. We simply cannot rely on someone to “do the right thing” given the risks that whistleblowers face. We are encouraged that the OSC has recognized this by providing for a monetary incentive as well as confidentiality and anti-retaliation provisions, which we comment on more fully below.

3. **FAIR Canada’s Specific Comments and Recommendations on the OSC’s Proposed Whistleblower Program**

A. **Whistleblower Eligibility**

Which Regulator You Report To

- 3.1 The program, ideally, should allow an individual who brings a possible securities violation to the attention of a regulator, in good faith, to receive the benefit of its anti-retaliation and confidentiality provisions and the payment of a potential reward regardless of whether they lodge their complaint with the OSC, the Mutual Fund Dealers Association of Canada or the Investment Industry Regulatory Organization of Canada and regardless of who ends up bringing regulatory proceedings. Ideally, individuals should not be prejudiced because of where they first bring their complaint or where the matter ends up being processed.

Culpable Whistleblowers

- 3.2 FAIR Canada recommends that the OSC not treat as ineligible for the program those whistleblowers that have some culpability in the activity being reported. While the OSC does not want to allow a wrongdoer to benefit from their own wrongdoing, the OSC should want to encourage and incentivize those who are culpable to come forward, as these individuals are in possession of valuable information about wrongdoing.
- 3.3 As noted by Yuan Wang (citing Prof. Ron Daniels’ 1995 paper): “...rewarding ‘insider’ whistleblowers, despite their complicity, is ultimately good for the public because ‘insider’ whistleblowers are often the only people who can stop a fraud. Daniels also argues that such a program promotes the public good by encouraging the morally weak or corrupt to report wrong-doing out of self-interest when such wrongdoing could have gone undetected...”²⁰
- 3.4 The SEC’s Dodd-Frank Whistleblower Program strikes this balance by not paying an award based upon either: (a) the monetary sanctions that such culpable individuals themselves pay in the resulting regulatory proceeding, or (b) the monetary sanctions paid by entities whose liability is based substantially on conduct that the whistleblower directed, planned or

¹⁹ Modesitt, at page 184 to 186.

²⁰ Yuan Wang, “Is a Whistleblower Incentive Program Right for Canada?” (December 3, 2010) at page 14, available online at: https://uwaterloo.ca/centre-for-accounting-ethics/sites/ca.centre-for-accounting-ethics/files/uploads/files/submission_6_-_wang-1.pdf.

initiated.²¹ The SEC rule also provides that the Commission will not include any such amounts in the total monetary sanctions collected for purposes of calculating the amount of an award payment to a whistleblower.²² In effect, the rule would allow payment to a culpable whistleblower for information that leads to monetary sanctions against other participants in the violation. This permits the commission to receive the greatest possible amount of useful information that it otherwise would not detect, to the benefit of investors.²³

- 3.5 FAIR Canada recommends that culpable whistleblowers should be eligible for an award with the level of culpability being a factor in the amount to be received determined in a similar manner to that of the SEC Whistleblower Program.

Internal Compliance Personnel, Directors, Officers, CCO's Should be Eligible in Certain Circumstances

- 3.6 FAIR Canada recommends that those who hold key positions within the corporation (such as Chief Compliance Officer or equivalent position, or directors or officers) should not be ineligible in all instances. We understand the concern that these individuals hold sensitive positions that can enable them to identify and stop possible violations of securities laws and their role is important to the company's ability to achieve compliance. However, if a given individual reports the information up the "chain of command" to the entity's audit committee or chief legal officer or other appropriate person, and a certain period of time has elapsed (Dodd-Frank uses 120 days) and the company, with knowledge of a possible securities violation, fails to act, the person should be able to come forward and be eligible for a reward.²⁴
- 3.7 As noted by Andrew Ceresney, director of the SEC's division of enforcement, "[c]orporate officers have front-row seats overseeing the activities of their companies."²⁵ The SEC has made two awards to whistleblowers who are senior level company insiders. The first was on August 29, 2014, where an award of \$300,000 was made to a company employee with audit and compliance responsibilities who reported the securities violation internally and then reported the violation to the SEC after the company failed to take appropriate, timely action

²¹ See: Jennifer M. Pacella, "Bounties for Bad Behavior: Rewarding Culpable Whistleblowers under the Dodd-Frank Act and Internal Revenue Code", U Pa J Bus L [forthcoming in 2015] available online at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2394687. The article examines the rationale behind providing bounties to whistleblowers who have unclean hands and examines the public policy concerns associated with rewarding culpable whistleblowers.

²² See Rule 21F-16 of the Securities and Exchange Act of 1934, available online at <http://www.sec.gov/rules/final/2011/34-64545.pdf>.

²³ See Rule 21F, at page 224-225.

²⁴ See Section 21F, in particular Rule 21F-4(b)(4)(v), which permits compliance and internal audit personnel as well as public accountants to become whistleblowers where: (i) a report to the Commission is necessary to prevent substantial harm to the entity or investors; (ii) the entity is engaging in conduct that will impede our investigation; or (iii) 120 days have elapsed.

²⁵ Press Release, U.S. Securities and Exchange Commission, "Former Company Officer Earns Half-Million Dollar Whistleblower Award for Reporting Fraud Case to SEC" (March 2, 2015), available online at <http://www.sec.gov/news/pressrelease/2015-45.html#.VQmCno7F Eo>.

in response to the information.²⁶ The second award was announced on March 2, 2015 when an award of \$475,000 was made for providing high quality information by a former company officer. The officer reported information about the violation to another responsible person at the company at least 120 days before reporting the information to the SEC. The SEC's Andrew Ceresney stated: "...this particular officer should be commended for stepping up to report a securities law violation when it became apparent that the company's internal compliance system was not functioning well enough to address it."²⁷

- 3.8 Allowing corporate officers and key individuals to be eligible in these circumstances will provide the appropriate incentives for companies to establish and maintain robust compliance policies and procedures, proper governance, and whistleblower hotlines. The threat of employees and key individuals being able to report externally should result in improved internal compliance and audit procedures, which should also deter wrongdoing and improve its detection..
- 3.9 The OSC's proposal to exclude from eligibility the Chief Compliance Officer ("CCO") and officers and directors (but not compliance department staff who report to the CCO) is too broad as it excludes those in key positions to learn about wrongdoing, even if they make significant efforts to stop the wrongdoing and are stymied by the corporation's other key actors (for example, the audit committee).

Individuals Should Be Able to Choose Whether to Report Internally or Externally

- 3.10 FAIR Canada strongly believes that individuals should not be required to report internally first before reporting a possible securities violation to the OSC. There are several reasons for this view:
- (i) Individuals face many risks in reporting possible wrongdoing within their firms. As described above, the risks include receiving poor performance reports, thwarted career advancement, termination, difficulty finding future employment, and severe consequences for the person's health and family relationships. We should not oblige them to take those risks.
 - (ii) Less wrongdoing will be uncovered if we require people to report internally first. Given that the treatment whistleblowers often face will lead them to do a cost-benefit analysis of whether it is worth reporting the matter, we can expect less reporting of wrongdoing if the costs must be incurred, and more wrongdoing will go unstopped.

²⁶ 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program, at page 1 and 11.

²⁷ Press Release, U.S. Securities and Exchange Commission, "Former Company Officer Earns Half-Million Dollar Whistleblower Award for Reporting Fraud Case to SEC" (March 2, 2015), available online at http://www.sec.gov/news/pressrelease/2015-45.html#.VQmCno7F_Eo. See also James Langton, "SEC hands out another whistleblower award: This is the first time a corporate officer will receive the payout reward", *Investment Executive* (March 3, 2015), available online at <http://www.investmentexecutive.com/-/sec-hands-out-another-whistleblower-award?redirect=%2Fsearch>.

- (iii) Moberly's analysis of SOX in the United States demonstrates that internal reporting failed to lead to effective efforts to address underlying wrongdoing²⁸.
- (iv) Allowing the individual to choose whether to report internally or externally, while providing incentives to report internally (as does the SEC's Dodd-Frank Whistleblower Program²⁹) will improve and enhance corporate internal reporting systems while not diverting a significant number of the tips from internal reporting. If firms fear that whistleblowers may be incited to report externally, they will strengthen their own internal systems to decrease the risk that this will occur. If companies create an environment where employees feel that they will be listened to seriously and their concerns addressed without being retaliated against, they will be more likely to report internally. In addition, the incentives that should be included in the OSC whistleblower program to report internally should make it less likely that significant number of tips will not be reported internally.
- (v) FAIR Canada agrees with SEC Chair Mary Shapiro's view that we should allow the whistleblower to have the choice: "I believe that the final recommendation strikes the correct balance – a balance between encouraging whistleblowers to pursue the route of internal compliance when appropriate – while providing them the option of heading to the SEC. This makes sense as well because it is the whistleblower who is in the best position to know which route is best to pursue."³⁰

B. Financial Incentives

3.11 FAIR Canada agrees with the OSC that a financial incentive is critical to the success of the proposed program.

²⁸ See Moberly, at pages 4 and 47. See also page 49-50 where Moberly explains that internal reporting often does not lead to the corporation effectively addressing the problem as most often people report internally to their supervisor, who could block and filter the reports.

²⁹ As noted in the SEC's Media Release, "SEC Adopts Rules to Establish Whistleblower Program" (May 25, 2011), available online at <http://www.sec.gov/news/press/2011/2011-116.htm>, the final rules provide incentives to encourage employees to utilize their own company's internal compliance programs (but do not require it) by, for instance:

- "Make a whistleblower eligible for an award if the whistleblower reports internally and the company informs the SEC about the violations"
- "Treat an employee as a whistleblower, under the SEC program, as of the date that employee reports the information internally – as long as the employee provides the same information to the SEC within 120 days. Through this provision, employees are able to report their information internally first while preserving their "place in line" for a possible award from the SEC."
- "Provide that a whistleblower's voluntary participation in an entity's internal compliance and reporting systems is a factor that can increase the amount of an award, and that a whistleblower's interference with internal compliance and reporting is a factor that can decrease the amount of an award."

See also the lengthy discussion of the Incentives for Internal Reporting by the SEC in the Final Rule, at pages 228 to 237.

³⁰ Mary L. Shapiro, "Whistleblower Program" (Opening statement at SEC Open Meeting, US Securities and Exchange Commission, Washington, DC, May 25, 2011) available online at: <https://www.sec.gov/news/speech/2011/spch052511mls-item2.htm>.

Threshold Amount Too High

- 3.12 FAIR Canada is of the view that the award eligibility threshold of \$1,000,000 in monetary sanctions is too high. We note the average sanction in Canada is significantly lower than that of the SEC yet the floor has been set at the same amount of \$1,000,000. FAIR Canada is of the view that the threshold amount here should be adjusted downward as a result, say to \$750,000. Otherwise, a significant number of whistleblowers who provide important information to the OSC about wrongdoing will not receive any financial benefit from doing so despite the risks that they take in coming forward. For example, only 6 out of the 23 enforcement proceedings concluded by the OSC in 2014 (with 48 individual and 43 company respondents), had fines that were in the amount of \$1,000,000 or more.³¹
- 3.13 FAIR Canada believes that consideration needs to be given to whether the threshold amount should be more flexible when the matter is determined through a settlement. In such situations it may be in the public interest to settle for an amount below the threshold, even though, had the matter gone to a hearing, it may have resulted in a sanction above the threshold.

Award Cap is too Low

- 3.14 Similarly, FAIR Canada believes that the upper limit of an award has been set too low. Capping the potential award at 15% up to a maximum limit of \$1,500,000 provides an inadequate financial incentive. This will not properly compensate whistleblowers, especially those who are in positions to have comprehensive and detailed knowledge of wrongdoing.
- 3.15 The following two examples make it clear the financial incentives have not been set appropriately:
- (i) A senior accountant reporting to a Chief Financial Officer will likely earn over \$100,000 annually so a reward of \$150,000 (should the firm be sanctioned in the amount of \$1,000,000) will not compensate the individual for more than a year's salary. In the meantime, the individual may have been dismissed, or passed up for any future promotion or incurred legal costs relating to actions taken by their employer or in order to consult with counsel prior to bringing their information to the OSC.
 - (ii) Senior employees and executive officers often have significant compensation packages so an upper limit of \$1,500,000 as a reward will not be an adequate incentive to compensate them for the substantial earnings they will forgo in the future as a result of speaking up and putting their career at risk.

Voluntary Payments

- 3.16 FAIR Canada believes that voluntary payments made by a respondent to investors may be relevant to the calculation of a reward to a whistleblower. If the sanction that is determined is lower than it otherwise would be because of the voluntary payment that was made, then the

³¹ OSC 2014 Enforcement Report, available online at https://www.osc.gov.on.ca/en/NewsEvents_nr_20150302_enforcement-activity-2014.htm. None of the actions in 2014 had sanctions in the \$750,000 to \$1,000,000 range but four of the actions had monetary sanctions between \$500,000 to \$750,000. A more thorough analysis of the data over a longer time period would be necessary before determining an equivalent threshold amount.

payment should be included in the amount of total sanctions upon which a reward is determined.

Outcomes that Should Qualify for an Award

- 3.17 FAIR Canada understands that the purpose of the whistleblower program is to increase the timeliness of the discovery of serious violations of Ontario's securities laws and provide stronger enforcement regarding such violations. Accordingly, FAIR Canada does not agree that awards should be granted if the enforcement outcome is simply a registrant conduct ban or a compliance review of the firm. However, given that the award (at least initially) is not proposed to be tied to how much is actually collected as a result of the information that the whistleblower has provided which results in a particular proceeding (or proceedings), an award could be given upon other types of related proceedings, such as criminal proceedings that result in other sanctions such as jail time. On its face, it makes sense that we should reward the whistleblower if that is the enforcement outcome. Consideration will need to be given as to how to determine the amount of an award that will result from a criminal sanction.
- 3.18 Similarly, FAIR Canada agrees with the proposal to require that the information provided by the whistleblower should lead to a completed and successful enforcement action rather than simply a Statement of Allegations issued by staff. The program's goal should be to improve the detection of wrongdoing and the successful prosecution of enforcement action against wrongdoers rather than the mere production of allegations without actual demonstration of wrongdoing.

C. Funding of the Whistleblower Program

- 3.19 FAIR Canada agrees that the OSC's proposed whistleblower program cannot, at least for the first few years of its operation, be based on monies actually collected from the successful individual action(s) that result from the whistleblower information. Unfortunately, the OSC (like other provincial securities commissions) has a dismal record collecting the sanctions it orders or agrees to in settlements. The numbers are sobering: in 2014, out of \$61,675,609 in sanctions, the OSC collected merely 7.7% of those which were settlements and just 1.2% of those that were ordered pursuant to contested hearings. In 2013, of the \$80,174,712 in sanctions, it collected only 3.7% of settlement amounts and 4.3% of contested amounts.³² This means that the likelihood of a whistleblower's award being paid, should it be based on amounts collected, is simply too low to incent whistleblowers to come forward.
- 3.20 The OSC has a much more difficult task ahead of it than that of the SEC in funding the program and providing appropriate incentives for prospective whistleblowers. The SEC, for the year ended September 2013, collected 42% of the amounts defendants were ordered to pay, which was down from 63% in the prior three year period.³³ In addition, Dodd-Frank established the Investor Protection Fund for the purpose of paying whistleblower awards (and to fund the SEC

³² See the OSC's Management Discussion and Analysis for the fiscal year ended March 31, 2014 at page 36, available online at http://www.osc.gov.on.ca/documents/en/Publications/rpt_2014_osc-md-and-a_en.pdf.

³³ Rachel Louise Ensign, "The Morning Risk Report: SEC's Poor Collection Rate May Impede Whistleblowers", *Risk & Compliance Journal of the Wall Street Journal*, (September 19, 2014) available online at: <http://blogs.wsj.com/riskandcompliance/2014/09/19/the-morning-risk-report-secs-poor-collection-rate-may-impede-whistleblowers/>.

office of the Inspector General's Employee Suggestion Program) and at the end of 2011 had transferred over \$450,000,000 into the Investor Protection Fund.³⁴ As of the end of the fiscal year 2014, over \$437,000,000 remains in the fund.³⁵

- 3.21 The OSC has proposed to use its designated funds (funds held pursuant to designated settlements and orders) to pay whistleblowers. In the initial years of the program, FAIR Canada believes that designated funds could help fund the program. As of fiscal year ended 2014, \$18.6 M was held as designated funds as compared to \$19.8 M held as of fiscal year ended 2013.
- 3.22 Should the program result in successful settlements and/or enforcement orders *and such monies are collected*, this should build up the amount of monies available for payments of awards to whistleblowers. Presumably, the OSC's expectation is that the program will result in enforcement action against entities who wish to continue to participate in the capital markets and, therefore, these entities and individuals will be more likely to pay the fine rather than abscond the jurisdiction and avoid payment. For example, the whistleblower program should result in the uncovering of more issuer fraud as opposed to fraud relating to unregistered individuals, pump and dump schemes, ponzi schemes and other forms of illegal distributions.
- 3.23 The other suggestion made by the OSC, upon which it seeks specific comment, is funding the program from the OSC's annual operating budget. FAIR Canada is of the view that the resources needed to properly resource and administer a Whistleblower Program (the annual operating budget for the program, as opposed to the award payments) should be funded from the OSC's annual operating budget rather than designated funds. Whether the award payments should, in the long term, continue to be funded from operating funds depends on whether, over time, the amount in designated funds grows significantly as a result of the enforcement program and the greater collection rate (as a result of the types of enforcement actions it is able to successfully because of whistleblower information) allowing the program to be adequately funded without the need for funding from the operating budget.

D. Program Structure

Adequate Systems and Resources Needed for Program to Succeed

- 3.24 FAIR Canada is strongly of the view that the OSC needs to ensure it has sufficient systems and personnel in order to run the program properly. The Dodd-Frank Act directed the SEC to establish a separate office within the SEC to administer and to enforce the program. It is currently staffed by nine attorneys and three paralegals, including Sean X. McKessy, Chief of the Office and Jane A. Norberg, the Office's Deputy Chief. The SEC whistleblower program has been institutionalized by creating a separate Office of the Whistleblower with a clear mandate, and with an organized and efficient system to handle whistleblower tips. It also operates with a fairly large degree of transparency and accountability as it discloses the number and types of tips that it receives, their geographic origin, and how they are processed. It makes public every action that results in monetary sanctions over \$1,000,000 so anyone who thinks they are entitled to a whistleblower award may submit an application. It does

³⁴ Sonia A. Steinway, "SEC "Monetary Penalties Speak Very Loudly," But What Do They Say? A Critical Analysis of the SEC's New Enforcement Approach", 124 Yale L J 209 at 217-221.

³⁵ 2014 Annual Report to Congress on the Dodd-Frank Whistleblower Program, at page 26.

public outreach and education, and it identifies and monitors whistleblower complaints alleging retaliation by employers or former employers in response to the employee's reporting of possible securities law violations internally or to the SEC. In addition, the SEC provides information on the number of complaints it receives, the top 10 types of complaints it receives from the public and the number of open, closed and ongoing investigations.³⁶

Transparency and Accountability Important

- 3.25 In order for investors, market participants and other stakeholders to see the impact that the whistleblower program has on OSC enforcement efforts, the OSC needs to improve its disclosure and transparency with respect to complaints, investigations and enforcement proceedings. For example, the OSC currently does not disclose the number of complaints it receives with respect to possible fraudulent activity or other wrongdoing, nor does it disclose the number of investigations it conducts. As noted in FAIR Canada's recent fraud report³⁷, there is a dearth of information on the incidence and prevalence of investment fraud in Canada and a lack of statistical information publicly disclosed by securities regulators and other responsible agencies in the system. Improvements in prevention, detection and enforcement of fraud are more probable with increased accountability by those in the system. It will be important for the OSC to be able to demonstrate that the whistleblower program has improved the number and quality of tips it receives by tracking and disclosing the number of tips and other complaints it now receives and those it will receive in the future upon the implementation of the program.
- 3.26 FAIR Canada strongly recommends that the Commission examine the SEC's systems and the expertise they have developed through interaction with whistleblowers in order to gain insight and learn best practices.
- 3.27 In addition, we note that Moberly's examination of the experience with SOX and its anti-retaliation provisions uncovered the following lessons:
- (i) Adequate training, staffing and expertise, and proper internal controls are needed to measure the program's performance;³⁸
 - (ii) Those who administer the protections must have the necessary knowledge and must make the whistleblower program a priority, and the program must receive support from those in key positions;³⁹
 - (iii) It must be made clear that the whistleblower program is vital and important, institutionalizing it within the securities regulator by creating a separate Office that is well funded;⁴⁰
 - (iv) "...individual players in the system, such as organizational supervisors, government administrators, and adjudicatory decision makers, impact whistleblowers as much as,

³⁶ Securities and Exchange Commission "Select SEC and Market Data Fiscal 2013", at page 20, available online at <http://www.sec.gov/about/secstats2013.pdf>.

³⁷ FAIR Canada "A Canadian Strategy to Combat Investment Fraud" (August 2014) available online at <http://faircanada.ca/wp-content/uploads/2014/08/FINAL-A-Canadian-Strategy-to-Combat-Investment-Fraud-August-2014-0810.pdf?a07595>.

³⁸ Moberly, at page 31-32.

³⁹ Moberly, at page 39-40 and 50-51.

⁴⁰ Moberly, at 52.

if not more than, any formal legal provisions. This impact can undermine the protections the formal provisions appear to provide. In other words, formal whistleblower mechanisms, while necessary, do not sufficiently protect and encourage whistleblowers by themselves. People interpret and enforce them, indicating that perhaps we ought to spend as much effort determining *who* is involved in whistleblower protections we do deciding *what* those protections should formally entail.”⁴¹ As a result, Moberly suggests that disclosure and transparency regarding the results of whistleblowing should be a focus and independent oversight of such programs could also help bring accountability.⁴²

Administrative Fairness

- 3.28 There should be a clear, transparent process for applying for a reward. If a separate office is set up rather than a unit of the enforcement division, this would allow a separate office to evaluate applications for awards based upon the information that was provided by the whistleblower, the correspondence between him or her and the office and with the enforcement division, and through discussions with enforcement to understand the contribution made by the individual against the criteria specified in the rule. A recommendation could be made which then is considered by an OSC Staff Committee.
- 3.29 FAIR Canada believes that the determination as to whether to pay an award, which is made by an OSC Staff Committee (that includes the Director of Enforcement) and the percentage amount of that award, should be provided in writing with reasons for the determination.⁴³ The whistleblower should be given the ability to request that the decision be reconsidered including obtaining a copy of the record that formed the basis for the OSC Staff Committee’s decision. After appropriate time periods have elapsed for any reconsideration of the determination, such determination could then be forwarded to the Commission for its decision and a final order made.

E. Confidentiality and Anonymity

Confidentiality Important

- 3.30 The OSC proposes to adopt a policy under which the OSC will use “all reasonable efforts” to keep confidential a whistleblower’s identity (and information that could be reasonably expected to reveal the whistleblower’s identity) subject to three express exceptions: (i) when disclosure is required to be made to a respondent in connection with a section 127 administrative proceeding to permit a respondent to make full answer and defence; (ii) when the relevant information is necessary to make OSC Staff’s case against a respondent; and (iii) when the commission provides the information to another regulatory authority, a self-regulatory organization, a law enforcement agency or other government or regulatory authorities pursuant to section 153 of the Securities Act. The Consultation Paper also sets out that the Commission would have to disclose the identity of the whistleblower if ordered to do

⁴¹ Moberly, at 45.

⁴² Moberly, at 45.

⁴³ FAIR Canada disagrees that the Commission should be able, in its discretion, to approve, reject or modify the amount of the recommended award without giving reasons for its determination, as contemplated in the Consultation Paper.

so by an appropriate authority such as a hearing panel of the Commission or under applicable freedom of information legislation.

- 3.31 FAIR Canada believes that confidentiality is a key requirement needed to encourage individuals to come forward with information. Confidentiality should be extended to all individuals who come forward with information regarding a possible securities violation, made in good faith. We also recognize, however, that absolute confidentiality cannot be guaranteed.
- 3.32 To the extent possible, the confidentiality of the whistleblower should be maintained. However, documents or other information may need to be produced in the Commission's administrative proceeding or a related proceeding which may reveal the identity of the whistleblower so we recognize the need for the first exemption above.
- 3.33 We do not understand the second exemption and believe it is too broadly worded and is duplicative of the first exemption. The third exemption is acceptable but should also provide that the other authorities or agencies will be subject to the same confidentiality provisions as those binding the Commission, or that the Commission will otherwise obtain assurances of confidentiality that the Commission deems appropriate.
- 3.34 Finally, the identity of the whistleblower should not be disclosed in response to requests under freedom of information legislation. In the U.S., whistleblower-identifying information is expressly exempted from the provisions of the Freedom of Information Act.⁴⁴ A similar provision should be included in the whistleblower rules here.
- 3.35 The extent of confidentiality must be made clear to potential whistleblowers in plain language on the Commission's website.

Allow Anonymity

- 3.36 FAIR Canada supports the idea of allowing a whistleblower to retain anonymity so that more people are willing to come forward with information. We agree in these situations the person should be represented by counsel as this is the most practical way to achieve this. We also agree that before the payment of any award, the person must disclose their identity to the Commission. The identity does not, however, need to be revealed to the public at this point.

F. Anti-Retaliation Provisions Needed

- 3.37 Whistleblowers often face discharge, demotion, suspension, harassment and other forms of discrimination because of coming forward with information about possible wrongdoing. Therefore, FAIR Canada strongly supports implementing anti-retaliation provisions as a key component of an effective whistleblower program. Anti-retaliation protections are necessary for all whistleblowers who come forward in good faith.
- 3.38 It is important that Canada learn from the experience in the U.S., first with SOX and later with the Dodd-Frank Whistleblower Program. Firstly, the research quoted above by Modesitt and Moberly make it clear that a civil right of action alone is of limited effectiveness. Whistleblowers have fared poorly in their ability to win in court or through administrative

⁴⁴ Rule 21F-16, at page 127, footnote 276.

processes regarding employer's retaliatory behaviour against them. Therefore, it is important that this right be coupled with the ability of the Commission (and the actual use of this power) to bring an enforcement proceeding against any employer who retaliates against a whistleblower for reporting information to the Commission. Individuals often have limited economic power to enforce their rights once dismissed from their job. It would be very helpful if the Commission could also take proceedings where appropriate to ensure that market participants play by the rules.

- 3.39 The SEC has used its ability to bring an enforcement action under the anti-retaliation provision of the Dodd-Frank Act in the case of Paradigm Capital Management. The head trader of Paradigm Capital Management reported to the SEC that the company had engaged in prohibited principal transactions. After learning that he had done so, the firm engaged in retaliation by removing him from his head trader position, stripping him of his supervisory responsibilities and marginalizing him in other ways. The firm and its owner agreed to pay the SEC \$2.2 million to settle the allegations including that of retaliation. This sends a strong message to market participants that retaliation against employees who report possible wrongdoing to the SEC will not be tolerated. Commenting on the case, Sean McKessy, chief of the SEC's Office of the Whistleblower, stated: "For whistleblowers to come forward, they must feel assured that they're protected from retaliation and the law is on their side should it occur".⁴⁵ It is important that the OSC demonstrate to employees that the OSC has their backs so that it makes the decision to report possible wrongdoing easier. FAIR Canada believes that the cap on any such penalty ordered by the OSC should be a penalty of up to \$5 million rather than \$1 million, as is suggested in the Consultation Paper. Moreover, it is important that penalties be assessed to send a strong message that this behaviour will not be tolerated rather than simply ordering a reprimand, or review and amendments to workplace policies and practices.
- 3.40 We agree that anti-retaliation provisions should be available to both individuals who report possible violations through their internal compliance reporting system and individuals who choose to report directly to the OSC. Whistleblowers should receive the same protection regardless of where they report the wrongdoing – to their employer or to the OSC or to another regulator.
- 3.41 Making it explicit that the anti-retaliation provisions will be available to internal whistleblowers and those that report directly to the OSC or other regulators will result in the promotion of internal reporting. As noted by an academic on the subject, to exclude internal whistleblowers would "...likely have the effect of discouraging internal whistleblowers to decide to report internally since they now face limited recourse in the courts for retaliation, especially in light of the devastating repercussions that such individuals face when they report information."⁴⁶
- 3.42 It is important that the rules prevent companies from imposing confidentiality agreements on their employees or consultants with provisions that may impede whistleblowers from coming

⁴⁵ Press Release, Securities and Exchange Commission "SEC Charges Hedge Fund Advisor with Conducting Conflicted Transactions and Retaliating Against Whistleblower" (June 16, 2014), available online at: <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542096307>.

⁴⁶ Pacella.

forward. It should be made unlawful for anyone to interfere with the whistleblower's efforts to communicate possible wrongdoing to the Commission through threatening to enforce a confidentiality agreement.

3.43 FAIR Canada supports making it clear that employers cannot stifle whistleblowing by using provisions in employment agreements, severance agreements, confidentiality agreements or otherwise that require individuals to tell their employer before communicating with a regulator or other agency or that prevent them from sharing information about their employer with the OSC. Making these agreements unlawful and unenforceable will not make them harmless if employees are unwilling to challenge the documents and remain silent or are unaware that they are wrongful. It needs to be made clear to individuals that they have an unwaivable right to report possible violations of securities law to the securities regulator or law enforcement agencies such as the police. The rule should make it clear that agreements that limit an individual's right to report possible wrongdoing are unlawful and they should (on the contrary) expressly set out the positive right of the individual to report without firm approval or fear of retaliation.

3.44 The SEC has brought an enforcement action against a company for using improperly restrictive language in its confidentiality agreements.⁴⁷ The OSC should not hesitate to do likewise.

4. **Conclusion**

In conclusion, FAIR Canada strongly supports the implementation of an OSC whistleblower program and urges the OSC to consider the recommendations we have made above in order to strengthen the framework.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Neil Gross at 416-214-3408 neil.gross@faircanada.ca or Marian Passmore at 416-214-3441 marian.passmore@faircanada.ca.

Sincerely,



Canadian Foundation for Advancement of Investor Rights

⁴⁷ KB\$ Inc. required witnesses in certain internal investigations interviews to sign confidentiality statements with language warning that they could face discipline and even be fired if they discussed the matters with outside parties without the prior approval of KBR's legal department. The investigations included allegations of possible securities law violations. KBR agreed to pay a \$130,000 penalty to settle the SEC's charges and it voluntarily amended its confidentiality statement by adding language making it clear that employees are free to report possible violations to the SEC and other federal agencies without KRB approval of fear of retaliation. See <http://www.sec.gov/news/pressrelease/2015-54.html>.