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The whistleblower program may need bigger payouts

By James Langton | February 2017

The Ontario Securities Commission's (OSC) whistleblower program still may be in its infancy, but an American expert in the field worries that the program needs to give prospective tipsters greater incentives to come forward.

In mid-2016, the OSC launched the first whistleblower program at a Canadian regulator. This program offers financial rewards for information that leads to major enforcement action. The program still is in the very early stages: it has taken in tips from prospective whistleblowers, but has yet to pay its first reward for a resulting enforcement action.

The success of the program in Canada is too early to call. Furthermore, Stephen Kohn, a lawyer with Washington, D.C.-based **Kohn Kohn & Colapinto LLP** who specializes in representing whistleblowers, warns that the OSC's program has flaws that, he believes, could prevent it from realizing its full potential in the long run.

Kohn warns that the \$5-million cap on a possible payout by the program represents a fundamental limitation that will hamper the effectiveness of the program. Speaking at a conference hosted by the University of Toronto's Joseph L. Rotman School of Management in late January, Kohn suggested that the ceiling on prospective whistleblower payouts will prevent the "big fish" from reporting corporate misconduct to the OSC.

Kohn also says that whistleblower programs need to have a minimum reward level to provide prospective tipsters with some assurance that they will get a reward if they are entitled to one.

At the moment, prospective whistleblowers face numerous roadblocks to reporting. Whistleblowers' careers are almost certain to suffer if these people come forward. And even with a bounty program, there's a relatively small chance that a whistleblower will ever actually receive a financial payout, according to Kohn.

Given these realities, Kohn argues, the potential payout has to be big enough - and certain enough - to offset those impediments. Without the prospect of a very significant reward, the factors that weigh against blowing the whistle on corporate misconduct are likely to continue to keep some potential tipsters quiet, Kohn suggests.

Nevertheless, he applauds the OSC for setting up its program, which is modelled, for the most part, on an initiative established by the U.S. **Securities and Exchange Commission** (SEC) in 2011. "What Canada has done is incredibly important," he says. "[Canada is] the first country, following the U.S., to establish a whistleblower office with realistic provisions for anonymity, [anti-]retaliation and rewards."

Heidi Franken, chief of the OSC's Office of the Whistleblower and deputy director of the enforcement branch at the regulator, says that she's been very pleased with the program's early results to date. Although she is reluctant to specify just how many tips the OSC has received through the program, she does say that it has attracted some high-quality information.

Speaking at the conference, Franken said that the OSC is confident that the regulator will achieve its objectives with the whistleblower program as it's currently constructed. However, she also acknowledged that the OSC is sensitive to the concern about the cap on rewards.

Franken notes that the original proposal for the OSC's bounty program would have capped awards at \$1.5 million. However, that was increased to \$5 million in response to feedback on the proposal - with the caveat that awards in excess of \$1.5 million are contingent on the OSC actually collecting the sanctions. Smaller awards can be paid regardless of whether the regulator collects any monies.

Moreover, the OSC's program still is in its early stages, and Franken indicates that the regulator may end up adjusting the program's parameters. For now, she says, OSC management believes that the program will be a "game changer" in helping the regulator uncover the sort of misconduct that would otherwise be hard to detect, such as insider trading and accounting fraud, as well as providing a deterrent to wrongdoing by improving the likelihood that misconduct will be reported to regulators.

A paper published in the Harvard Business Review in January concludes, in part, that whistleblowing programs can work. Andrew Call, associate professor at the W.P. Carey School of Accountancy at Arizona State University, co-authored the paper, entitled Research: Firms Give More Stock Options When They're Committing Fraud. This research found that cases that involve tipsters are associated with higher monetary penalties for offenders (both companies and individuals), longer jail terms and bigger sanctions for third parties, such as auditors, that are implicated in accounting fraud.

At the Rotman conference, Call also revealed that the research found that when whistleblowers are involved, regulators bring forth cases more quickly, are more likely to impose monetary penalties and that accompanying criminal proceedings are more common.

Call's paper concludes: "Our findings suggest whistleblowers are a valuable source of information for regulators who investigate and prosecute financial misrepresentation."

The OSC anticipates its program will prove effective, but may take some time for that confidence to be borne out. In the U.S., the SEC waited slightly more than a year after launching its whistleblower program before announcing the first award.

However, the OSC indicates that a prospective whistleblower may have to wait several years from the time the tipster provides the regulator with information before an award is paid - the program requires enforcement proceedings to be completed and have all appeal rights exhausted.

In the meantime, shrewd companies could be coming up with their own ways of discouraging whistleblowers. Call and his colleagues also found in other research that the advent of regulators paying whistleblowers for information about alleged misconduct may be offset by companies that pay their employees not to run to the authorities.



The researchers found that firms with financial reporting violations provide their "rank and file" employees with larger stock option grants than firms that aren't committing violations.






The researchers also found that misbehaving companies provide their employees with larger options grants during the time of the misconduct than they do in the years before the violations, or in the years after their misdeeds are uncovered.

Overall, the paper concludes: "Our findings suggest that firms discourage whistle-blowing by giving employees incentives to remain quiet about financial irregularities."

That conclusion suggests that the OSC has to worry about whether its payouts are big enough - and also may have to worry that wayward firms will begin paying employees to keep their mouths shut.

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