

Via email

February 24, 2015

Kenmar 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

The Secretary ,Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

Kenmar is pleased to provide comments on the proposed whistleblower program. Kenmar Associates is an Ontario- based privately-funded organization focused on investment fund investor education via on-line research papers hosted at www.canadianfundwatch.com .Kenmar also publishes ***the Fund OBSERVER*** on a bi-weekly basis discussing investor protection issues primarily for investment fund investors. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused investors and/or their counsel in filing investor complaints and restitution claims.

We realize 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 retaliated against. With the incentives and planned protections of the well conceived OSC Whistleblower Program, they can significantly limit their downside risk. We fully support the initiative as it will make the Canadian securities marketplace safer. Kenmar see a whistleblowing program as an important investor protection tool – one that will encourage those with robust information to come forward and report illegal activities . Financial incentives are a key factor of the OSC program. It is clear to us that the MFDA and IIROC whistleblower programs have not been fruitful because they do not offer financial incentives.

Presented below are our comments , observations and questions:

The OSC will need to be a good listener. One Kenmar Associate has told us that in late 2000 he, through his investment club, advised a regulator of excessive redemption ratios in a family of mutual funds . He received a polite acknowledgment letter but nothing was done. In 2003 ,after NYAG Elliot Spitzer exposed the stale dating issue in international mutual funds , the CSA acted .A

similar situation arose with the SEC who didn't listen to an analyst who questioned Mr. Madoff's investment results despite being provided a comprehensive analysis. A responsive, well trained OSC whistleblower team is a key success factor for the program.

Reward schedule is reasonable We believe that the reward schedule is a good start albeit well below SEC levels. An award to an eligible whistleblower 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 is not unreasonable , assuming reward is tax exempt.

The maximum amount of \$1,500,000 may be adequate but the rule should allow for amendment based on experience . It should be noted that Canadians are just as interested in seeing perpetrators 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.

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 That is a discussion for another time.

What happens if fines levied are unpaid? A recent article spoke to the vast majority of fines remaining unpaid. Will the OSC pay whistleblowers out of their budget.... People will call in expecting to be paid and it gets held up because the fine goes unpaid by the perpetrator , a vulnerable whistleblower would be in a sorry situation. Many of the individuals and companies on the OSC's Name and shame list of those with unpaid fines were found by the OSC to be involved in frauds, usually with the illegal sale of questionable securities to often financially unsophisticated victims, seniors, church members, widows etc.. Information on respondents who are delinquent in paying monetary sanctions, disgorgement orders and costs is available under [Respondents Delinquent in Payment of Commission Orders](http://www.osc.gov.on.ca/en/Proceedings_respondents-delinquent-list_index.htm) (http://www.osc.gov.on.ca/en/Proceedings_respondents-delinquent-list_index.htm).

Are rewards subject to income tax? Will the reward be considered as a lottery win or earned income? If the reward is taxed as ordinary income, we believe the amounts are too low.

Would a whistleblower policy have helped detect/prosecute certain scandals earlier? We leave it to the experts to determine if the Livent, Portus, Crocus, Atlas Freezer , FMF , Hollinger, YBM, Sino-Forest, ABCP and countless other scandals would have been uncovered earlier. The SEC experience suggests that financial rewards are a powerful incentive for whistleblowers to come forward.Of course, crimes by individuals and organized crime will require additional enforcement tools.

Changes may need to be made to Ontario Labour Code 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 just amending the Ontario Securities Act.

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.

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?

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. Is this correct? 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.

How does the Statute of Limitations Apply?

Would the whistleblower statute apply only to publicly-traded companies? We assume it applies to any entity covered by the OLA .

What happens if the company or issuer is not domiciled in Ontario or if the OSC is not the principal regulator?

What will happen to this proposal should the OSC fall under the umbrella of the Cooperative Capital Markets regulatory system?

Are companies currently required by the OSC to have an internal whistleblowing policy and system? And if so, is it normally part of the external auditor's statement of work? If not, perhaps it should be a regulatory requirement.

Why limit the reward to an individual? In the case of the mutual funds mentioned above it was an investment club that uncovered the wrongdoing . 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.

We believe the potential for whistleblower reporting under an OSC Whistleblower Program would be a motivating factor for market participants to self-report misconduct . Obviously the program will have no impact on fraudsters . There are some investor advocates who argue that a recent case of overcharging fees by a bank owned brokerage firm was self-reported because of impending changes to fee disclosure under CRM2 The overcharging had been going on for years and was apparently "missed" by advisors, supervisors , compliance ,management and auditors. Great care should be exercised in giving pardon for self-reporting .

When is a complaint a whistleblower? A number of our Associates pointed out that they had complained 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. They viewed 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 , Ontarions want to see a more aggressive approach in dealing with white collar crime. A reduced payment may however be appropriate in such a case.

Can informants remain anonymous and name a nominee recipient? In two cases in the last 3 years the only goal of the whistleblower was to see justice done. The whistleblowers were willing to provide valuable and reliable information but did not want to identify themselves for fear of retaliation. But they would want any reward made , paid to a recognized Charity – in these cases the Charities were the Salvation Army and the Canadian Cancer Society.

We are of the conviction that individuals 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.

We believe individuals culpable in the conduct being reported should be eligible for a whistleblower award . Sometimes it is necessary to bend with a small fish in order to catch big fish. The greater good is served.

In conclusion , Kenmar supports the OSC whistleblowing initiative. Investment fraud is serious and in many cases is a life -altering event . With senior demographics being what they are, the OSC initiative could not be more timely as research and statistical evidence has shown that seniors are a vulnerable segment of society.

Enforcement is a key component in the fraud prevention /investor protection system and whistleblowing is a invaluable tool.

It is important however to also work on fraud prevention activities. The Small Investor Protection Association (SIPA) 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 our 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. Requiring EMD's to be OBSI members is a positive first step. Another emerging fraud threat according to SIPA is Equity Crowdfunding -they have recommended that this "reform" not be approved.

We also wish to stress that the initiative must be integrated and harmonized with other

Kenmar Associates
Investor education and Protection

regulatory initiatives such as fraud prevention, investor “Streetproofing”, TSX listing requirements , reverse takeover rules (“ backdoor listings”) ,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 , Equity crowdfunding and the OSC's own process for granting regulatory exemptions. We'd also like to see better communications between IIROC and OBSI with the OSC when serious wrongdoing is suspected/observed.

Kenmar Associates agree 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,

Ken Kivenko P.Eng.
President, Kenmar Associates
kenkiv@sympatico.ca

REFERENCES

Dodd Frank Whistleblower Program: Report to Congress

<http://www.kkc.com/wp-content/uploads/2014/11/SECannual-report-2014.pdf>

SEC Whistleblower Program Handbook

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. That said, the program isn't right for everyone. 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> [A similar Handbook would be required for the OSC Program]

Will there be Whistleblowers?

<http://object.cato.org/sites/cato.org/files/serials/files/regulation/2011/7/regv34n2-8.pdf>

A good practice guide to whistleblowing policies

<http://governanceforstakeholders.com/wp-content/uploads/2013/04/Whistleblower-policy.pdf>

Elements of an Effective Whistleblower Hotline — The Harvard Law School Forum

Kenmar Associates
Investor education and Protection

on Corporate Governance and Financial Regulation
<http://blogs.law.harvard.edu/corpgov/2014/10/25/elements-of-an-effective-whistleblower-hotline/>

Whistleblowing: An employer's Guide to global compliance

<http://www.dlapiperuknow.com/export/sites/uknow/products/files/uknow/DLA-Piper-Whistleblowing-Report.pdf>

Pattern of Failure (Al Rosen) <http://www.advisor.ca/investments/market-insights/pattern-of-failure-107364> “.. In his decision, the judge seems to give the auditors and management free passes, saying the “enormous losses” meant they were “quite reasonably concentrating on doing all things necessary to make sure that Nortel had sufficient cash reserves to survive.”With this exoneration, auditors will likely do little to step up their games...”

PwC 2014 Global Economic Crime Survey

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

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.

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.

Equity Crowdfunding: Good for Capitalism or for Fraudsters?

<https://ca.finance.yahoo.com/news/equity-crowdfunding-good-capitalism-fraudsters-151735965.html>

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

Former Nortel Executives Acquitted of Fraud: Can Lessons be Learned from the Decision? - <http://www.davis.ca/publication/former-nortel-execs-acquitted-of-fraud/>

4 Canadians charged in \$140M international penny stock fraud

<http://www.cbc.ca/news/canada/toronto/4-canadians-charged-in-140m-international-penny-stock-fraud-1.1336065>

Stock market swindles galore in Canada

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

Investing fraud leads to record \$47 million fine

<http://www.theglobeandmail.com/report-on-business/bc-investing-fraud-leads-to-record-47-million-fine/article1839623/?cmpid=rss1>

Will Canadian regulators be able to avoid the final fatal crash of the TSX Venture Exchange?

<http://www.mining.com/web/will-canadian-regulators-be-able-to-avoid-the-final-fatal-crash-of-the-tsx-venture-exchange-tsx-v/>

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/>

The ABCP Crisis in Canada :Report

<http://www.expertpanel.ca/documents/research-studies/The%20ABCP%20Crisis%20in%20Canada%20-%20Chant.English.pdf>

Sino-Forest case cries out for justice

<http://www.theglobeandmail.com/report-on-business/rob-commentary/sino-forest-case-cries-out-for-justice/article4210097/> Canadians must not forget the lessons of Sino-Forest. Unwarranted hype helped perpetuate the alleged Sino-Forest fiction. One major Canadian newspaper hailed Mr. Chan in 2007 as "China's greatest lumber baron." Analysts talked of vast untapped profits. Regulators must also crack down on the kind of reverse takeover that allowed Sino-Forest a back-door listing on the TSX, with less scrutiny than an initial public offering. Regulators need more resources to track the activities of companies that raise money in Canada, but operate largely offshore, under the direction of non-Canadians. Maybe Canadian stock markets shouldn't welcome these listings. And if prosecutors can't secure prosecutions in stock fraud cases, perhaps they need new legal weapons.

Diane Urquhart's Statement on ABCP CCAA Restructuring Plan Decision of the Supreme Court of Canada http://investorvoice.ca/ABCP/Urquhart_Statement.htm "...

The retail owners worked hard to accomplish this settlement of just getting their own money back, with the assistance of the Co-Counsel appointed to represent them in the CCAA court-administered CCAA process. The Federal and Provincial

Kenmar Associates
Investor education and Protection

governments were not helpful to this group of Canadians getting their money back. In fact, many retail ABCP owners were shocked to learn that our governments actually facilitated the sale of this flawed money market product into the unsophisticated retail marketplace through multiple law and regulation changes, blind enforcement and exemptive relief decisions that allowed the securities dealers and banks to side-step investor protection laws that Canadians fought years to achieve...."

Lessons from the Financial Crisis: Bank Performance and Regulatory Reform

<http://www.banqueducanada.ca/wp-content/uploads/2013/12/dp2013-04.pdf>

Mobsters masquerade as capitalists

<http://www.themoscowtimes.com/news/article/tmt/274416.html> (the YBM Magnex case)

Welcome to the Magnex files :TSE's changing tune on the Magnex/Mafia scandal

<http://enconv.org/docs/index-51043.html?page=6> " Amazingly the North American public never learned - not from the company itself, nor from any brokers, securities analysts, mutual fund managers, advisors, or stock market regulators (all of whom were in position to have informed themselves) - about the dubious origins of YBM Magnex entities or details about the Russian organized crime links well publicized in Europe. "

Swindlers: Cons & Cheats and How to Protect Your Investments from Them

(Bruce Livesey) Book available from amazon.ca

Thieves of Bay Street: How Banks, Brokerages and the Wealthy Steal Billions from Canadians (Al Rosen) Book available via amazon.ca

Like Moths Attracted to Flames: Managerial Hubris and Financial Reporting Fraud

<http://clients.oakbridgeins.com/clients/blog/hubris.pdf>

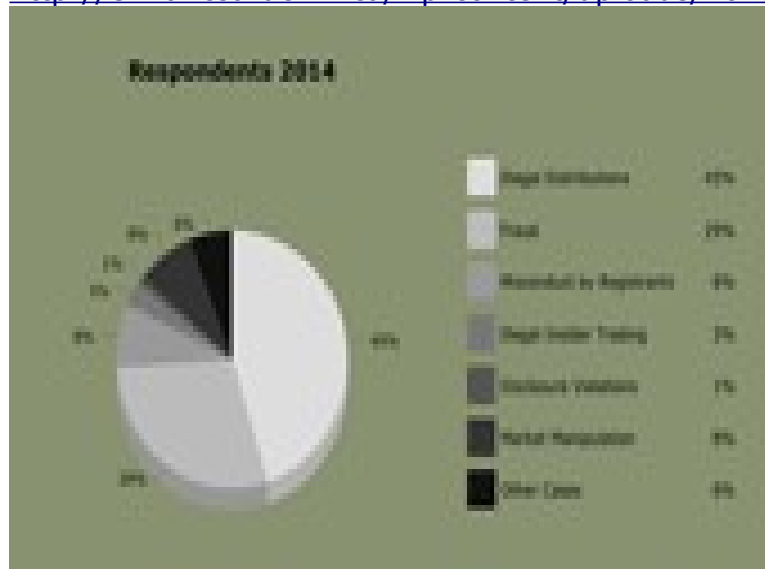
Governance practices at 5 famous fiascos

<http://v1.theglobeandmail.com/series/boardgames/stories/20021007fiascos.html>

The Corporate Whistleblower's Survival Guide: A Handbook for Committing the Truth. Published by Berrett-Koehler, this step-by-step guide details key information that potential business whistleblowers should know before, during, and after blowing the whistle. GAP Legal Director Tom Devine and former GAP investigator Tarek F. Maassarani, co-authors of the book, summarize a decade-long under-the-radar legal revolution in corporate worker free speech rights. See more at: <http://whistleblower.org/corporate-whistleblowers-survival-guide#sthash.TfXfBJw5.dpuf>

2014 CSA Enforcement Report

<http://er-ral.csa-acvm.ca/wp-content/uploads/2015/02/CSA-2014-English.pdf>



Illegal distributions account for nearly half (45%) of enforcement actions. The Report notes "Total penalties can vary considerably year to year, depending on the nature of the cases. In 2014, approximately \$58.2 million was ordered in fines and administrative penalties. While penalties, costs and other monetary sanctions/orders can be difficult to collect, every effort is made by regulators to do so, including using the services of collection agencies "

The OSC is clearly no collection Agency (Jan. 19, 2012)

<http://www.theglobeandmail.com/report-on-business/streetwise/the-osc-is-clearly-no-collection-agency/article620882/> " Since 2005, the OSC has collected less than 1 per cent of the \$73.36-million in fines it has imposed on fraudsters and other rule-breakers after defeating them in contested hearings. The agency blames the lack of recovered money on the ability of bad guys to hide assets. It points out that it has had success with winning more and longer jail sentences for some offenders lately, and says it extends bans on trading and other activities for deadbeats who don't pay up.>"

2013 Canadian Securities Regulators' Enforcement Report Highlights Fraud

<http://www.lautorite.qc.ca/en/press-releases-2013-conso.html> [2013 canadian-securities-regulators-enforcement-report-highlights-fraud21-02-2013-11-0.html](http://www.csc.gc.ca/eng/press-releases-2013-conso.html)

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

CSA Investor Index

http://www.msc.gov.mb.ca/about_msc/csa_inv_index_oct_2006.pdf Interesting stats on fraud • Canadians generally recognize the common indicators of 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.

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]

Kenmar Response to Dept. Of Finance Consultation on a Financial Consumer Protection Framework <http://www.canadianfundwatch.com/2014/08/our-response-to-ministry-of-finance-on.html> (alternate <http://www.fin.gc.ca/consultresp/fcpf-cpcpsf/036-fcpf-cpcpsf.pdf>)