

Connector Article: What Effect Has the SEC's Whistleblower Award Program had on Ponzi Schemes and their Victims? – More Canadian Content

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I. INTRODUCTION

In Janet Austin's article, the author provides various data released by the United States Securities and Exchange Commission ("SEC") to highlight the impact of the SEC's whistleblower award program on Ponzi schemes.¹ This article will connect with Austin's article and focus on Canada's approach to these issues through the lens of the Ontario Securities Commission's ("OSC") whistleblower award program, and the relevant Canadian legislation in relation to Ponzi schemes.

First, this article will provide a brief introduction to Ponzi schemes and examine the structure and the role of securities regulators in Canada. Additionally, this article will examine the whistleblower award program as established by the OSC and compare the effect of its establishment with the effects of the SEC's whistleblower award program. Finally, this article will discuss the relevant federal and provincial legislation surrounding Ponzi scheme in Canada.

II. PONZI SCHEME AND SECURITIES REGULATOR IN CANADA

A. What is a Ponzi scheme?

¹ Janet Austin, "What Effect Has the SEC's Whistleblower Award Program Had on Ponzi Schemes and Their Victims?" (2022) 22 *Asper Rev of Intl Bus and Trade L* 1 at 2-4 [Austin].

A Ponzi scheme is an investment fraud that uses money collected from new investors to pay earlier investors.² To lure investors, Ponzi scheme organizers often guarantee consistent and high returns on the investment with little to no risk.³ However, in many cases, Ponzi scheme organizers do not invest the money to earn profit. Rather, the money from newer investors is used to pay earlier investors the "investment returns" promised to them.⁴

A Ponzi scheme needs a constant flow of money from new investors in order to continue paying its earlier investors. Thus, a Ponzi scheme tends to fall apart when the scheme organizer fails to recruit new investors or when too many investors seek to withdraw their money at the same time.⁵

B. Securities Regulators in Canada

Securities regulators are responsible for overseeing the capital market and enforcing the securities laws, which prohibit securities fraud such as a Ponzi scheme.⁶ In the United States, while each state has such a regulator, much of the "heavy lifting" in the regulation of the securities market is overseen by the national securities regulator: the SEC.⁷ On the other hand, Canada lacks a securities regulator at the federal level. Rather, each of the ten provinces and three territories in Canada has its own securities commission and securities law.⁸ The securities regulators from the provinces

² Financial Consumer Agency of Canada, "Your Financial Toolkit, Module 12.1.4 Investment Fraud" (last modified 12 May 2022), online: *Government of Canada* <www.canada.ca/en/financial-consumer-agency/services/financial-toolkit/fraud/fraud-1/5.html> [perma.cc/L939-YR2L]. See also U.S. Securities Exchange and Commission, "Ponzi Scheme" (last visited 26 July 2022), online: *Investor.gov* <www.investor.gov/protect-your-investments/fraud/types-fraud/ponzi-scheme> [perma.cc/EY6X-JVQX].

³ See Financial Consumer Agency of Canada, *ibid.*

⁴ *Ibid.* See also U.S. Securities Exchange and Commission, *supra* note 2.

⁵ See Financial Consumer Agency of Canada, *ibid.* See also U.S. Securities Exchange and Commission, *ibid.*

⁶ "Protecting Investors" (last visited 26 July 2022), online: *Canadian Securities Administrators* <www.securities-administrators.ca/about/> [perma.cc/8ABR-LFPP]. See also "About the SEC" (last visited 26 July 2022), online: *U.S. Securities and Exchange Commission* <www.sec.gov/about.shtml> [perma.cc/AGM8-M7DG].

⁷ Vanisha H Sukdeo, "Introduction - Corporate Social Responsibility" (2019) 36 Windsor YB Access Just 1.

⁸ "About us" (last visited 26 July 2022), online: *Canadian Securities Administrators* <www.securities-administrators.ca/about/> [perma.cc/HA4S-9MPA].

and territories form the Canadian Securities Administrators (CSA).⁹ The CSA members often engage in joint investigations and conduct joint hearings for cases that cross jurisdictional boundaries, which sometimes involve cases dealing with Ponzi schemes.¹⁰

III. THE ESTABLISHMENT OF WHISTLEBLOWER AWARD PROGRAM BY SECURITIES REGULATOR

A. Whistleblower Award Program in Canada

In 2011, the SEC established a whistleblower award program. One of the main motivating factors behind the SEC's introduction of the program was the catastrophic losses caused by Bernie Madoff's Ponzi scheme.¹¹ The whistleblower award program encourages whistleblowers to provide information to help securities regulators achieve efficient enforcement actions and deter potential wrongdoings. Recently, in response to the success of the SEC whistleblower award program, the OSC launched its own whistleblower program in July 2016.¹² The OSC Whistleblower Program accepts tips from whistleblowers across Canada on possible violations of Ontario securities law.¹³ The OSC Whistleblower Program is significant in

⁹ *Ibid.*

¹⁰ See "Canadian Securities Administrators 2013 Enforcement Report" (last visited 26 July 2022), online (pdf): *Manitoba Securities Commission* <mbsecurities.ca/about-msc/pubs/enf_report_13.pdf> [perma.cc/JUR9-SGKG]. See also "Canadian Securities Administrators 2012 Enforcement Report" (last visited 26 July 2022), online (pdf): *Manitoba Securities Commission* <mbsecurities.ca/about-msc/pubs/enf_report_12.pdf> [perma.cc/3Z9S-P8GL]; *Re Arbour Energy Inc*, 2012 ABASC 416 [*Arbour*]. Canadian securities regulators sometimes enter into collaboration agreements with international regulators, which includes the Securities and Exchange Commission (SEC). The *Arbour Energy* case dealt with a Ponzi scheme and is an example of a case that crossed jurisdictional boundaries and involved collaboration among the Canadian securities regulators and the Securities and Exchange Commission.

¹¹ *Austin*, *supra* note 1 at 1-5.

¹² Janet Austin & Sulette Lombard, "The Impact of Whistleblowing Awards Programs on Corporate Governance" (2019) 36 *Windsor YB Access Just* 1-2 [Austin & Lombard].

¹³ "OSC Whistleblower Program Marks Five-Year Milestone, Praises Contributions of Whistleblowers" (14 July 2021), online: *Ontario Securities Commission* <www.osc.ca/en/news-events/news/osc-whistleblower-program-marks-five-year-milestone-praises-contributions-whistleblowers> [perma.cc/2VHL-UYKL].

that it is the Canadian securities regulator's first and only whistleblower program that offers an award to the whistleblowers who meet the award criteria.¹⁴ The other Canadian provinces and territories encourage and accept tips from the whistleblowers, but lack an incentive mechanism.¹⁵

B. Promising Effect of Whistleblower Award Program

In Janet Austin's article, the author discusses the impact of the SEC's whistleblower award program on Ponzi schemes and their victims. Based on statistical evidence, the SEC is receiving a large number of tips in response to SEC's whistleblower award program and "the tips have steadily increased each year from 3001 tips in 2012 to 6911 tips in 2020."¹⁶ This consistent increase in reporting seem to have contributed to improved enforcement actions in cases dealing with Ponzi scheme.¹⁷ According to Austin's analysis, "there does seem to be a reduction in the median amount raised by each Ponzi scheme and the median number of victims of each scheme."¹⁸

Similarly, Canada is also witnessing promising results following the OSC's implementation of the Whistleblower Program. Since the program's establishment in July 2016, the OSC has witnessed consistent growth in the number of tips with each subsequent year, leading to more efficient enforcement actions.¹⁹ The year 2020-2021 achieved a "13 per cent" increase

¹⁴ *Ibid.* See also "OSC Whistleblower Program" (last visited 26 July 2022), online: Ontario Securities Commission <www.osc.ca/en/enforcement/osc-whistleblower-program> [perma.cc/3E3K-9GPG]; "Award Eligibility and Process" (last visited 26 July 2022), online: Ontario Securities Commission <www.osc.ca/en/enforcement/osc-whistleblower-program/award-eligibility-and-process> [perma.cc/WS36-TJFV]. OSC offers an award of "up to \$5 million for tips that lead to enforcement action," if both the whistleblower and the whistleblower's submission report meet the eligibility criteria. See "OSC Policy 15-601 Whistleblower Program" (last visited 23 May 2022), online (pdf): Ontario Securities Commission <www.osc.ca/sites/default/files/2021-02/pol_20181004_15-601_unofficial-consolidation.pdf> [perma.cc/ES92-KLUK]. Details regarding eligibility and award amount are provided under Policy 15-601 of the OSC Whistleblower Program.

¹⁵ Austin & Lombard, *supra* note 12. See also *supra* note 13.

¹⁶ Austin, *supra* note 1 at 10-12.

¹⁷ *Ibid* at 14-16.

¹⁸ *Ibid* at 18.

¹⁹ See *supra* note 13. See also James Langton, "Whistleblower Program Sparks Enforcement Action" (29 June 2018), online: Investment Executive <www.investmentexecutive.com/news/from-the-regulators/whistleblower-program-sparks

in tips.²⁰ Hopefully, the increase in tips from whistleblowers will continue to fuel the OSC's enforcement actions and serve as a deterrent to potential Ponzi scheme organizers.

IV. CANADIAN LEGISLATIONS DEALING WITH PONZI SCHEME

Enforcement actions against Ponzi scheme organizers are taken at both the federal and provincial level,²¹ under the federal *Criminal Code*²² and the provincial *Securities Acts*.²³ However, there are no specific provisions in the *Securities Act* or in the *Criminal Code* that directly deal with cases involving Ponzi schemes.²⁴

A. Federal Legislation: *Criminal Code*

A Ponzi scheme is a form of fraud that involves “fraudulent transactions relating to contracts and trade,”²⁵ and such fraudulent conducts are

enforcement-action/> [Langton].

²⁰ “OSC Publishes 2021-2022 Statement of Priorities” (29 June 2021), online: *Ontario Securities Commission* <www.osc.ca/en/news-events/news/osc-publishes-2021-2022-statement-priorities> [perma.cc/K9KH-ZMUT].

²¹ See “David Lorne Pitcher” (16 November 2016), online: *The Manitoba Securities Commission* <docs.mbsecurities.ca/msc/oe/en/item/182250/index.do> [Pitcher]; “Tulsiani Investments Inc and Sunil Tulsiani” (30 May 2012), online: *The Manitoba Securities Commission* <docs.mbsecurities.ca/msc/oe/en/item/103670/index.do> [Tulsiani]; *R v Samji*, [2016] BCJ 1059 at paras 1-5, 335 CCC (3d) 231 [Samji]. But see the *Competition Act*, RSC 1985, c C-34, s 55.1. Note that in many cases, those accused of operating a Ponzi scheme are found to be involved in the operation of a less serious scheme, such as multi-level marketing or pyramid scheme. Multi-level marketing is legal in Canada while pyramid schemes are not. Subsection 55.1(1) of the *Competition Act* provides the definition of a pyramid scheme and differentiates pyramid scheme from multi-level marketing. Subsection 55.1(2) of the *Competition Act* prohibits the operation of a pyramid scheme in Canada and individuals who acted contrary to s-s. 55.1(2) will be punished under s-s. 55.1(3) of the *Competition Act*.

²² RSC 1985, c C-46 [*Criminal Code*]

²³ See, for example, *Securities Act*, RSO 1990, c S5; *Securities Act*, CCSM, c S50.

²⁴ “A Canadian Strategy to Combat Investment Fraud” (August 2014), online: *FAIR Canada* <faircanada.ca/submissions/a-canadian-strategy-to-combat-investment-fraud/> [perma.cc/VWA4-7W6R].

²⁵ See *R v Cruz*, 2010 ONCJ 640 [Cruz]; *R v Mazzucco*, 2012 ONCJ 333 [Mazzucco]; *R v Link*, 2013 SKQB 138 [Link]; *Samji*, *supra* note 21. See also “Canadian Securities Administrators

addressed by s-s. 380(1) of the *Criminal Code*. Subsection 380(1) of the *Criminal Code* reads as follows:²⁶

380 (1) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,

- (a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding fourteen years, where the subject-matter of the offence is a testamentary instrument or the value of the subject-matter of the offence exceeds five thousand dollars; or
- (b) is guilty
 - i. of an indictable offence and is liable to imprisonment for a term not exceeding two years, or
 - ii. of an offence punishable on summary conviction, where the value of the subject-matter of the offence does not exceed five thousand dollars.

In order to prove fraud, two essential elements of fraud, deceit and deprivation, must be present.²⁷ In Ponzi scheme cases, the prohibited act of deceit is satisfied where the scheme organizer induces an investor into believing that they are actually investing in the high-return and low-risk product, and the prohibited consequence of deprivation is satisfied where the scheme organizer's deceit caused an actual, or a risk of, "detriment, prejudice, or prejudice to the economic interest of the victim."²⁸ Fraud under s-s. 380(1) is established as long as the accused scheme organizer had the subjective knowledge of undertaking the prohibited act of deceit and that

2015 Enforcement Report" (last accessed 23 May 2022), online (pdf): *Manitoba Securities Commission* <mbsecurities.ca/about-msc/pubs/enf_report_15.pdf> [perma.cc/T3KR-U3JH]. Sometimes, only a certain sector of the population, such as a certain religious group, age group, or profession, is targeted. A fraudulent investment scheme that targets a particular sector of population is called affinity fraud. The *Rashida Samji* case in British Columbia, *supra* note 21, is an example of a Ponzi scheme involving affinity fraud.

²⁶ *Criminal Code*, *supra* note 22, s-s 380(1).

²⁷ *Link*, *supra* note 25 at paras 9-15; *Canadian Securities Administration 2015 Enforcement Report*, *supra* note 25. See also Simon N Verdun-Jones, *Criminal Law in Canada*, 7th ed (Ontario: Nelson Education, 2015) at 81-84 [Verdun-Jones].

²⁸ See *Link*, *ibid* at para 14. See also Verdun-Jones, *ibid*.

the accused scheme organizer was subjectively aware that the act could result in the deprivation of another.²⁹

Under the *Criminal Code*, the sanctions for Ponzi scheme may include large fines, imprisonment, restitution, and permanent criminal record.³⁰ In order to determine the appropriate sentence in Ponzi scheme cases, the court will first refer to the sentences customarily imposed for similar crimes and offenders.³¹ From there, the court will consider aggravating and mitigating factors of the particular case and make adjustments to the sentence accordingly.³² Some examples of aggravating factors in Ponzi scheme cases include high degree of planning and deception, greed as the sole motivation for committing fraud, and the fraudster's misuse of his or her respectable status in the community.³³ On the other hand, some examples of mitigating factors in Ponzi scheme cases include early guilty plea, absence of a prior criminal record, and willingness to make restitution.³⁴ The sentencing for fraud takes aggravating circumstances into consideration under s. 380.1.³⁵

B. Provincial Legislation: *Securities Act*

In many cases involving Ponzi scheme, securities commissions have made enforcement orders against the Ponzi scheme organizer under the provincial or territorial *Securities Act*.³⁶ Canadian securities regulators may pursue charges related to provincial securities-law violations in court³⁷ or

²⁹ See *Link*, *ibid.* See also Verdun-Jones, *ibid.*

³⁰ See *Cruz*, *supra* note 25; *Mazzucco*, *supra* note 25; *Link*, *supra* note 25; *Samji*, *supra* note 21. See also "The Four Stages of Enforcement" (last visited 23 May 2022), online (pdf): *Manitoba Securities Commission* <mbsecurities.ca/complaints-guidance/file-a-complaint/pubs/investigative-process.pdf> [perma.cc/ZLB7-YMZX].

³¹ See *Cruz*, *ibid.* at para 23. See also *Mazzucco*, *ibid.* at para 29.

³² See *Cruz*, *ibid.*; *Mazzucco*, *ibid.* See also *Criminal Code*, *supra* note 22, s 718.2.

³³ *Mazzucco*, *ibid.* at paras 19-21.

³⁴ *Ibid.*

³⁵ *Criminal Code*, *supra* note 22, s-s 380.1(1).

³⁶ See *Pitcher*, *supra* note 21; *Tulsiani*, *supra* note 21. See also *Re Chieduch*, 2019 LNBCSC 61 at paras 1-6; *Re Tang*, 2016 LNONOSC 212 at para 5.

³⁷ Cases involving provincial securities law violations will be heard in a court if the securities regulator intends to seek a jail term. In 2013, Michael Chodorowski pled guilty to four charges of fraud under the *Criminal Code* and thirty charges under the British Columbia *Securities Act*. Chodorowski, who operated a Ponzi scheme, was sentenced to two years in

bring allegations of securities misconduct to a hearing before an administrative tribunal.³⁸

Each Canadian province and territory have different sections of the *Securities Act* that address the liability and sanctions for Ponzi schemes.³⁹ The Manitoba Securities Commission is able to impose sanctions on Ponzi scheme organizers under s. 148(1), s. 148.3, and s. 19(5) of *The Securities Act*,⁴⁰ if such orders are in the public interest.⁴¹ These sections of *The Securities Act* of Manitoba set out the following permanent prohibitions:⁴²

- (a) under subsection 148(1), from trading in securities or derivatives;
- (b) under section 148.3, from becoming or acting as a director or officer of an issuer; and
- (c) under section 19(5), from relying on exemptions specified under s-s. 19(1) and s-s. 19(2).

V. CONCLUSION

Enforcement actions against Ponzi scheme organizers are taken at both the federal and provincial levels, through the *Criminal Code*⁴³ and the *Securities Acts*.⁴⁴ Recently, SEC's establishment of whistleblower award program contributed to an observable decline in "the median amount raised

prison under the British Columbia *Securities Act*, RSC 1996, c 418, to be served concurrently with the six-year jail sentence for the fraud-related criminal offences. See the Canadian Securities Administrators 2013 Enforcement Report, *supra* note 10 at 28.

³⁸ Cases dealing with provincial securities law violations will be heard before an administrative tribunal if the securities regulator intends to impose sanctions or orders. See Pitcher, *supra* note 21. See also *Tulsiani*, *supra* note 21.

³⁹ See *Re Lathigee*, 2015 LNBSC 66 at para 1. See also *Re GoldQuest International*, 2010 LNONOSC 887 at para 1. It is evident that the relevant sections of the *Securities Act* of British Columbia, *supra* note 37, and the *Securities Act* of Ontario *supra* note 23, dealing with liability and sanctions for Ponzi scheme are different from each other.

⁴⁰ *Ibid.*

⁴¹ See Pitcher, *supra* note 21. See also *Tulsiani*, *supra* note 21.

⁴² *Securities Act* of Manitoba, *supra* note 23, c S50, s-s 19(1), 19(2), 19(5), 148(1) and s 148.3.

⁴³ *Supra* note 22.

⁴⁴ Examples include the *Securities Act* of Manitoba, *supra* note 23; *Securities Act* of Ontario, *supra* note 23; *Securities Act* of British Columbia, *supra* note 37.

by each Ponzi scheme”⁴⁵ and “the median number of victims of each scheme.”⁴⁶ Similarly, in Canada, the OSC Whistleblower Program contributes to a remarkable increase in the number of tips provided and the number of enforcement actions against securities-related misconduct.⁴⁷ Hopefully, this promising trend continues and inspires the other Canadian provinces and territories to adopt a similar whistleblower award program in the near future.

⁴⁵ Austin, *supra* note 1 at 18.

⁴⁶ *Ibid.*

⁴⁷ See *supra* note 16. See also Langton, *supra* note 19.