

What Effect Has the SEC's Whistleblower Award Program had on Ponzi Schemes and their Victims?

D R . J A N E T A U S T I N *

I. ABSTRACT

In 2011, at the direction of the US Congress, the US Securities and Exchange Commission (SEC) established a whistleblower award program. Since its inception, this program has resulted in the SEC paying approximately US\$562M to 106 whistleblowers. It has also led to orders directing wrongdoers to pay a total of US\$2.7B in monetary sanctions.

A key reason why the SEC asked Congress to pass legislation to enable it to establish such a program was the catastrophic losses to victims caused by Bernie Madoff and his Ponzi scheme. A Ponzi scheme involves the theft of victims' money held by the perpetrator, often someone holding themselves out as a broker or investment adviser. The Bernie Madoff Ponzi scheme operated from at least the early 1990's until 2008 and was one of the largest Ponzi schemes ever uncovered, with some estimates putting losses at US\$64.8B. The whistleblower award program is designed to encourage whistleblowers to come forward and provide information to the SEC in the hope that it will be able to shut down fraudulent schemes before they cause significant losses to victims.

This article considers the impact of the SEC's whistleblower award program on Ponzi schemes. My hypothesis is that the existence of the award program should result in people who hear about a suspected Ponzi scheme being much more motivated to report it to the authorities than if there was no such program. As such, the SEC should be able to shut Ponzi schemes

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down earlier, with a corresponding reduction in the length of time they operate along with the losses accruing to the victims. I test this hypothesis by utilizing data released by the SEC in relation to enforcement actions taken against Ponzi schemes for the seven years prior to the introduction of the award program and the ten years since. The data reveals no real link between the introduction of the program and the number of Ponzi schemes discovered each year or the length of time Ponzi schemes are operating. It does however show that the median amount raised by Ponzi schemes has fallen. It also shows that the median number of victims of Ponzi schemes has decreased. This suggests that the whistleblower awards program may be having an impact at reducing the number of victims of Ponzi schemes as well as the amounts raised by Ponzi schemes. The article then discusses these findings as well as their policy implications.

II. INTRODUCTION

In 2000, 2001, and 2005 Harry Markopolos, a whistleblower, reported to the SEC that Bernie Madoff could be operating a Ponzi scheme.¹ Yet, it was not until 2008, following information provided by Madoff's sons, that the SEC initiated enforcement action and shut the scheme down.² The Bernie Madoff Ponzi scheme proved to be one of the largest Ponzi schemes ever discovered. Although the exact amount lost by victims is somewhat contentious, estimated losses were between US\$20B and US\$64.8B.³

After the exposure of the Madoff Ponzi scheme, the SEC came under intense criticism. This criticism focused on the failure of the SEC in not acting on the tips from Markopolos because, it was argued, this may have reduced the number of victims and the funds lost by those victims.⁴ The SEC conducted its own examination of why it failed to discover the Ponzi scheme at an earlier point in time.⁵ One of the outcomes was that the SEC decided

¹ See Diana B Henriques, *The Wizard of Lies: Bernie Madoff and the Death of Trust* (New York: Times Books Henry Hold and Company, 2011) at 122-125, 153. See also Harry Markopolos, *No One Would Listen: A True Financial Thriller* (Hoboken: John Wiley & Sons, 2010).

² Henriques, *ibid* at 10.

³ Henriques, *ibid* at 256.

⁴ Henriques, *ibid* at 240-242.

⁵ Henriques, *ibid* at 302.

to enhance its response to whistleblowers. As part of this, it sought legislation for a program to pay financial awards to whistleblowers to encourage them to come forward. As a result, in 2008 the United States Congress passed the *Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act)*.⁶ The *Dodd Frank Act* contained a direction to the SEC to establish a program to pay financial awards to whistleblowers. Shortly thereafter the SEC established this program, and in 2011, it began operating.⁷

As the Madoff Ponzi scheme was one of the key reasons behind the introduction of the SEC award program, the purpose of this article is to determine the impact of this award program on Ponzi schemes. My hypothesis is that a regulator should be able to detect Ponzi schemes earlier where a whistleblower award program exists as compared to where there is no such award program. Put simply, the possibility of a significant monetary award should act as a powerful motivator for people who hear about a suspected Ponzi scheme to report it to the authorities. It could then be anticipated that, where there is a whistleblower award program, the regulator will act to shut such schemes down earlier. There should then be a corresponding reduction in the length of time Ponzi schemes can operate and a reduction in the magnitude of the losses accruing to those who have put money into such schemes. To test this hypothesis, I use data produced by the SEC on enforcement actions taken in relation to Ponzi schemes for the seven years prior to the whistleblower award program and the ten years since.

Part III of this article briefly outlines the history and rationale of the SEC's whistleblower awards program. It also considers the impact this program may have had on the SEC's enforcement actions. Part IV moves on to consider how the program may have affected Ponzi schemes. This part also contains my methodology, data collection procedures, and results of this empirical analysis. This analysis shows that the program has had no real impact on the number of Ponzi schemes the SEC takes action against each

⁶ See *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub L No 11-203 § 922(a), 121 Stat 1894 (2010).

⁷ *Ibid.* The Act inserted a new § 21F into the Securities Exchange Act 1934 (Pub.L. 73-291, 48 Stat. 881, enacted June 6, 1934, codified at 15 U.S.C. § 78a et seq.). The whistleblower awards program established by the SEC became effective on August 12, 2011, see SEC Rule 17 CFR Parts 240 and 249 [Release No. 34-64545; File No. S7-33-10] Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934 (August 12, 2011).

year, the length of time during which Ponzi schemes operate, or the total amount raised by Ponzi schemes. The data does show that the median amount raised by Ponzi schemes has fallen. It also shows that the median number of victims of Ponzi schemes has decreased. Part V discusses these findings as well as the policy implications of this study.

III. THE SEC'S WHISTLEBLOWER AWARD PROGRAM

A. History and Rationale

The SEC has had an award program for whistleblowers since 1989. However, until 2011, it was limited to information provided to the SEC about insider trading. Furthermore, this program was not widely known about, even within the SEC, and only five awards were made in 20 years, the highest of those being US\$55,220.⁸

In 2009, the failure of the SEC to respond to tips about the fraudulent operations of Bernard Madoff, as well as the impact of the Global Financial Crisis on the US economy, prompted a new focus on the issue of encouraging whistleblowers to come forward to report corporate wrongdoing and fraud. Given these debacles, it seems many within the SEC believed that it needed a broad-based financial reward program to incentivize whistleblowing. The hope was that this would allow the SEC to detect fraudulent schemes quickly before they embarrassed the SEC and rattled investors and the capital markets.⁹ Jordan Thomas, who at the time worked for the SEC in developing the whistleblower award program, stated:

At that [sic] time the program was considered, the financial crisis had just occurred, and the Madoff scandal had surfaced. At that time, the SEC and other financial watchdogs did extensive sole searching across the organization about how they could be better, and the first kind of question was, what was the vision? What was the vision for the organization? Was it to be expansive or just be better at what they were currently doing? And the answer is they wanted to be more aggressive, had a more ambitious vision for enforcement. The second question was, were the strategies and tactics that they were using essentially the status quo effective? And

⁸ This program was created following the stock market crash of October 1987 when the US Congress passed a number of amendments to the *Securities Exchange Act* to improve the detection and punishment of insider trading. See § 21A(e) of the *Securities Exchange Act*, 15 USC § 78a (1934) (which was added by the *Insider Trading and Securities Fraud Enforcement Act of 1988* (ITSEA), Pub L No 100-704. See also US, Office of Inspector General, *Assessment of the SEC's Bounty Program* (Report No 474) (Washington, DC: 2010) at 1.

⁹ Miriam H Baer, "Reconceptualizing the Whistleblower's Dilemma" (2016) 50:5 UCD L Rev 2215 at 2224.

the answer was, it was not. And the third question was basically, what do we have to lose? Okay. Because in a whistleblower context, you pay for success. So you are developing a program that allows for it to work. If you establish a program and people don't come or they don't come with the kind of thing you want, you don't pay. And so the cost of establishing the program, yes, there are costs for establishing the office of the whistleblower. But otherwise, essentially you're just feeding more tips into your enforcement staff and you are able to triage it. Yes they have limited resources, but the thinking was they would have the opportunity to do better cases.¹⁰

This review of operations resulted in the SEC seeking legislation allowing it to reward whistleblowers, similar to a successful whistleblower award program that was run by the US Internal Revenue Service.¹¹ The award scheme developed by the SEC was contained in a proposed *Investment Protection Act*, which the Obama Administration took to Congress on July 10, 2009.¹² The rationale set out in the accompanying press release was that this would encourage insiders and others with strong evidence of securities-law violations to bring that evidence to the SEC and thereby improve its ability to enforce the securities laws.¹³ Although this proposed Act did not proceed, provisions allowing the SEC to establish a whistleblower award program were contained in the *Dodd Frank Act* which was signed into law on July 21, 2010. The *Dodd Frank Act* stipulated that a whistleblower providing original information to the SEC was entitled to a minimum award of 10%

¹⁰ Ontario Securities Commission, "Unedited Transcript of Roundtable Discussion" (9 June 2015) at 37-38, online (pdf): <www.osc.ca/sites/default/files/pdfs/irps/oth_20150609_15-401_transcript.pdf> [perma.cc/8AAM-BT9W].

¹¹ Hon Mary Schapiro, "Testimony to the Subcommittee of Financial Services and General Government Appropriations Committee", 111 Congress (2 June 2009) at 10, online: <www.scribd.com/document/328584364/SENATE-HEARING-111TH-CONGRESS-FINANCIAL-SERVICES-AND-GENERAL-GOVERNMENT-APPROPRIATIONS-FOR-FISCAL-YEAR-2010> [perma.cc/KF2T-G744].

¹² US Department of the Treasury, "Fact Sheet: Administration's Regulatory Reform Agenda Moves Forward Legislation for Strengthening Investor Protection Delivered to Capitol Hill", online: <www.treasury.gov/press-center/press-releases/pages/tg205.aspx> [perma.cc/6NRJ-RT2T]. This Act would have allowed the SEC to pay whistleblowers a reward of up to 30% for information that led to monetary penalties that were over US\$1 million.

¹³ *Ibid.*

and a maximum of 30% if monetary penalties over US\$1 million were imposed.¹⁴

Following the enactment of the *Dodd Frank Act*, on November 3, 2010, the SEC released proposed rules for the whistleblower award program and provided the public with just over a month to comment.¹⁵ The cost-benefit analysis accompanying these proposed rules stated that:

Overall, enhanced whistleblower incentives should likely result in more frequent reporting of misconduct, which will result in greater deterrence of securities law violations and more effective and efficient enforcement on the part of the Commission.¹⁶

The empirical evidence cited in support of this statement was contained in a paper by Dyck, Morse, and Zingales. They collected data in relation to 216 cases of corporate frauds and found that employees were an important source for revealing such fraud. Dyck *et al* found that 41% of frauds in the health care industry were brought to light by employees, compared to just 14% of frauds in other industries. They reasoned that the higher disclosure of frauds by employees in the health care industry was because such employees could become entitled to a reward by bringing a *qui tam* suit under the *False Claims Act*. They concluded that the logical implication of their findings was that other industries should adopt monetary incentives for whistleblowers.¹⁷

The SEC adopted the final rules for its whistleblower award program on May 25, 2011, and they went into effect on August 12, 2011.¹⁸ Since then, the SEC has paid approximately US\$567 million to 106 whistleblowers and

¹⁴ Geoffrey Christopher Rapp, "Mutiny by the Bounties - The Attempt to Reform Wall Street by the New Whistleblower Provisions of the Dodd-Frank Act" (2012) 1 *BYU L Rev* 73 at 89 notes that there was relatively little debate of the whistleblower provisions in Congressional hearings in relation to the *Dodd Frank Act*.

¹⁵ US Securities and Exchange Commission, "SEC Proposes New Whistleblower Program Under Dodd-Frank Act - Additional Materials: SEC Rule Proposal" (Press Release No 2010-213; 3 November 2010), online: <www.sec.gov/news/press/2010/2010-213.htm> [perma.cc/49WK-XTKT].

¹⁶ *Ibid* at 104.

¹⁷ Alexander Dyck, Adair Morse & Luigi Zingales, "Who Blows the Whistle on Corporate Fraud?" (2010) 65:6 *J Finance* 2213 at 2251.

¹⁸ US Securities and Exchange Commission, "SEC's New Whistleblower Program Takes Effect Today (2011-167; 12 August 2011), online: <www.sec.gov/news/press/2011/2011-167.htm> [perma.cc/XEY5-5FRK].

has ordered wrongdoers in enforcement matters involving whistleblower information to pay a total of US\$2.7 billion in monetary sanctions.¹⁹

B. Effect of the Whistleblower Award Program on the SEC's enforcement actions

The program is generating a large number of tips and the tips have steadily increased each year – from 3001 tips in 2012 to 6911 tips in 2020, with only a slight decline in 2019.²⁰ Although motivations for whistleblowers vary, some whistleblowers seem to be motivated by the possibility of an award. Furthermore, despite efforts of authorities to hide their identity, blowing the whistle may result in a person's loss of employment and capacity to be employed if they become known in the industry as someone who is

¹⁹ US Securities and Exchange Commission, "2020 Annual Report to Congress Whistleblower Program" (2020), online (pdf): <www.sec.gov/files/2020%20Annual%20Report_0.pdf> [perma.cc/4BHX-FTP7].

²⁰ The SEC received 3001 tips in 2012. See US Securities and Exchange Commission, "2012 Annual Report to Congress Whistleblower Program" (November 2012) at 4, online (pdf): <www.sec.gov/files/annual-report-2012.pdf> [perma.cc/3XZC-G4US]. In 2013 the SEC received 3238 tips. See US Securities and Exchange Commission, "2013 Annual Report to Congress Whistleblower Program" (2013) at 1, online (pdf): <www.sec.gov/files/annual-report-2013.pdf> [perma.cc/HE6Z-4K44]. In 2014 the SEC received 3620 tips. See US Securities and Exchange Commission, "2014 Annual Report to Congress Whistleblower Program" (2014) at 3, online (pdf): <www.sec.gov/files/owb-annual-report-2014_2.pdf> [perma.cc/N2DE-5886]. In 2015 the SEC received 3923 tips. See US Securities and Exchange Commission, "2015 Annual Report to Congress Whistleblower Program" (2015) at 21, online (pdf): <www.sec.gov/files/owb-annual-report-2015.pdf> [perma.cc/X9LD-W6GD]. In 2016 the SEC received 4218 tips. See US Securities and Exchange Commission, "2016 Annual Report to Congress on the Dodd-Frank Whistleblower Program" (2016) at 23, online (pdf): <www.sec.gov/files/owb-annual-report-2016.pdf> [perma.cc/M6AX-QLW8]. In 2017 the SEC received 4484 tips. See US Securities and Exchange Commission, "2017 Annual Report to Congress Whistleblower Program" (2017) at 23, online (pdf): <www.sec.gov/files/sec-2017-annual-report-whistleblower-program.pdf> [perma.cc/TY27-9E5C]. In 2018 the SEC received 5200 tips. See US Securities and Exchange Commission, "2018 Annual Report to Congress Whistleblower Program" (2018) at 2, online (pdf): <www.sec.gov/files/sec-2018-annual-report-whistleblower-program.pdf> [perma.cc/PT3W-FWX9]. In 2019 the SEC received 5200 tips, see US Securities and Exchange Commission, "2019 Annual Report to Congress Whistleblower Program" (2019) at 2, online (pdf): <www.sec.gov/files/sec-2019-annual%20report-whistleblower%20program.pdf> [perma.cc/JHL3-HKRD]. In 2020 the SEC received 6900 tips. See US Securities and Exchange Commission "2020 Annual Report to Congress Whistleblower Program" (2020) at 2, online (pdf): <www.sec.gov/files/2020%20Annual%20Report_0.pdf> [perma.cc/6J9X-DKL9].

willing to speak out. The possibility of obtaining an award may act as some compensation for this risk.

It also seems clear that some of these tips have translated into enforcement actions by the SEC and that whistleblowers have become key sources for actions covering a broad range of misconduct including fraudulent investment schemes.²¹ Tips from whistleblowers have also led to significant enforcement orders and monies returned to investors.²²

To protect whistleblowers from possible retaliation, the SEC does not disclose when it takes an enforcement action because of information provided by a whistleblower. As such, the SEC does not provide numbers linking when whistleblower tips have led to specific enforcement actions. Accordingly, it is not possible to directly link whistleblower tips to actions taken in relation to specific fraudulent investment schemes, such as Ponzi schemes. However, figures released by the SEC do suggest that it is receiving tips in relation to Ponzi schemes. This can be gleaned from information provided by the SEC setting out the most common complaint categories reported by whistleblowers. In 2020, the most common complaint categories reported by whistleblowers were corporate disclosures and financials (25%), offering fraud (16%), and manipulation (14%).²³ ‘Offering fraud’ is not defined but seems to include Ponzi schemes, pyramid schemes, and possibly also straight theft of investor monies by a perpetrator. The SEC reported that it is less common to receive tips in relation to insider trading which only comprised 5% of all tips in 2020.²⁴ As is demonstrated by Figure 1, tips in

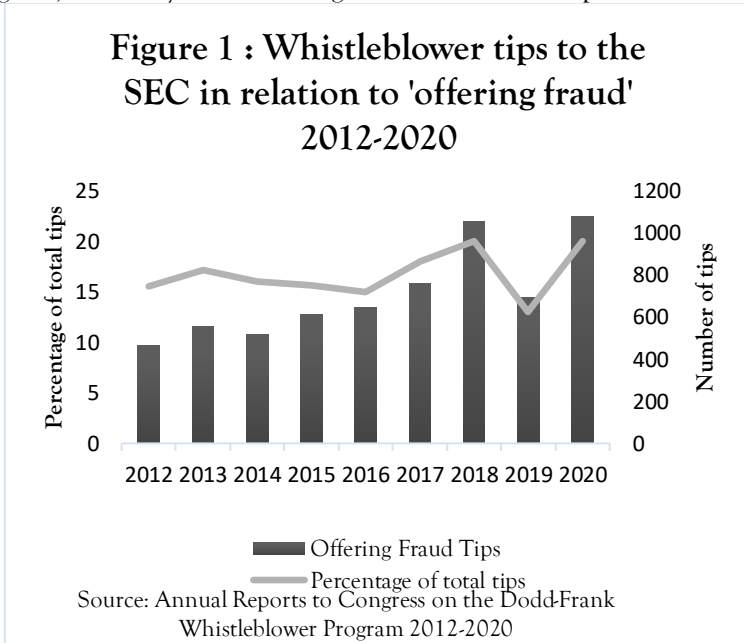
²¹ US Securities and Exchange Commission, “A New Model for SEC Enforcement: Producing Bold and Unrelenting Results” (18 November 2016), online: <www.sec.gov/news/speech/chair-white-speech-new-york-university-111816.html> [perma.cc/92HP-Y9FG]. See also US Securities and Exchange Commission, “Division of Enforcement Annual Report 2019” (2019) at 8, online (pdf): <www.sec.gov/files/enforcement-annual-report-2019.pdf> [perma.cc/E2JF-2K89]. The SEC also has said that the program has been of tremendous value to the SEC’s enforcement efforts by assisting the SEC uncover and stop fraudulent investment schemes and allowing hundreds of millions of dollars to be returned to investors, see US Securities and Exchange Commission 2017 Annual Report, *supra* note 20 at 1.

²² In 2020 the SEC stated that information from whistleblowers resulted in \$1.5 billion in orders for disgorgement of ill-gotten gains and of which more than \$850 million has been, or is scheduled to be, returned to investors. See *US Securities and Exchange Commission 2020 Annual Report*, *supra* note 20 at 5.

²³ *US Securities and Exchange Commission 2020 Annual Report*, *supra* note 20 at 28.

²⁴ *Ibid.*

relation to offering fraud have steadily risen since the whistleblower program began, albeit falling slightly in 2019. They have also consistently comprised a significant percentage of the overall tips received in the whistleblower program, in most years consisting of over 15% of all tips.



The relatively high number of tips in relation to offering fraud may suggest that, since the whistleblower award program commenced, the SEC would bring more enforcement actions for this type of fraud. There is some existing empirical evidence suggesting this may be the case. Specifically, in 2015 Caroline Dayton conducted a study of the SEC's enforcement actions before and after the introduction of the whistleblower award program with a view to determining how its enforcement program may have changed.²⁵ She theorized that a whistleblower is more likely to be present in some types of cases, such as corporate non-disclosures, as against other types of matters, such as insider trading. This is because in some types of cases more individuals know of these violations, and, as such, it is more likely that there will be a person willing to come forward as a whistleblower.²⁶ As a result, the

²⁵ Caroline E Dayton, "An Empirical Analysis of SEC Enforcement Actions in Light of the Dodd-Frank Whistleblower Program Student Notes" (2015) 12:1 NYU JL & Bus 215.

²⁶ *Ibid* at 277.

SEC's enforcement actions may have become skewed towards those where there may be a whistleblower.

Dayton based her analysis on data in relation to the types of violations in which the SEC acted and the amount of the sanctions imposed. She found that since the introduction of the whistleblower award program there was an increase in SEC enforcement actions where a whistleblower is likely to be present as opposed to one in which a whistleblower was less likely. She also found that since the introduction of the whistleblower award program, there was a decrease in the median civil penalty and disgorgement amounts in whistleblower likely cases as against non-whistleblower likely cases.²⁷ This suggests that because of whistleblowers, the SEC is now able to go after more marginal violations of securities laws.²⁸

IV. WHAT IMPACT HAS THE WHISTLEBLOWER AWARD PROGRAM HAD ON PONZI SCHEMES?

Dayton argues that a whistleblower is more likely in some types of matters actioned by the SEC than others. This is because, put simply, in some types of matters more people know of the fraud and therefore, there is a greater chance that one or more of these people will come forward to 'blow the whistle' in the hope of receiving an award. Building on this theory, it seems also likely that in some types of matters there is more of a chance that there will be outsiders who become aware of the existence of the fraud. Outsiders are those who are not implicated in the fraud, compared to insiders who may be implicated in, or in some way linked to, the fraud. It could reasonably be expected that outsiders are more likely to 'blow the whistle', as compared to insiders. This is because insiders may be reluctant to report the matter as they may in some way lose from its exposure, such as losing their job, investment or becoming liable to prosecution.

Ponzi schemes are a type of fraud where there are likely to be quite a few people aware of its existence. The typical structure of a Ponzi scheme is that those behind the scheme, typically a person holding themselves out as a

²⁷ *Ibid* at 231-232.

²⁸ *Ibid* at 235. Dayton does however note that other variables may have impacted her findings. These include the SEC's increase in administrative proceedings, including the fact that the SEC can now impose administrative sanctions on non-regulated persons. Furthermore, the SEC's change in enforcement policy after the financial crisis and the SEC's more recent focus on cooperation may have had an impact on her results.

broker or investment adviser, promises investors an above average return coupled with no risk or low risk. The returns are said to derive from some type of business, product, or financial arrangement. In fact, there is no such business, product, or financial arrangement. The person behind the scheme takes the investors' money and steals the funds, either for their own personal use or to pay returns to other investors. Moreover, to pay returns, as well as repaying any investors who demand reimbursement of their principal, funds must be constantly raised from new investors. Inevitably and eventually the scheme will collapse when no more new investors can be attracted and as such there are no funds to pay out old investors.²⁹

Consequently, each Ponzi scheme should have insiders (such as those behind the scheme and investors) who are aware of the scheme. However, there are also likely to be quite a few outsiders who become aware of, or may suspect, a Ponzi scheme. These would be people who have been invited to invest but did not. There are likely to be quite a few of these outsiders, because, to attract new investors to keep the scheme going, those behind the scheme must continually pitch it to potential new investors.

Accordingly, in relation to each Ponzi scheme, there are likely to be many people who could potentially report it to the authorities. My hypothesis is that where there is a whistleblower award program this should act as an incentive for people to tell the authorities. As such, it could be expected that people who become aware of a suspected Ponzi scheme will be more motivated to report it to the authorities where there is a possibility of an award than if there was no such award program. This should have an impact on Ponzi schemes by allowing the authorities to shut such schemes down earlier, with a corresponding reduction in the length of time Ponzi schemes operate, and the number of victims and the losses accruing to those victims.

A. Methodology and Data Collection Procedures

To test this hypothesis, I used data released by the SEC. In relation to each enforcement action it takes, the SEC announces information about the action in the form of a 'Litigation Release'. Usually, a copy of a 'SEC

²⁹ The term 'Ponzi scheme' was coined after Charles Ponzi who conducted a scheme in 1919 in which he promised returns to investors of 10% a month when banks were paying 5% a year. Eventually the scheme collapsed with losses of \$15M. Tamar Frankel, *The Ponzi Scheme Puzzle: A History and Analysis of Con Artists and Victims* (New York: Oxford University Press, 2012) at 15. US Securities and Exchange Commission, "Litigation Releases", online: <www.sec.gov/litigation/litreleases.htm> [perma.cc/J8BJ-BZW3].

Complaint', setting out more facts about the matter, is attached to the Litigation Release. Each of these are publicly available on the SEC's website.³⁰ As is referred to above, due to the possibility of retaliation, the SEC does not link specific enforcement actions to whistleblower tips and no mention is made in the Litigation Releases of whether there was a whistleblower.

I extracted data from Litigation Releases in relation to each Ponzi scheme in which the SEC took enforcement action in the seven years prior to the whistleblower award program and the ten years since, that is from August 12, 2004, to August 11, 2011 (before awards), and August 12, 2011, to August 11, 2021 (after awards). There are different types of Ponzi schemes, but for the purpose of this study, a scheme was classified as a Ponzi scheme if (a) it was called a Ponzi scheme, or (b) used investors' funds to pay existing investors.³¹ Hence, it captured schemes that started intentionally as a Ponzi scheme, as well as those that started as some sort of legitimate business, but over time, because of business or investment failure, degenerated into a Ponzi scheme.³²

For each Ponzi scheme, the data collected included how long the scheme operated, the number of victims, and the total amount raised by the scheme. This data was contained in most, although not all, Litigation Releases concerning Ponzi schemes.

The SEC only sporadically reported losses incurred by victims in its Litigation Releases, perhaps because it is not always possible to determine losses to victims until sometime after the scheme is wound up. Although I collected this data, because of inconsistent reporting of losses by the SEC, I ultimately did not use this for my analysis.

B. Results

The result of the research and analysis is set out below. In sum, after the introduction of whistleblower awards, the number of Ponzi schemes in relation to which the SEC has taken enforcement action each year seems to have remained about the same. In relation to the Ponzi schemes acted upon

³⁰ US Securities and Exchange Commission, "Litigation Releases", online: <www.sec.gov/litigation/litreleases.htm> [perma.cc/J8BJ-BZW3].

³¹ Pyramid schemes were not included unless they were also Ponzi schemes.

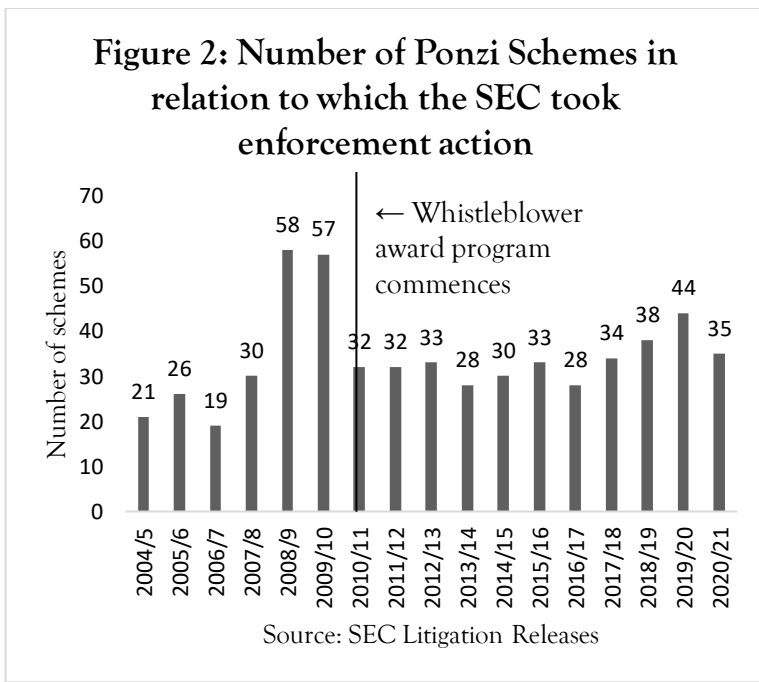
³² As to this categorization as well as the myriad types of Ponzi schemes see Marie Springer, *The Politics of Ponzi Schemes History, Theory and Policy* (New York: Routledge, 2021).

by the SEC, whistleblowing awards do not seem to have altered the total amount raised by Ponzi schemes, the length of time they are in operation, or the total number of victims. However 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.

1. Number of Ponzi schemes in which the SEC takes enforcement action each year

As shown in Figure 2, the number of Ponzi schemes in relation to which the SEC has taken enforcement action each year is relatively stable and does not seem to have been impacted by the introduction of the whistleblower award program. The only significant change is the increase in cases in the years 2008/9 to 2009/10. The increase in cases in those years coincided with the Global Financial Crisis (GFC). It seems that the GFC resulted in the exposing of an atypical number of Ponzi Schemes. This was probably because the GFC caused a liquidity crisis and, as such, perhaps an unusual number of investors tried to withdraw their funds from the scheme. At the same time, again because of this lack of liquidity, those behind such schemes were almost certainly unable to attract new investors to pay returns and pay out old investors thereby causing many Ponzi schemes to collapse.³³

³³ *Ibid* at 214-215.



2. Total Amount raised by Ponzi schemes

As shown by Table 1, the total amount raised by Ponzi schemes in relation to which the SEC took enforcement action each year varies significantly. However, the introduction of the whistleblower award program does not seem to have had a significant impact on the total amount raised each year. Again, the high point coincides with the GFC and seems to reflect the extraordinary number of enforcement actions the SEC took against Ponzi schemes in those years.

Table 1: Total Amount Raised by Ponzi Schemes acted upon by SEC each year

Year	\$USM
2004/5	456.44
2005/6	757.76
2006/7	375.96
2007/8	1600.78
2008/9*	10002.38
2009/10	2620.36

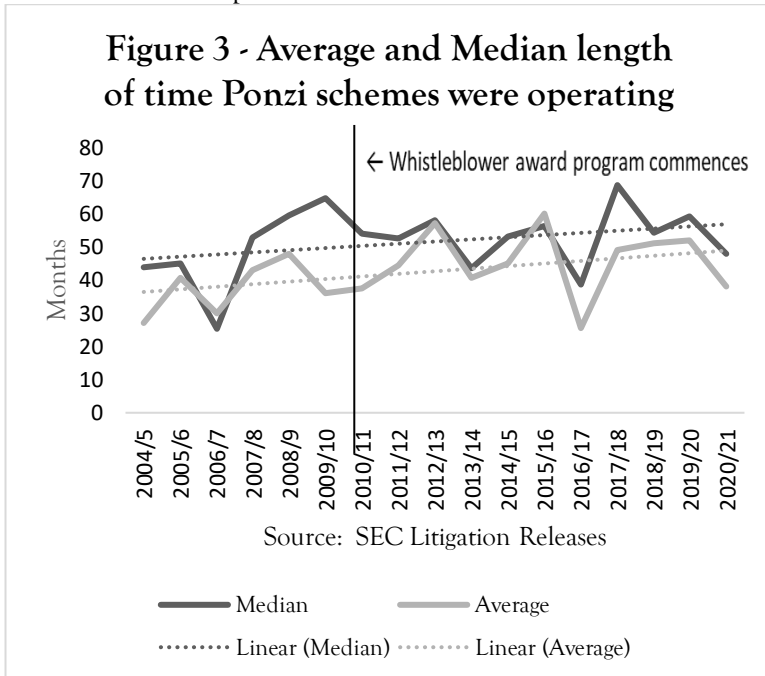
2010/11	670.47
Introduction of Whistleblower Awards	
2011/12	1665.96
2012/13	1336.02
2013/14	1493.16
2014/15	814.75
2015/16	1390.90
2016/17	283.64
2017/18	1732.79
2018/19	655.52
2019/20	2026.98
2020/21	1597.58

*Excludes Madoff Ponzi Scheme

Source: SEC Litigation Releases

3. Length of time the Ponzi schemes were in operation

As shown in Figure 3, the average and median length of time schemes operated before being shut down by the SEC has not varied significantly over the seventeen years, except, as indicated by the trend lines, they trend slightly upwards. The introduction of the whistleblower award program does not seem to have had an impact.



4. Number of Victims of Ponzi Schemes

Table 2 sets out the average number of victims each year. This shows no particular trend, and the introduction of the whistleblower award program does not seem to have had an impact.

Table 2: Average number of Victims of Ponzi Schemes acted upon by SEC each year

Year	Average Number of Victims
2004/5	342
2005/6	390
2006/7	1908
2007/8	2812
2008/9	357
2009/10	322
2010/11	296
Introduction of Whistleblower Awards	
2011/12	357
2012/13	38609
2013/14	376
2014/15	346
2015/16	6240
2016/17	87
2017/18	5350
2018/19	789
2019/20	59
2020/21	155

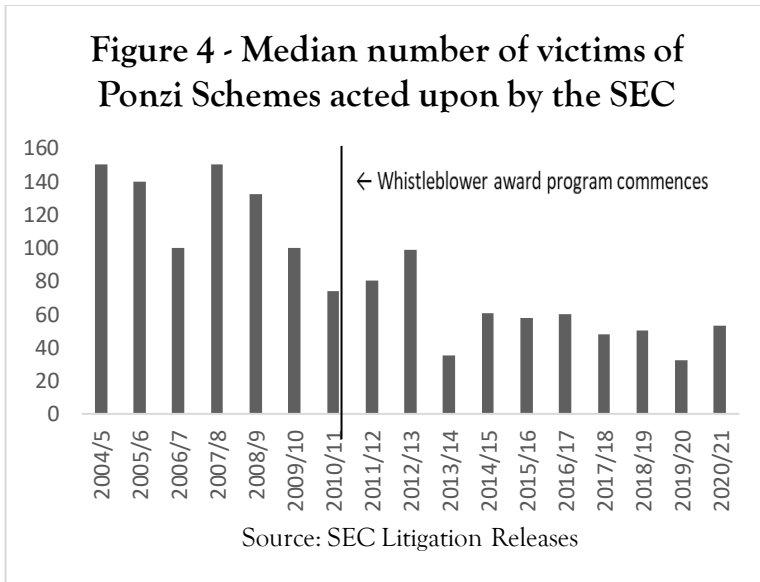
Source: SEC Litigation Releases

One of the difficulties with using the average as the metric for the number of victims is that the data has several outliers. For example, in 2012/13 one Ponzi scheme reported on by the SEC had raised more than \$600 million from more than one million victims worldwide via the internet.³⁴ Another in 2015/16 raised \$207 million from over 162,000 victims again via the internet.³⁵ To correct for the impact of outliers on data,

³⁴ US Securities and Exchange Commission, "Rex Venture Group LLC et al." (Litigation Release No 22456; 22 August 2012), online: <<https://www.sec.gov/litigation/litreleases/2012/lr22456.htm>> [perma.cc/EPQ8-6Q2Q].

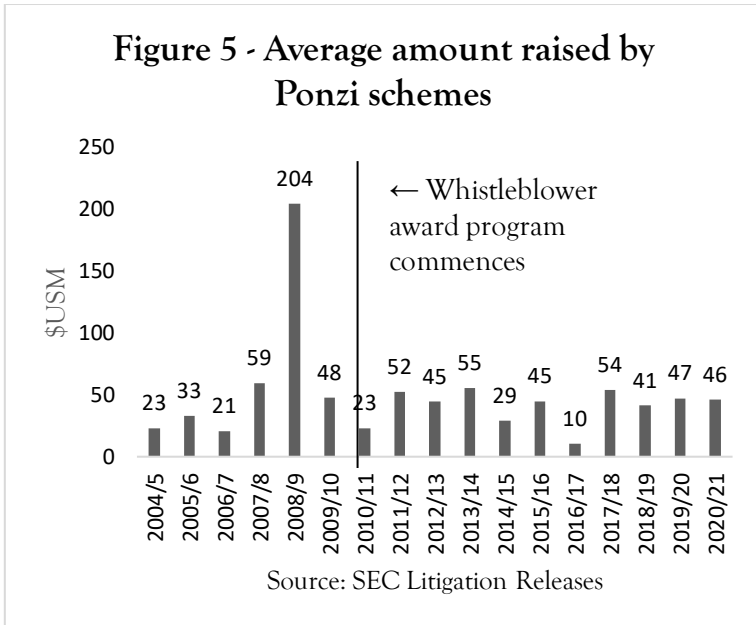
³⁵ US Securities and Exchange Commission, "Traffic Monsoon et al" (Release No LR-23604; 28 July 2016)", online: <www.sec.gov/litigation/litreleases/2016/lr23604.htm>

Figure 4 shows the median number of victims of Ponzi schemes subject to enforcement action each year. This shows that after the introduction of the whistleblower awards program, the median number of victims of each Ponzi scheme has decreased.

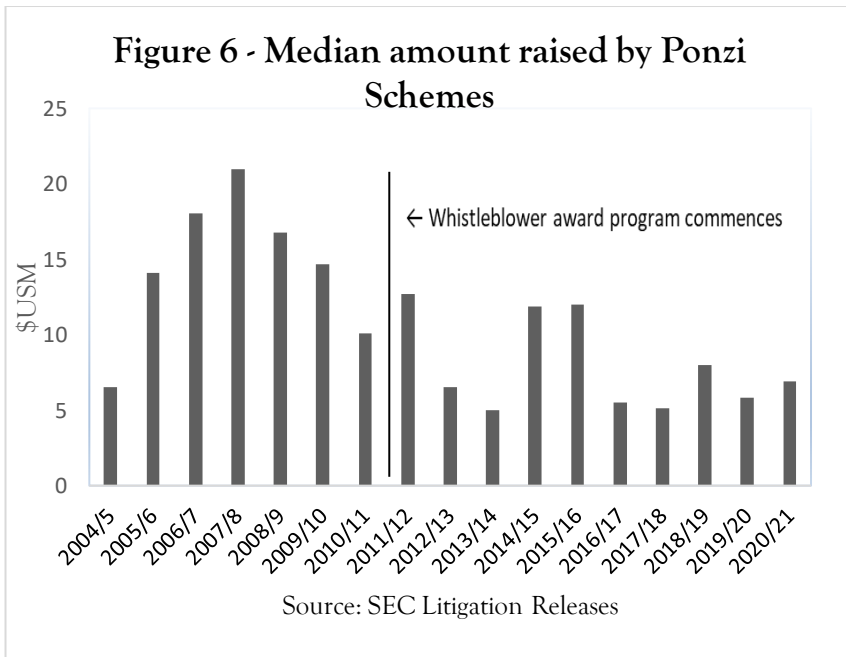


5. Amounts raised by Ponzi Schemes

As is referred to above, due to inconsistent reporting by the SEC on losses to victims, it is not possible to collect a consistent data set to measure this. However, the SEC does usually report the amount raised by each Ponzi scheme. Figure 5 sets out the average amount raised by Ponzi schemes each year. Apart from the atypical years surrounding the GFC, there appears to be no discernable pattern and no impact of the whistleblower awards scheme.



However, like the data in relation to the number of victims, the data in relation to the amount raised by Ponzi schemes each year also has several outliers. For example, in 2016/17, the highest amount raised by a Ponzi scheme was \$97M and the lowest was \$504,475.24. To correct for the impact of outliers, Figure 6 shows the median amount raised each year. This shows that there has been a decrease in the amounts raised by each Ponzi scheme since the introduction of the whistleblower award program and, in particular, during the last five years.



V. DISCUSSION AND POLICY IMPLICATIONS

A. The Findings

The figures released by the SEC in relation to the number of tips it is receiving from whistleblowers in relation to offering fraud (Figure 1) suggest that it is now receiving more tips in relation to Ponzi schemes than before the awards program commenced. This, somewhat surprisingly, does not seem to have translated into the SEC taking more actions against Ponzi schemes each year. This seems contrary to Dayton’s analysis that because of the whistleblower award program, the SEC has changed its focus towards enforcement actions in which it is more likely to receive tips from the outside public. The relatively steady number of actions taken by the SEC against Ponzi schemes may be related to other factors. Such factors could include limitations imposed by the SEC’s enforcement budget, the SEC may have different enforcement priorities, it may be receiving multiple tips about each Ponzi scheme, or perhaps the tips it receives are not of a sufficient quality to initiate an enforcement action.³⁶

³⁶ This may be true even though the SEC’s enforcement budget has steadily increased from

The total amount raised by Ponzi schemes acted upon by the SEC each year also does not seem to have been impacted by the whistleblower award scheme. This is of concern because the perpetrators of Ponzi schemes are apparently still managing to collect multi-millions of dollars from their victims. Furthermore, and contrary to my hypothesis, the length of time Ponzi schemes are in operation does not seem to have changed.

However, the median amount raised by Ponzi schemes does seem to have fallen since the introduction of the whistleblower award program, suggesting fewer overall losses to victims per scheme. In addition, a fall in the median number of victims suggests fewer victims fall prey to each Ponzi scheme. This does suggest that the whistleblower award program may be assisting the SEC in detecting and shutting down Ponzi schemes, and as a result there may be a decrease in losses to victims per scheme, and a lesser number of victims per scheme than if there was no whistleblower award program. This is also consistent with Dayton's findings that the whistleblower awards program is allowing the SEC to go after more marginal violations. Of course, correlation does not equal causation, and there may be other reasons for this trend. For example, the publicity surrounding the Madoff Ponzi scheme may have resulted in more public awareness of Ponzi schemes such that they cannot attract as many victims.

It is however somewhat surprising that the introduction of whistleblowing awards is not more significantly correlated with a reduction in the harm caused by Ponzi schemes. This may be because of some of the psychological traits displayed by perpetrators and victims of Ponzi schemes which might translate into a reluctance by persons to blow the whistle, even if the person becomes suspicious or has lost money. For example, Mervyn Lewis has identified several typical characteristics of perpetrators which seem to translate into 'successful' Ponzi schemes. These include that the perpetrators are like entrepreneurs in that they are optimistic, confident, and assured which encourages trust and investor confidence; they tend to live in big houses, act wealthy, mingle with the very rich, and can be choosy in selecting clients to create an aura of exclusiveness and give lavishly to charity

US\$318M in 2008 to \$589M in 2020, see US Securities and Exchange Commission, "Reports and Publications", online: <www.sec.gov/reports?field_article_sub_type_secart_value=Reports+and+Publications-BudgetReports> [perma.cc/5MNS-H624].

(using investors funds).³⁷ Perpetrators may also neutralize or rationalize their conduct and challenge those who question the scheme.³⁸

Specific psychological factors may also characterize persons who become victims of such schemes. It has been suggested that the reason why even highly educated persons fall for Ponzi schemes is because of factors such as the situation the victim finds themselves in (e.g. the perpetrator was very persuasive), cognition (e.g. the victim was naïve or bad at reading people), personality (e.g. the victim was too trusting), and the situation (e.g. the victim greatly admired the perpetrator).³⁹ There may also be group thinking at play as Ponzi schemes often thrive amongst affinity groups and close-knit communities.⁴⁰ Victims of Ponzi schemes may display ‘blind obedience’ because some people feel they need to honour their commitments (even if they have some doubts), follow the lead of others they trust, admire the people they are dealing with, or perceive the perpetrator as a person in authority.⁴¹ Clearly, many of these factors were at play in the Bernie Madoff Ponzi scheme and resulted in the scheme being able to continue for a long time. Once the fraud is revealed the victims may realize their naivety and be too embarrassed to report it to the authorities.⁴²

B. Policy Implications

Despite this study not showing a strong correlation between whistleblower awards and the detection of Ponzi schemes, if the whistleblower award program is resulting in a lesser number of victims and losses per scheme this provides some support for continuing, and perhaps strengthening, this program. A significant part of the SEC’s mandate is to protect retail investors from fraud, those investors being particularly

³⁷ Mervyn Lewis, *Understanding Ponzi Schemes: Can better financial regulation prevent investors from being defrauded?* (Cheltenham, UK & Northampton, Mass: Edward Elgar, 2015) at 121-123.

³⁸ *Ibid* at 145-146, which discusses research in relation to ‘Neutralization Theory’ and how perpetrators neutralize or rationalize their decisions.

³⁹ *Ibid* at 132-135 which discusses systematic biases in decision making.

⁴⁰ Lewis, *supra* note 37.

⁴¹ *Ibid* at 141-142.

⁴² The author has worked as a prosecutor of white-collar crime and found that victims of fraud and Ponzi schemes, particularly highly educated victims, frequently refused to give evidence as witnesses because they were embarrassed that they had fallen victim to fraud.

vulnerable to bad actors.⁴³ Ponzi schemes are an especially egregious form of white-collar crime because the instigators of such schemes frequently prey on unsophisticated investors, often retirees, who lose their life savings. Perhaps more publicity around the whistleblower award program, and with a particular focus on retail investors, would further strengthen the ability of the SEC to act against these schemes.

The results of this study should also be of interest to other securities regulators around the world who have, or are considering, using whistleblower awards. Ponzi schemes are, of course, not limited to the United States.⁴⁴ For example, from 2011 to 2015, Virginia Tan of Vancouver, British Columbia, Canada, ran a Ponzi scheme attracting 117 investors who lost a total of at least \$30 million. Her victims included businesspeople, retirees, and university students. Some retirees lost their life savings and one couple had to sell their home because of the losses they incurred.⁴⁵ Sadly, this is not an isolated occurrence. Unsophisticated investors are often attracted to the low risk and high returns that Ponzi schemes promise in comparison to traditional investments, and frequently can invest, and then lose, a disproportionate amount of their wealth.

To date, only the Ontario Securities Commission in Canada has followed the lead of the SEC and adopted a similar whistleblower award program.⁴⁶ Other securities regulators in Canada and in other countries

⁴³ SEC Division of Enforcement Annual Report 2019, *supra* note 21 at 2.

⁴⁴ For some examples of Ponzi schemes outside of the United States see Springer, *supra* note 32 at 6-7.

⁴⁵ Gordon Hoekstra, "West Vancouver woman admits to \$30-million Ponzi scheme", Vancouver Sun (19 April 2017), online: <vancouversun.com/business/local-business/west-vancouver-woman-admits-to-30-million-ponzi-scheme> [perma.cc/Q7DD-YGP3]. See also Gordon Hoekstra, "Trustee report reveals 177 investors caught up in alleged Ponzi scheme", Vancouver Sun (7 June 2016), online: <vancouversun.com/business/local-business/trustee-report-reveals-177-investors-caught-up-in-alleged-ponzi-scheme> [perma.cc/97YN-JBP5].

⁴⁶ Ontario Securities Commission, "OSC Launches Office of the Whistleblower" (14 July 2016), online: <www.osc.gov.on.ca/en/NewsEvents_nr_20160714_osc-launches-whistleblower.htm> [perma.cc/2663-BJFV]. This program provides that a whistleblower may become entitled to an award of between 5-15% of the monetary sanctions imposed if the sanctions ordered against wrongdoers are C\$1 million or more. The maximum whistleblower award under the OSC program is set at C\$1.5 million if the aggregate amount of monetary sanctions and/or voluntary payments is equal to or greater than C\$10 million. However, if the OSC collects the monetary sanctions and/or voluntary payments

(such as the UK) have considered, but rejected, whistleblower awards. The Alberta Securities Commission (ASC) and the securities regulator for Quebec, the Autorité des Marchés Financiers (AMF), considered, but rejected, the introduction of a whistleblower award program.⁴⁷ The securities regulator in the United Kingdom, the Financial Conduct Authority (FCA), also considered but then rejected introducing such a program.⁴⁸ In summary, the main reason why the AMF, the ASC, and the FCA chose not to adopt a whistleblower award program was because of a lack of conclusive data about the effectiveness of such programs.⁴⁹ This study provides some evidence which helps fill in this lacuna as to the effectiveness of whistleblower awards.

V. CONCLUSION

This study adds to the empirical evidence as to the effectiveness of the SEC's whistleblower award program. It was focused on Ponzi schemes because the Madoff Ponzi scheme was a key reason behind the introduction of the SEC award program. I find that the award program seems to have made no difference as to the number of Ponzi schemes in relation to which the SEC acts each year, nor the length of time that Ponzi schemes tend to

in an amount equal to or greater than C\$10 million, then the maximum award is increased to C\$5 million. See Ontario Securities Commission, "OSC Policy 15-601 Whistleblower Program" (14 July 2016) at 18, online (pdf): <www.osc.gov.on.ca/documents/en/Securities-Category1/20160714_15-601_policy-whistleblower-program.pdf>[perma.cc/T2HC-8UVF].

⁴⁷ Barbara Shecter, "Alberta securities watchdog considering whistleblower program - but sorry, no financial reward", *Financial Post* (13 February 2017), online: <business.financialpost.com/news/fp-street/alberta-securities-watchdog-considering-whistleblower-program-but-sorry-no-reward> [perma.cc/GG49-DJ8J]. See also Autorité des Marchés Financiers, "No rewards for whistleblowers" (18 February 2016), online: <lautorite.qc.ca/en/general-public/media-centre/news/fiche-dactualites/no-rewards-for-whistleblowers-1/>.

⁴⁸ Bank of England Prudential Regulation Authority & Financial Conduct Authority, "Financial Incentives for Whistleblowers" (July 2014), online (pdf): <<https://www.fca.org.uk/publication/financial-incentives-for-whistleblowers.pdf>> [perma.cc/CSF7-B5ZP].

⁴⁹ See Janet Austin, "To Reward or Not to Reward: A Cross-Jurisdictional Comparison of the Reasons Why Securities Regulators Have Adopted or Rejected Policies to Pay Whistleblowers", in Sulette Lombard, Vivienne Brand & Janet Austin, *Corporate Whistleblowing Regulation: Theory, Practice and Design*, (Singapore: Springer, 2020).

operate. I do however find that the median amount raised by Ponzi schemes has fallen and the median number of victims of Ponzi schemes has decreased. This suggests that the whistleblower award program is reducing the detrimental impact of Ponzi schemes to some extent.

However, despite these results, as shown by Table 1, the total amount raised by Ponzi schemes each year seems to be stubbornly high, comprising US\$1.5B in the last year of the study. Behind these figures are no doubt many stories of misery to victims as they have watched their savings and retirement plans obliterated. Ponzi schemes also inflict tremendous harm on the economy with losses each year in the United States equal to the losses from shoplifting.⁵⁰ Going forward, perhaps more could be done to publicize the whistleblower award program in investor education programs targeted to retail investors and vulnerable groups.

Furthermore, more empirical studies are needed to measure the impact and effectiveness of the SEC's whistleblower award program. This is necessary because the program still has many critics and other countries have not followed with their own award programs because of this paucity of evidence.⁵¹ Although the SEC does need to protect the anonymity of whistleblowers, perhaps it could consider providing more specific data to academics on a confidential basis to enable this to occur.

⁵⁰ Springer, *supra* note 32 at 8.

⁵¹ See e.g., Steven Davidoff Solomon, "Whistle-Blower Awards Lure Wrongdoers Looking to Score" (30 December 2014), online: *DealBook* <dealbook.nytimes.com/2014/12/30/whistle-blower-awards-lure-wrongdoers-looking-to-score/> [perma.cc/QQ3C-S3FZ].