



Financial Incentives for Whistleblowers

Note by the Financial Conduct Authority and the Prudential Regulation Authority for the Treasury Select Committee

July 2014

Introduction

1. The Financial Conduct Authority (FCA) and the Bank of England Prudential Regulation Authority (PRA) welcome the recommendations of the Parliamentary Committee on Banking Standards (PCBS) about whistleblowing.

Both regulators agree that strong measures are needed to encourage and protect whistleblowers, who can play an important role in helping to protect the safety and soundness of firms and to prevent and detect wrongdoing. We agree with the PCBS about the need for a better culture in financial services firms to help improve behaviour, and value the opportunity to improve senior management accountability for whistleblowing.

2. The FCA and PRA, in our responses to the PCBS, agreed to take forward and consider many of these recommendations, and are working together to determine how best to implement them. The FCA and PRA will publish proposals later this year that address how to improve whistleblowing regimes within firms.

3. We also agreed to conduct further research into the impact of financial incentives on encouraging whistleblowing in the US, working with the Treasury and the Department for Business, Innovation and Skills (BIS), and to publish the conclusions. This note sets out our agreed conclusions.

4. The research showed that introducing financial incentives for whistleblowers would be unlikely to increase the number or quality of the disclosures we receive from them.

Key points

From our research into the use of financial incentives by US regulators, we concluded that:

- a. Incentives in the US benefit only the small number whose information leads directly to successful enforcement action resulting in the imposition of fines (from which the incentives are paid). They provide nothing for the vast majority of whistleblowers.
- b. There is as yet no empirical evidence of incentives leading to an increase in the number or quality of disclosures received by the regulators.
- c. Introducing incentives has been accompanied by a complex, and therefore costly, governance structure.
- d. The incentives system has also generated significant legal fees for both whistleblowers and firms, although many whistleblowers are represented on a contingency basis (no award, no fee).
- e. Incentives offered by regulators could undermine the introduction and maintenance by firms of effective internal whistleblowing mechanisms, which both the regulators and the PCBS want to see.

We note also that the response published on 25 June by BIS to their Call for Evidence on Whistleblowing states that the Government does not believe that financial incentives should form an integral part of the whistleblowing framework. In these circumstances we do not think the case has been made for introducing financial incentives for whistleblowers who report to us.

As made clear in our responses to the PCBS in October 2013, and reiterated by the FCA in its update to the Treasury Select Committee in March 2014, we welcome the PCBS recommendations for giving senior management responsibility and personal accountability for ensuring that there are effective whistleblowing mechanisms in firms, and for safeguarding appropriate protection for whistleblowers.

We agree with the PCBS that making these changes should help to create a culture in financial services where speaking up becomes normal business practice and people are more prepared to report concerns, which will help to improve behaviour in firms and ultimately improve outcomes.

To improve the process for whistleblowers, from autumn 2014 the FCA and the PRA will also start to publish annual reports on the whistleblowing disclosures we receive and how we handle them. This will provide greater transparency on how we respond to whistleblowers, which in turn should increase their confidence in coming to the regulators where they feel they cannot report internally, or where they consider that an internal report has been ignored.

The research

5. The FCA and PRA have concerns about the impact of providing financial incentives to whistleblowers. These were set these out in oral and written evidence to the PCBS, and in the FCA's responses to the 2013 consultation by Public Concern at Work and the 2013 Call for Evidence from BIS. In our view, financial incentives could create a number of moral and other hazards:

a. Malicious reporting: Financial incentives might lead to more approaches from opportunists and uninformed parties passing on speculative rumours or public information. The reputation of innocent parties could be unfairly damaged as a result.

b. Entrapment: Some market participants might seek to 'entrap' others into, for example, an insider dealing conspiracy, in order to blow the whistle and benefit financially.

c. Conflicts of interest in court: If a whistleblower's disclosure led to a criminal prosecution which relied on the whistleblower's evidence, the court could call into question the reliability of their evidence because the witness stood to gain financially, thus undermining the prosecution's case.

d. Inconsistency with the regulators' expectations of firms¹: Rewarding whistleblowers for performing what is arguably their regulatory duty would be difficult to reconcile with the requirements that firms and Approved Persons deal with their regulators in an open and cooperative way, and with the requirement that firms should conduct their business with integrity. It could also undermine the existing personal responsibility of individuals, as well as firms, to report wrongdoing to the regulators.

e. Qualification criteria: A whistleblower motivated by a reward would need to be confident of receiving the money, particularly if making a report could put their career in jeopardy. However, we would not want to reward those providing poor information, particularly if it was not provided in good faith.

f. Public perceptions: In many cases rewards would need to be substantial, because a well-remunerated individual in the financial industry might expect their career prospects to be harmed by reporting other insiders and being associated with criminal acts. Handing over large sums, perhaps in the millions, would be a substantial shift in UK policy norms, which are very different to those in the US. Moreover, paying significant sums to high-income individuals for fulfilling a public duty could reinforce perceptions that the financial sector is at odds with the rest of society, particularly given the Government's decision not to introduce financial incentives for whistleblowers generally.

¹ The FCA's Principles for Businesses: <http://fshandbook.info/FS/html/handbook/PRIN> ; the FCA's Statement of Principles for Approved Persons: <http://fshandbook.info/FS/html/handbook/APER> ; and the PRA's Fundamental Rules: <http://fshandbook.info/FS/html/PRA/FR1/-link-/PDF>.

Analysis of the US position

6. In autumn 2013 the FCA and PRA undertook a joint visit to the US to discuss these issues with both the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission, which have powers under the 2010 Dodd-Frank Act to pay awards. We also visited the US Department of Justice, which has the power to make awards to whistleblowers in relation to prosecutions under the Foreign Corrupt Practices Act. We also met the Office of the Comptroller of the Currency, the United Nations, a whistleblower support group, and a number of attorneys representing both whistleblowers and firms subject to accusations from whistleblowers.

7. Also in autumn 2013, the FCA seconded a member of staff to the SEC to study how they have implemented the provisions of the Dodd-Frank Act which enable them to pay awards to whistleblowers.

8. While there are some differences in the approaches the three main US agencies take to handling awards to whistleblowers, there are a number of important common factors which have a bearing on our thinking:

a) Awards can be made only when information from a whistleblower leads directly to a successful regulatory or criminal case and appropriate funds are recovered. This means that very few whistleblowers are eligible to be considered for awards (no more than a handful since Dodd-Frank came into force in July 2010). Most disclosures made to the FCA and PRA lead to supervisory rather than enforcement outcomes, and less than 1% of whistleblowing cases lead to financial penalties being imposed.

b) Unless a whistleblower waives their right to it, the statutory requirement for confidentiality impedes the use of anti-retaliation deterrents with employers; it means the agencies cannot issue specific warnings to firms about the need to protect the employee who has made a disclosure. So there is no additional protection for whistleblowers using this route.

c) None of the agencies has seen a significant increase in either the number or the quality of reports from whistleblowers.

9. Another route used by whistleblowers in the US is a lawsuit under the False Claims Act, where a citizen may be authorised to bring a so-called 'Qui Tam' lawsuit on behalf of the government. However, this route is available only where fraud against the government is alleged.

10. These schemes reward a few individuals very significantly, but provide little or no protection to whistleblowers whose information does not lead to an enforcement outcome.

Findings in the UK

11. We have discussed incentivisation with a number of bodies in the UK, including the British Bankers' Association and organisations representing whistleblowers. All of them opposed the idea of regulators offering financial incentives to whistleblowers.

12. In the report of the Whistleblowing Commission of the charity Public Concern at Work, published in November 2013, the Commission noted that respondents to its consultation had not supported incentivisation, for very similar reasons to those set out above. Those respondents who did support it did so mainly because whistleblowers act in the public interest rather than their own, yet may suffer personal detriment.

13. In their response to the BIS Call for Evidence, the Government have concluded that financial incentives should not be introduced as an integral part of the whistleblowing framework.

14. We have also looked at the existing reward for information schemes operated by certain UK agencies, such as the Office of Fair Trading (now the Competition and Markets Authority), HMRC and law enforcement. The key difference between these schemes and any incentives we might offer whistleblowers is that they have all been set up primarily to make payments to Covert Human Intelligence Sources (CHIS), or informants. Handling CHIS is subject to a number of requirements under the Regulation of Investigatory Powers Act 2000, to ensure appropriate protection for the individuals concerned. CHIS and whistleblowers are very different.

15. Protection for whistleblowers in the UK comes through the Public Interest Disclosure Act 1998 (PIDA). Under PIDA an employment tribunal which finds in favour of an employee relying on PIDA can award unlimited compensation. This differs from employment tribunal cases under other legislation, where compensation is capped.

Improvements in the regulators' handling of whistleblowing disclosures

16. In recent months the FCA and the PRA have made a number of important changes to the way we handle whistleblowing disclosures: we have introduced new internal tracking mechanisms to increase the support and feedback we provide to whistleblowers; and we offer face-to-face meetings with our Whistleblowing Units to those providing complex or particularly sensitive intelligence.

17. In October 2013 the FCA held its first forum to discuss the issues of feedback and confidentiality with other regulators, whistleblower support groups and charities. The FCA plans to hold a further forum later this year. FCA staff also meet whistleblower groups from time to time. These meetings give the FCA the opportunity to hear and respond to whistleblowers' concerns.

18. Later this year both regulators will start publishing annual reports about the disclosures we receive and the action we take on them. These reports, demonstrating the importance we attach to the intelligence we receive from whistleblowers, should encourage individuals to feel even more confident in coming to the regulators. This is in line with the Government's proposal, in the recent response to the BIS Call for Evidence, to introduce a duty for all prescribed persons who can receive disclosures to report annually on these issues.

19. The FCA has more than doubled the size of its specialist whistleblowing unit, and has taken advantage of this extra capacity to introduce new systems to track the

action it takes on all disclosures. As this new management information builds up, the FCA will be able to identify the sectors of the industry from which it receives most and fewest reports, and will analyse the reasons for disparities.

20. The number of disclosures received by the FCA continues to rise. The number of whistleblowing cases recorded by the FCA rose by 55% from 2011 to 2012, and by a further 42% from 2012 to 2013. It is likely that the number of cases recorded will rise by around 30% in 2014 to reach around 1,200.

21. In addition to working alongside the FCA on whistleblowing and the Senior Managers Regime, the PRA has also started an education programme to improve staff awareness of whistleblowing.

Proposed regulatory changes

22. The regulators agree with the PCBS on the need for better culture in financial services firms to help improve behaviour. In our responses to the PCBS of October 2013 we accepted all the PCBS recommendations relating to senior management accountability for whistleblowing. These include requiring firms to have effective mechanisms in place for employees to raise concerns, with accountability for those mechanisms, and for ensuring safeguards for individual employees, resting with the member of senior management responsible for the firm's whistleblowing regime. At a time when we are seeking to improve firms' internal whistleblowing processes, introducing significant financial incentives for whistleblowers to come to the regulator rather than raise their concerns within the firm risks undermining our supervisory approach as well as the improvements in culture we want to encourage.

23. Later this year we intend to publish proposals on whistleblowing. Our aim will be to ensure that the culture in firms is one where people are prepared to speak up, as part of improving behaviour throughout the firm. We therefore want to avoid taking any action that could discourage firms from making these changes in a whole-hearted way. We are conscious that the introduction of rules in this area could lead to additional costs for firms.

Alternatives to financial incentives

24. Alongside these regulatory changes, we will continue to welcome disclosures from whistleblowers who choose to come to us, rather than their employers.

25. The FCA will:

- Use its new management information to identify any gaps in the intelligence it receives from whistleblowers, such as sectors of the industry from which it receives fewer disclosures than might be expected.
- Develop an outreach programme aimed at raising awareness among potential whistleblowers in those sectors. This will building on the new tracking mechanism, existing forums for meeting whistleblowers, and normal communications tools including the new annual report on whistleblowing.

- Consider whether there is any additional feedback it can give whistleblowers, within the constraints of the confidentiality provisions in the Financial Services and Markets Act 2000 and European directives.

26. The PRA will contribute to these developments and continue to work closely with the FCA to deliver a cohesive approach to whistleblowing in the financial services sector.

Conclusions

27. We consider that providing financial incentives to whistleblowers will not encourage whistleblowing or significantly increase integrity and transparency in financial markets.

28. There is no empirical evidence to suggest that the US system raises either the number or the quality of whistleblowing disclosures within financial services. Nor do the incentives in the US model appear to improve the protection available to whistleblowers. What whistleblowers tell us they would like is better protection for all whistleblowers rather than large payments to a tiny minority. This is consistent with the findings of the BIS Call for Evidence, and with the proposals for action by businesses and regulators that BIS have now published, which reject the idea of financial incentives as an integral part of the whistleblowing framework.

29. We therefore propose not to introduce financial incentives, but to press ahead with the regulatory changes necessary to require firms to have effective whistleblowing procedures, and to make senior management accountable for delivering these.