BLOWING It

Warning: Whistleblowing May Be Hazardous to Your Career's Health. Do investment professionals still have an ethical obligation to take action?

BY LORI PIZZANI

Hollywood has a fascination with intriguing and compelling whistleblower stories. From *Silkwood* in 1983 (an employee exposes dangerous practices at a nuclear power plant in Oklahoma) to 1993's *The Firm* (a young attorney who exposes his law firm's ties to members of the Mafia) to the abusive sales tactics used by hungry stockbrokers in the more recent *Boiler Room*, whistleblowers have often been romanticized as do-gooders who seek to right ethical wrongs in a single bound and leave the world a better place.

In the real world whistleblowers aren't always celebrated as champions of truth and justice for blowing the cover off illegal or unethical conduct and corporate malfeasance. Instead, they can be ostracized and defamed, and their efforts to do the right thing may cost them their careers.

THE BALANCE OF POWER

In light of the corporate scandals of the late 1990s and the early 2000s (as well as passage of the Sarbanes–Oxley Act of 2002, which imposed tougher corporate requirements), *TIME* magazine celebrated two corporate whistleblowers for their courageous actions: Sherron Watkins, formerly vice president and managing director of corporate development at Houston-based energy company Enron, and Cynthia Cooper, former vice president of WorldCom. (The magazine also honored a government whistleblower: Coleen Rowley, the U.S. Federal Bureau of Investigation agent who accused her superiors of ignoring terrorist warning signs.) But few whistleblowers are ever rewarded with high praise or even a pat on the back, and many find the aftermath to be very different from what they expected.

Even the much-lauded Enron whistleblower has regrets.

"With the benefit of hindsight, I do not regret that I went to Ken Lay [Enron's chairman] to alert him to accounting irregularities at Enron, but I do regret that I went alone," says Watkins. "I should have realized that when speaking truth to power, one has to try to change the balance of power. If five of us vice presidents/managing directors had met with Lay, then he could not have dismissed my concerns as just that of one voice, one opinion."

"I discovered what I thought was a significant material accounting fraud at Enron—an overstatement of the prior year's net income by nearly half—and was contemplating what to do next. I immediately started looking for another job, circulating my résumé, refreshing my network of business connections, etc.," Watkins recalls. "Within two weeks of my discovery, Jeff Skilling, our CEO, resigned in an abrupt, inadequately explained departure from a job he'd sought for over 10 years yet held for less than eight months. It confirmed for me what I was seeing was fraud and Skilling knew it too and was getting out before the whole thing imploded."

When Watkins met with Lay a second time, she was armed with several pages of memos, an Excel spreadsheet confirming her allegations, and a presentation to the board of directors. She assumed that Lay would be forced to confront the situation, and she was confident that the right steps would be taken.

"None of those optimistic assumptions happened," she continues. "In fact, when I testified in front of Congress after Enron went bankrupt, I was shown a document from Enron's outside attorneys outlining, at Lay's request, the potential consequences of discharging employees who raise accounting concerns. The date on the document was 24 August 2001, two days after I'd met with Lay. His first reaction was to determine if he could dump me on the street."

In October 2001, Enron wrote off the structures that concerned Watkins, but the write-off was not done in a way that was acceptable by accounting standards. Questions about the company swirled. Creditors withdrew their lines of credit, the ability to conduct business evaporated, and Enron declared bankruptcy in early December 2001. Watkins' corporate memos were later leaked to the press, and she became a symbol of whistleblowers worldwide. But she admits that the aftermath was challenging.

"Although doors of employment in corporate America are closed to me, many other opportunities to lecture and tell my story have opened," she says. Watkins considers herself fortunate. The stories of whistleblowers rarely have a happy ending, primarily because the companies they report on do not implode but continue with their poor behavior and often prosper.

Whistleblowers need to realize that once they've reported the truth, they've done their part. "Unfortunately," says Watkins, "most whistleblowers become obsessed with seeing the wrong corrected and drive themselves nearly insane trying to rectify the problem single-handedly."

DEFINING WHISTLEBLOWING

"Whistleblowing means different things to different people," says Curtis Verschoor, professor emeritus at DePaul University's School of Accountancy and Management Information Systems and a current member of the Committee on Ethics at the Association for Accountants and Financial Professionals in Business. He notes, for example, that Watkins reported internally but never went outside of her company. "She had the best of intentions, to protect the company she worked for," he says.

Verschoor embraces the definition of whistleblowing that was included in the 1999 book *The Whistleblower's*

WHAT MAKES A TRUE CFA CHARTERHOLDER

"It's extremely difficult to stand up against the crowd of senior executives who want to go ahead with actions that are wrongfully intended," says Rik Albrecht, a CFA charterholder who is vice president of the CFA Society of The Netherlands (as well as a board member for outreach and awareness, advocacy, and technology). Albrecht, who also teaches ethics at two CFA Program Partner universities, notes the usual excuses: "I'm just following orders," "Everybody's doing it," and "If we don't do it, the company will show losses and thousands of people will lose their jobs." Going along is easier than challenging decision makers, and ignoring instructions from senior management may result in punishment. "It's exactly this that makes it hard to be a CFA charterholder and follow the Code and Standards," he says.

One notable case involved a CFA charterholder who was a portolio manager based in a major eurozone market. When asked by an employer to execute obscure financial transactions that were designed to hide financial losses, the portfolio manager faced the difficult task of trying to convince a group of worried senior executives to disclose rather than conceal the bank's troublesome situation. Even reporting to the bank's compliance officer did not help because the compliance officer was in on the game. In the end, the charterholder chose to avoid being associated with unethical conduct.

Albrecht recommends that CFA charterholders first dissociate from the unethical behavior and then, in plain writing, explain their reasons and suggest an alternative course of action. "Communication is key," he says. "Make it clear from the start what your position is so that it doesn't come as a surprise to your boss."

Next, stay well clear of unethical conduct. "Take the day off, or call in sick on the day any unethical transactions are taking place. In this way, you give a very clear message to the organization and you don't run the risk of being a spectator which may later be construed as a cooperator," Albrecht counsels.

As happened in the case of this portfolio manager, sometimes the ultimate victim of unethical behavior is an anonymous one; one without a voice. "It's the general marketplace. It's the investor base. It's the confidence of ordinary investors in the financial system," says Albrecht. "Why would you put the anonymous marketplace first? You will not be rewarded for it; the anonymous investor will not give you a pat on the shoulder. However, your readiness to put the integrity of the capital markets first is what makes you a true CFA charterholder."

WHAT SHOULD CFA INSTITUTE MEMBERS AND CANDIDATES DO?

Say you've come to the unwelcomed realization that your boss, co-worker, employer, or organization has been engaging in some illegal activity. You know it's wrong, and you know it shouldn't be allowed to continue. What should you do? Jonathan Stokes, head of Standards of Practice at CFA Institute, offers the following suggestions in light of the CFA Institute Code of Ethics and Standards of Professional Conduct.

Under Standard I(A)—Knowledge of the Law, CFA Institute members and candidates are prohibited from participating or assisting in violations of laws, rules, or regulations. Dissociation from activities of others is required when a member or candidate has reasonable grounds to believe the actions are illegal or unethical. The Code and Standards do not compel members to report suspected activities to outside parties unless such disclosure is mandatory under applicable law, but disclosure may be prudent.

The following steps represent appropriate actions for members and candidates to undertake to dissociate from the unethical actions of others and personally remain in compliance with the Code and Standards:

- Express your concerns to the individual committing the actions in hopes of correcting the situation.
- Inform your employer, through a supervisor or compliance department, of the activity(ies) causing concern in order to bring about a correction of the situation.
- Ask to be removed from the environment where the problem is occurring (e.g., request a new project or refuse to accept the new client). This may not correct the situation, but it serves to remove you from being viewed as assisting in the activity(ies).
- Report the activities to appropriate outside authorities for investigation. For violations committed by fellow CFA Institute members or candidates, the Professional Conduct Program investigates complaints based on the requirements of the Code and Standards. Industry regulators also sponsor reporting services concerning the activities under their jurisdiction.
- Resign from the organization if your continuing association with those involved with illegal or unethical conduct may be construed as participation in or assistance with such conduct. Members and candidates may delay taking this step if there is an ongoing investigation of the activities by the appropriate oversight authority.

Additional guidance on all principles of the Code and Standards can be found in the Standards of Practice Handbook (10th edition, 2010), which is available on the CFA Institute website (www.cfapubs.org).

Handbook: How to Be an Effective Resister by Brian Martin, a professor of social sciences at the University of Wollongong in Australia: "Whistleblowing is an open disclosure about significant wrongdoing made by a concerned citizen, totally or predominantly motivated by notions of public interest, who has perceived the wrongdoing in a particular role and initiates the disclosure of her or his own free will to a person or agency capable of investigating the complaint and facilitating the correction of wrongdoing."

Verschoor acknowledges that opting to blow the whistle is a gut-wrenching decision. But even though every employee has the duty of loyalty, one can't turn a blind eye to illegal activities. "Going along with your boss should not be an option," says Verschoor. "Don't look the other way."

A section of the Sarbanes–Oxley Act was intended to protect employees who refused to go along with fraudulent or unethical acts, including fudging financial statements, but the results of those whistleblower supports "have been abysmal," according to Verschoor. The U.S. Department of Labor, which has been administering the whistleblower provisions, is more accustomed to working with workplace safety, discrimination, harassment, and other human resource issues rather than dealing with securities law issues, such as creative accounting and disclosure concerns. Decisions by lower courts or administrative law judges have been overturned at a high rate. Very few cases have had favorable outcomes for whistleblowers. According to the Center for Public Integrity, since the enactment of the Sarbanes–Oxley Act whistleblower provisions through 30 June 2010, the Department of Labor has tossed out 1,066 claims while upholding only 25. In other words, only 2.3 percent of the claims have been successful. Moreover, the law provides for no mandatory monetary damages. Government employees and some (but not all) industries have additional protections for whistleblowers, such as restrictions on employer retaliation.

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The Dodd–Frank Act of 2010 includes a formal definition of a whistleblower as "any individual who provides, or two or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established by rule or regulation, by the Commission." Under the new law, whistleblower provisions are being ratcheted up for those who provide so-called "original information" to the U.S. Securities and Exchange Commission (SEC). Whistleblowers will be able to collect from 10 percent to 30 percent of the monetary sanctions imposed by the regulator as long as those sanctions exceed US$1 million. The SEC is now drafting necessary and definitive rules to implement the new provisions.

"Dodd–Frank now provides a real financial incentive for whistleblowers," says Peter Mina, senior associate at the Tully Rinckey law firm in Washington, DC. A whistleblower must be a direct source about the information or illegal activity, and the disclosure must be a real disclosure, not merely a disagreement over policies. The law also provides a new anonymity provision. Whistleblowers can report activity directly to the SEC or choose to remain anonymous by reporting through an ombudsman or representative. Still, past experience has shown that the process can take years. In addition, "absent a financial benefit, there is little personal benefit to disclosure other than knowing you're doing the right thing," Mina adds.

PERSONAL AND PROFESSIONAL IMPACT

"Whistleblowing doesn't necessarily mean reporting an activity that is going to rock the world," counsels Roy Cohen, a New York-based career coach and author of the book *The Wall Street Professional's Survival Guide*. Because many financial institutions are in the business of taking risks, an activity seen as illegal by one person may be a case of aggressive risk taking that borders on—but doesn't cross over to—illegality.

"Whistleblowing happens at every level of organizations," he continues. "At higher levels, you have a greater support system, but if you're further down the food chain, you may not have that support system. Your boss may say, 'I don't want to hear about this right now.'" Resigning a position once an employee becomes aware of questionable activity is a viable option, even if the whistle is never blown. "If you haven't told anyone but you leave, you don't damage your reputation. But if you have a non-compete agreement in place, it can become dicey," he counsels. "Unless you are willing to expose your former employer's bad behavior, there's usually no way to contest a non-compete."

Moreover, if you do blow the whistle and then leave, you will have to do damage control. When you apply for a new job and have to provide your former employer as a reference, you can say, "Here are my references, but I should tell you that the company is angry at me because

I reported this activity. I knew I was jeopardizing my reputation, but I didn't want to ruin the reputation of the company," says Cohen.

Rudolph Elmer is the whistleblower at the center of a recent and still controversial case. He spent 15 years working for the Swiss investment giant Bank Julius Baer, most recently in the Cayman Islands. Elmer alleges that he became aware of his employer assisting several American clients and others with tax evasion, including his own firm's attempts to avoid paying taxes to the Swiss government, among other illegal activities. "After having tried, in-house, to solve the issue, I was fired," Elmer tells *CFA Magazine*.

Julius Baer has a different version of events. The bank claims that Elmer expressed concerns only after being denied a promotion and further alleges that he subsequently stole internal bank documents, an action for which he was dismissed. In a public statement, a representative of the bank depicted Elmer as a disgruntled former employee who didn't receive the financial settlement he was seeking.

It took two years for Elmer to get the attention of the proper Swiss authorities. He filed a suspicious-transaction report, but a question of jurisdiction (Cayman Islands versus Switzerland) complicated the matter. He also talked to tax authorities in the United States. Although they were interested in the data, they offered no personal protections, according to Elmer. In 2005, Elmer says he was arrested in Switzerland and jailed for 30 days on suspicion of violating bank confidentiality laws. Three years later, he turned to WikiLeaks.org to get his story out. "Public attention is a kind of security," Elmer says. To protect his interests, he also hired a lawyer based in Washington, DC, who specializes in legal cases involving money laundering and offshore tax evasion. Elmer will get his day in court in January 2011 when his case, the first whistleblower case to be heard in a court in Switzerland, will begin.

Elmer's subsequent efforts to find new employment failed. He lost two jobs—one in Switzerland and another in Mauritius—not long after being hired, and he believes those employers were motivated by concern about his reputation as a whistleblower.

Elmer's advice to anyone considering blowing the whistle is to plan ahead. "You have to have a very strategic approach," he says. "You should not think about the moment of the whistleblowing but what happens to your family and friends and know that your lifestyle will change dramatically." Moreover, he adds, "Financially, you have to be certain you can survive. Thinking money-wise,

WHEN THE WHISTLE FALLS ON DEAF EARS

From 2000 to 2008, with analysis from two trusted business associates, Harry Markopolos, CFA, tried to report his suspicions that Bernard Madoff was running a Ponzi scheme. There were multiple letters and reports to and discussions with a series of officials at both the Boston and New York offices of the U.S. Securities and Exchange Commission as well as a communication with an investigative reporter at the *Wall Street Journal*. Yet nine years later, Madoff was still running his Ponzi scheme, eventually turning himself in to authorities in December 2008.

In his 4 February 2009 testimony before the U.S. House of Representatives Financial Services Committee, Markopolos detailed his repeated attempts at getting the regulators to understand Madoff's bogus split-strike derivatives strategy and investigate a fictitious performance record that showed only three down months in 1987, although the S&P 500 had 28 down months during the same time period. Other red flags included Madoff's strategy boasting good performance during all market conditions, stating that his strategy replicated one equity index but comparing performance to another, too-good-to-be-true correlations and the need for fresh money to be invested (which, for a real money manager, would have diluted performance returns).

"Bernard Madoff's math never made sense, his performance charts were clearly deceiving, and his return stream never resembled any known financial instrument or strategy," Markopolos told congressional leaders.

"Every bit of information was in the public domain. We never had any sensitive documents or smoking gun e-mails. We did what we could to stop Bernard Madoff from bilking the public. … we failed to achieve a positive result," Markopolos lamented.

A complete transcript of Markopolos' 4 February 2009 congressional testimony is available online at www.house.gov.

I lost at least US$3 million or more as well as my job and my reputation."

Despite the lost money, "If you think about the ethics and morality and social responsibility we all carry, I would do it again," Elmer says. "Make sure you are right with your facts. Try to discuss the matter with someone, in-house if possible, in a very informal way, without disclosing too much. If nothing changes, then find people you can trust, such as a lawyer. Do not [blindly] trust authorities or journalists." Finally, he says, "Try to control your emotions and play it smart and protect your name as long as possible."

A LONELY ROAD

"The vast majority of whistleblowers who come to us have gone to their employers first," says Erika Kelton, partner with the Washington, DC, law firm of Phillips & Cohen. Consequences have run the gamut for the firm's clients, from seeing the complaint go nowhere to getting the cold shoulder from bosses and co-workers to having their jobs marginalized or even being fired. Most people like their work lives and are loyal, but they want to work for an ethical firm. Anyone looking to gain by blowing the whistle should think again. "This is not like playing the lottery," Kelton says.

"It's a very lonely road being a whistleblower," says Mina. "Colleagues are flat out told not to associate with you." Retaliation can include a reduction of duties, isolation or a transfer, a salary reduction, or termination. Moreover, expectations for a pat on the back or huge monetary awards are unrealistic in most cases. "There can be recoveries, but sometimes the financial recoveries are small," Mina adds. "I wouldn't get into the whistleblower business to get rich."

In the United States, the False Claims Act, which was strengthened in 1986, covers cases in which bogus or inflated claims are filed for the payment of federal/government money (e.g., under a federal contract or federally funded program). The False Claims Act contains whistleblower provisions called "qui tam," which allow citizens with evidence of such fraud to sue and recover the stolen money. As a reward for blowing the whistle, whistleblowers can recoup between 15 percent and 25 percent of monies recovered. But the False Claims Act doesn't cover tax fraud. A separate U.S. Internal Revenue Service whistleblower rule allows for those who expose tax evaders to be awarded a similar 15–25 percent of the amount recovered.

But there's a catch for would-be whistleblowers. Under the False Claims Act, although files are sealed in U.S. federal court for seven years, the whistleblower's identity eventually will be made public. Currently, the outcome for Dodd–Frank provisions remains to be determined. It's unclear whether the SEC will have any mechanism for disclosing the name(s) of whistleblowers or might be forced to provide such disclosures.

SOMETIMES THE GOOD GUYS WIN

Not all whistleblowers are punished for their good deeds. Sometimes, they prevail.

Consider the story of an American whistleblower who spoke to *CFA Magazine* on condition of anonymity. As a quality assurance manager for his employer, a manufacturer of products for the U.S. military, he became aware of a suspicious work-related situation. Based on his experience in regulatory contractual work, the circumstances just didn't smell right, but he wasn't entirely sure that the situation was wrong. So he did some research. "I found out that it wasn't my imagination. It was something contractually that [my company] shouldn't have been doing; it was wrong," he says. "I uncovered what I found to my peers and multiple levels of management, but I was put off with phrases like 'Don't worry about it' and 'It will be taken care of,' but nothing changed," he says. "I told an expanded group of people about this, but same thing. I talked to the ethics officer and compliance officer, but zero changed. They never followed up with me or did an investigation. I was the annoying fly."

He decided to blow the whistle on his employer's activity—anonymously—and hired a lawyer to protect his interests. "It was the single hardest decision I have ever had to make, akin to laying people off as a manager," he explains. "But I could envision our product not doing what it should for U.S. military personnel when they needed it. That just tore my insides out," the whistleblower says.

Because he was able to protect his identity, his employer never knew he'd been the whistleblower. "I stuck with my job, and I didn't let it interfere with my job or my attitude," he says. The process took about three and a half years from start to finish, and in the end, the case was settled with fines being paid to the government, of which he received a percentage. "I'm no longer with the company, but that was by my choosing. There never was any retaliation," he says.

"What I learned is that the system is not as simple as the news media and movies present it to be," adds the whistleblower. "The cloak and dagger is way over-portrayed, even though I had to do this secretly."

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