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We are pleased to have an opportunity to submit comments in relation to the proposed amendments to By-law 20 and other affected By-laws. We recognize and commend the Association for the considerable work that has already been put into the proposed By-law changes. It is in the interest of all market participants, including investors, to have a strong and credible securities market and an enforcement process that is effective, responsive, transparent, just and above all, fair. With this in mind, we have attempted to highlight through our comments certain issues that we feel are important and warrant further consideration and discussion by regulators and Members. Our comments are as follows:

1. **Part 1 – Definitions, 20.1** – It would be in the public interest and a benefit for all market participants for the following terms to be clarified, defined and included in the Part I definitions section:

   "Due Diligence"– [diligence consistent with industry standards, conduct and practices]

   "Burden of Proof" – [quasi- criminal standard and based on clear and cogent evidence]

   "Fiduciary Duty"- [See Hunt v. TD Securities Inc., et al. (2003), (Ont.C.A.)]

   "Supervision" – [Two Part Test: (1) Were there in place procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect the securities violation in question, and (2) Did the person responsible for administering such procedures and system reasonably discharge his duties and obligations, and without reasonable cause to believe that such procedures and system were not being complied with. See Dean Witter Reynolds Inc., et al. (2001), SEC Release No. 179, File No.3-9686]

2. **Part 2 – General Authority of Panels, 20.2(2)** – The proposed section 20.2(2) provides a Hearing Panel, District Council Panel, Board Panel or Appeal Panel with virtually unlimited discretion to admit anything into evidence, *whether or not given or proven under oath or affirmation and whether or not inadmissible by any statute or law*. While it is not uncommon to relax the rules of evidence for administrative proceedings, we recommend that there be at least some minimum standard or test of admissibility based on relevance and probative value versus prejudicial effect. This is necessary to ensure principles of natural justice, fairness, and the perception of fairness, are being observed in the hearing process, particularly in light of the severity of the penalties that could be imposed by Panels based on otherwise inadmissible evidence. We are similarly concerned with proposed **Rule 1.5(2)**.

3. **Part 3 – Decision-Making, 20.3(3)** – We fully endorse proposed section 20.3(3), which requires all decisions by a Hearing Panel pursuant to By-law 20, including any dissenting decisions, be made in writing and contain reasons for the decision. A finding of guilt and the imposition of penalties is of limited remedial or deterrent value without some guidance from the Hearing Panel regarding the expected behavior or degree of due diligence required of an Approved Person or Member in similar circumstances. We believe section 20.3(3) will assist in achieving better reasoning and consistency in decisions. We further request disciplinary actions that are uncontested / unanswered by a Respondent be identified as such in the reasons and on Association Disciplinary Bulletins.

4. **Part 4 - Continuing Jurisdiction, 20.7(1)** – The proposed section 20.7 continues the jurisdiction of the Association for five years from the date on which any Member or Approved Person ceases to be a Member or Approved Person. We suggest that this proposal be revisited in light of recent amendments to the Ontario *Limitations Act, 2002*, S.O. 2002, c. 24, Schedule B. Effective January 1, 2004, the limitation period for civil claims will be significantly reduced to two years. In our view, exposure to regulatory liability should be relatively consistent with, and should not extend beyond, exposure to civil liability for the same alleged misconduct by an Approved Person or Member. In the vast majority of cases, there is little public interest, or complainant interest, in pursuing regulatory action years after the alleged misconduct and after the related civil matters have been concluded. We also question generally whether the Association has the power to regulate former Members or employees. [*Chalmers v. T.S.E. (1989) 70 O.R. (2d) 532 at p. 543 (C.A.)*].

5. **Part 5 – Appointment of Industry Members to Hearing Committees and Hearing Panels, 20.9 & 20.13** - We strongly recommend there be a specific requirement that industry members serving on enforcement Hearing Panels must possess significant compliance experience attained at a Member firm. Industry members with compliance backgrounds generally have a better understanding of regulatory requirements and how those requirements are actually implemented internally within a firm through the development of compliance systems and supervisory procedures and practices. Thus, they are in a better position to determine issues such as the gravity of the misconduct, or whether the degree of due diligence exercised by a Respondent was adequate in the circumstances considering existing street practices and industry standards. We believe Hearing Panels with compliance representation are more likely to produce sensible decisions that are less reactionary and that take into account the realities of the market and the working environment within a firm.

   We suggest the participation of active industry members on enforcement Hearing Panels may be preferable to retired industry members. Active members are more likely to be attuned to current industry practices, trends, new investment products and the technological capabilities and limitations within a firm. Their representation on Hearing Panels would provide some assurance that enforcement decisions are not being made in a vacuum and isolated from the business impact of those decisions. However, we recognize certain retired industry members, particularly those with

considerable compliance experience, are equally knowledgeable, insightful and capable of rendering appropriate and fair decisions.

Part 10 - Enforcement Hearings

6. **Enforcement Hearing Policy Statement** – With a view to enhancing the transparency and credibility of the enforcement process, we believe there should be a general Policy Statement articulating that the purpose of an enforcement hearing is to enable a Hearing Panel to make a fair determination, based on clear and cogent evidence, whether an Approved Person or Member has contravened an Association By-law, Regulation, Ruling or Policy. Not all complaints are meritorious, nor do they all fall within the "public interest" to prosecute. Complainants frequently evoke the enforcement process with a view to advancing their own parallel civil claim. Enforcement Staff are not, and should not be perceived as, advocates for Complainants. Rather, Staff's mandate should be publicly stated and clarified, that they are required to make a fair and unbiased presentation of all relevant and probative evidence so that a Hearing Panel can make a fair determination regarding a Respondent's conduct. We would suggest a similar policy statement be incorporated into the Rules of Practices and Procedure.

7. **Initiation of Disciplinary Hearings, 20.30(1)** – Proposed sections 20.30(1), 20.33(1)(a) and 20.34(1)(a) purport to provide the Association with the power to enforce compliance and impose penalties with respect to *all federal or provincial statutes, regulations, rulings or policies relating to trading or advising in respect of securities*. By doing so, the Association may be viewed as usurping the jurisdiction of a court or a statutory body, thereby evoking the application of various statutory rights and protections, including the *Statutory Powers and Procedures Act*, the *Evidence Act* and/or the *Charter of Rights*. We question whether the Association can require through regulation and/or as a condition of membership that Members waive their rights and protections. If the Commission or Market Regulation Services were to prosecute alleged misconduct, such as market manipulation for example, pursuant to securities legislation, the *SPPA* would apply to its' respective proceedings. If the same activities were prosecuted criminally as a form of securities fraud, the *Charter* and the *Evidence Act* would apply. However, under proposed By-law 20, the Association could bring an enforcement action in respect of the very same activities without having to comply with any of the forgoing statutes. To avoid this conundrum, we recommend that the scope of enforcement hearings be limited to alleged contraventions of Association By-laws, Regulations, Rulings or Policies. Alternatively, the *SPPA* at a minimum, and the *Evidence Act* and the *Charter,* should apply to enforcement hearings and the enforcement process generally. In any event, we feel this issue warrants further consideration and discussion.

8. **Penalty Hearings, 20.30(2)** – Penalty hearings should be included as a specific category of enforcement hearings under By-law 20. In certain cases, a Respondent may be willing to admit to a contravention of a By-law, Regulation, Ruling or Order, but may nevertheless disagree with the appropriateness of the penalty being sought by

Enforcement Staff. A penalty hearing would recognize a Respondent's admission of guilt to the charges, remorse and cooperation with the Association, without requiring him to forfeit his right to make full submissions regarding the appropriate penalty. There may be important mitigating factors or extenuating circumstances that a Respondent wants a Hearing Panel to consider, but that Enforcement Staff may refuse to include in a Settlement Agreement. A penalty hearing would provide a Hearing Panel with an opportunity to consider all relevant aggravating and mitigating factors in order to creatively fashion an appropriate penalty that is reasonably designed to redress the misconduct and to promote the future compliance of the Respondent, and other market participants generally.

9. **Rule 14 and 15 of the Rules of Practice and Procedure** – Proposed Rule 14 and 15 of the Rules of Practices and Procedure purport to preclude a Respondent from referring to or disclosing any facts not included in a Settlement Agreement without the prior consent of Enforcement Staff. In accordance with principles of natural justice and procedural fairness, a Respondent has the right to make full submissions at any hearing in which he or she is named, including a settlement hearing. This right is not and should not be subject to the prior consent of Enforcement Staff. Without undercutting or reneging on a negotiated settlement, a Respondent should nevertheless be able to refer to any relevant facts or evidence that may assist a Hearing Panel understand the context of the actions giving rise to the misconduct and the appropriateness of the jointly proposed penalty in the Settlement Agreement. We request that proposed Rules 14 and 15 be deleted or amended accordingly.

10. **Powers of Compulsion, 20.31** – We recommend that Complainants should be subject to certain compulsions, namely: (i) to be interviewed by Investigative Staff regarding their complaint against an Approved Person and/or Member; (ii) to attend and give evidence at a hearing; and (iii) to provide Investigative Staff with any documents that may be relevant and probative to their complaint or to the hearing, including disclosure of any trading accounts held at any time with other Members and any prior complaints and/or settlements. Failure by a Complainant to cooperate with these reasonable requirements should dissuade Enforcement Staff from proceeding with the matter to a Disciplinary Hearing. We believe these requirements are essential to ensuring balance and fairness in the proceedings, particularly since there is no equivalent process for discovery of the Complainant by a Respondent prior to the hearing.

11. **Rule 11.1(1)(b)(iii) of the Rules of Practice and Procedure** – We are very concerned with Rule 11.1(1)(b)(iii) of the Rules of Practices and Procedure, which purports to relieve Enforcement Staff from having to obtain a signed witness statement or transcript, and would allow Staff to provide *in lieu* a summary of the evidence that Staff anticipates a witness will give at a hearing. Witnesses obviously cannot be cross-examined on the basis of a summary of anticipated evidence produced by Staff. Further, in absence of a signed witness statement or transcript, we believe in most cases there will be insufficient clear and cogent evidence upon which Staff can, or should, lay charges against a Respondent. While the Association may

not have the power to compel witness statements from non-Members, we have difficulty understanding how the public interest is served by prosecuting a Respondent where a Complainant refuses to cooperate with Staff and provide a statement. We request that proposed Rule 11.1(1)(iii) be deleted. We further recommend that disclosure of any Complainant statements, letters, tapes or transcripts be provided to a Respondent as soon as practicable and in any event, prior to a Notice of Hearing, so that a Respondent can make an informed decision based on the disclosure whether to settle a matter or proceed to a penalty or full disciplinary hearing.

12. **"No Contest" Pleas** – The ability of a Respondent to enter a "no contest" plea at a Disciplinary Hearing should be explored. This type of plea is commonplace in the U.S. and other jurisdictions and often provides a pragmatic and reasonable resolution of an enforcement matter where a parallel civil or class action claim exists. By insisting on an admission or finding of guilt, Canadian Member firms and Approved Persons are arguably exposed to greater liability than U.S. counterparts under similar circumstances. This disparity is difficult to justify. The unavailability of a "no contest" plea in Canada may act as an impediment to the efficient settlement of enforcement charges, which ultimately may not be in the public interest. We believe the merits of this type of plea warrant further consideration and discussion.

Penalties

13. **Penalty Policy Statement** - There should be a Penalty Policy Statement clearly articulating that penalties imposed by a Hearing Panel are intended to be remedial and rehabilitative, not punitive. This is consistent with principles of administrative law. Enforcement Hearing Panels have a responsibility, and an opportunity through its written reasons, to clarify where a particular Respondent has failed to meet his/her/its regulatory responsibilities, and to provide guidance as to what conduct or due diligence would have been required in the circumstances. Enforcement Hearing Panels should not be seeking to set new precedents or establish new "best practices" through the imposition of penalties applied with the benefit of 20/20 hindsight. Any significant changes to industry standards, practices or conduct should be introduced by the Association through the issuance of new policies, guidelines or Member Regulation Bulletins, rather than through enforcement proceedings.

Settlement Hearings

14. **Hearing Panel Powers, 20.36** – We are of the general view that properly negotiated settlements are in the best interest of all market participants. Long and litigious enforcement proceedings do not promote the interests of the public or anyone else. The proposed Accept / Reject settlement model, however, is too rigid and inflexible and does not encourage or facilitate settlements. A more flexible approach is preferred, which could include penalty hearings, "no contest" pleas, suspended or conditional penalties, diversion programs, etc.

We are of the further view that negotiated settlements should be respected and given considerable deference by Hearing Panels. We have every confidence that retired judges chairing a Hearing Panel already understand this and will only rarely disturb jointly proposed resolutions where the underlying facts do not support the charges or proposed penalty. A Hearing Panel nevertheless has an obligation to set aside a proposed settlement or penalty if it is unreasonable in the context of the case. Thus, a Panel should have the discretion and power to accept or reject a proposed settlement, or alternatively, to reject a proposed penalty and convene a penalty hearing with the consent of both the Respondent and Enforcement Counsel, without necessarily having to reject the settlement entirely. The proposed Accept / Reject settlement model does not provide a Panel with the discretion or flexibility to do this where required in a particular case.

15. **Penalties, 20.33(2)** – We have some concerns regarding the maximum fines that may be imposed *per contravention*. We believe there should be some direction to Enforcement Staff requiring the principle in *R. v. Kienapple, [1975] 1 S.C.R. 729 (SCC),* be observed such that there is not a multiplicity of charges laid where a single charge of misconduct could suffice. Such Staff direction could also be included in the Rules of Practices and Procedures.

16. **Rule 13.3 of the Rules of Practice and Procedure, Evidence By Witnesses** – We are surprised and somewhat concerned with the inclusion of Rule 13.3(2), which requires the Chair of the Hearing Panel *exercise control over the scope and manner of questioning of a witness in order to protect the witness from undue harassment or embarrassment and to disallow a question that may be vexatious or irrelevant to any matter at issue in the hearing.* We would expect that ex-judges chairing a Hearing Panel are already adept at controlling the proceedings they oversee, thus making this rule unnecessary. We are concerned that including this rule may result in a chilling effect on strenuous, but legitimate, cross-examination of a witness. Given the Association is seeking a considerable relaxation of the rules governing the admissibility of evidence at an enforcement proceeding, rigorous cross-examination may be necessary in a given case in order to test and ensure the veracity of the evidence put forth by a witness. We request that Rule 13.3 be deleted.

17. **Assessment of Costs** – We are concerned with the current practice of the Association to routinely impose costs on a Respondent. These costs amount to a fine by any other name since no supporting documentation is ever provided or disclosed by Enforcement Staff. Further, there are currently no controls, and thus no incentive, for Investigative or Enforcement Staff to ensure that investigations and prosecutions are carried out in a focused, fair, efficient and cost-effective manner. Costs should only be imposed on a Respondent in those cases where warranted in the opinion of the Hearing Panel, and then only if supported by appropriate documentation.

18. **Consultative Committees** – We propose that consideration be given to setting up Consultative Committees as a resource for Investigative and Enforcement Staff in a similar manner to NASD's pilot initiative as set out in its Notice to Members 03-10

and 03-32. The purpose of Consultative Committees is to provide regulatory staff with a resource for obtaining industry expertise and opinions on industry practices and products, without impinging on Staff's independence and autonomy in performing its regulatory obligations. Under the NASD model, the opinions of Consultative Committees are "without prejudice" and are generally protected from disclosure requirements. Consultative Committee opinions could reduce or eliminate the need, time and costs of Enforcement Staff having to resort to commissioned outside expert opinions, thereby increasing the overall efficiency of the enforcement process. Where existing industry practices or standards are unclear or an industry-wide compliance weakness is revealed, Enforcement Staff should consider issuing corrective guidance to all Members through a Compliance Bulletin rather than pursuing enforcement action with the benefit of 20 / 20 hindsight against a particular Member. We recommend the establishment and use of Consultative Committees be explored.

19. **By-law 28** - The proposed amendment to By-law 28.4(d) would have retired and public members of a District Council Panel, Hearing Panel or Appeal Panel receive remuneration out of the Discretionary Fund. However, any penalties/fines/costs imposed by a Hearing Panel following an enforcement hearing currently go into the same Discretionary Fund. We believe this raises concerns with the independence, or certainly the perception of independence, of the Panel members. We recommend that Panel members be remunerated by some other mechanism so as to avoid any appearance of a conflict of interest.

In closing, we once again commend the Association for the considerable thought and effort put into proposed By-law 20. We recognize the significant impact these proposed changes will have on the enforcement process if the By-law is adopted in its current form. Because of this, we feel the forgoing issues highlighted in this comment letter require further consideration and discussion either within the Association or together with Members and other market participants. Once again, we thank you for the opportunity to submit our comments.

Yours truly,

Scotia Capital Inc.
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cc. Catherine Evans, OSC