INVESTMENT DEALERS ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

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Tel: 416.943-5878
Fax: 416.364.2998

Scotia Capital Inc.
RBC Dominion Securities
HSBC Securities (Canada) Inc.
TD Waterhouse

Re: By-law 20 and Rules of Practice and Procedure Comments Dated January 7, 2004

The following is in response to the joint comments provided by Scotia Capital Inc., RBC Dominion Securities, HSBC Securities (Canada) Inc., and TD Waterhouse regarding By-law 20 and the Rules of Practice and Procedure, dated January 7, 2004 and received January 9, 2004.

Your comments and questions are appreciated and have been carefully reviewed and considered. The By-law 20 proposal seeks to meet the stated goals in your comment letter of achieving an enforcement process that is timely, just and transparent. The Canadian Securities Administrators and the Investment Dealers Association have agreed to ensure that our process is fair and that it supports the public interest. The proposed amendments to By-law 20 have been developed with a view to meeting this overriding principle.

COMMENT 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]

Response

By-law 20 is not the appropriate place to define the terms "due diligence", "burden of proof", "fiduciary duty" and "supervision." These terms are concepts in law that by their very nature will need to be determined by the adjudicator. It is our submission that it would not be appropriate to define these concepts. The enunciated terms and concepts are dependent upon a wide variety of considerations, the least of which is their development in case law, and the context and facts raised in a particular matter. In many cases, the interpretation placed on the concepts will go directly to the ultimate issue to be determined by the decision makers. The author of this comment has referred to definitions based on

case law. Law is a living tree and subject to changes that cannot and should not be fixed in time. To fix such definitions are not in the interest of any of the parties and could be argued as constraining the decision-makers discretion, particularly, where it goes to the heart of the ultimate issue being determined.

COMMENT 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).

Response

By-law 20.2 reads as follows:

> *(2) A Hearing Panel, District Council Panel, Board Panel, or Appeal Panel, may, in its discretion, admit any evidence, information, testimony, document, affidavit or thing, whether or not given or proven under oath or affirmation and whether or not inadmissible by any statute or law.*

This provision is in keeping with principles of administrative law. The provision is modeled after the *Statutory Powers and Procedures Act ("SPPA"). S. 15 SPPA* reads as follows:

What is admissible in evidence at a hearing
S. 15(1) Subject to subsections (2) and (3), a tribunal may admit as evidence at a hearing, whether or not given or proven under oath or affirmation or admissible as evidence in a court,

(a) any oral testimony; and
(b) any document or other thing,

relevant to the subject-matter of the proceeding and may act on such evidence, but the tribunal may exclude anything unduly repetitious.

What is inadmissible in evidence at a hearing
(2) Nothing is admissible in evidence at a hearing,

(a) that would be inadmissible in a court by reason of any privilege under the law of evidence; or
(b) that is inadmissible by the statute under which the proceeding arises or any other statute.

The Hearing Panel should have the latitude to admit evidence whether or not given or proven under oath or affirmation and whether or not inadmissible by any statute or law. Any test of admissibility based on relevance and probative value versus prejudicial test is for the Hearing Panel in the particular case to apply.

Rule 1.5(2) is intended as a simple restatement of the generally accepted principle that Rules of Evidence are relaxed for administrative proceedings. Nothing in the rule prevents a respondent from objecting to the introduction of evidence on the basis that it has no probative value or is prejudicial, nor does it require a Hearing Panel to accept any such evidence. This Rule is permissive "may" not mandatory. A ruling on the admissibility of evidence is at the discretion of the Hearing Panel and, in such circumstances, submissions from counsel would be appropriate.

COMMENT 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.

Response

Typically, disciplinary actions that are uncontested are identified as such in Bulletins and reasons for decisions. Attempts will be made to continue to identify uncontested decisions in a uniform and consistent manner.

COMMENT 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.)*].

Response

Consistency with Civil Limitation Periods

Exposure to civil liability and the taking of a regulatory action serve two distinctively different purposes. A civil court does not have the authority to suspend a registrant, impose conditions on registrations or permanently ban an individual from practicing in a particular category of registration. There does not exist a sufficient nexus justifying that civil and regulatory limitation periods be consistent as the two regimes operate separately serving different functions.

Even if the Association were to accept the notion that regulatory limitation periods ought to reflect civil limitation periods it should be noted that the limitation period suggested in the comment only refers to the general limitation period in the Ontario *Limitations Act*, 2002, S.O. 2002. The Association is a national organization and if it were to limit its regulatory jurisdiction to a civil limitation period, it would not be appropriate to look only to one of its jurisdictions. Even where the Ontario jurisdiction is looked to there are exceptions to the general limitation period that are broader than suggested. When one does look at the limitation periods in Ontario and elsewhere, a five year period appears to fall well within the range of limitation periods even for civil matters.

Furthermore, it would be contrary to the public interest and the mandate of the Association to limit the current jurisdiction to take action against those believed to have committed regulatory or securities law violations while a Member of the Association or a registrant.

Public Interest

Whether or not there is public interest in pursuing regulatory action years after the alleged misconduct is a matter that is fact dependent to be judged by the Association based on the circumstances of the case.

The fact that there clearly is a public interest in extended jurisdiction of regulators over former members is supported by the proposed Uniform Securities Legislation ("USL"). The recommendation made by the self-regulatory organizations ("SRO") in joint submissions to the USL Steering Committee for a provision similar to that found in Section 63(2) and (3) of the Alberta Securities Act to confirm the contractual jurisdiction of SROs over current and former members/regulated persons and their current and former directors, officers, partners and employees has been adopted in the USL at *Part 2, Division 2, Section 2.6(2)(a)(b) and (c)*.
USL *Part 2, Division 2, Section 2.6:*

> *"2.6(2) The authority of a recognized entity to regulate its participants or the participants of another recognized entity extends to*
> *(a) its former participants or the former participants of the other recognized entity,*
> *(b) former employees, agents or subscribers of its participants and former participants, or*
> *(c) former employees, agents or subscribers of participants or former participants of the other recognized entity with respect to the person's activities while a participant, or employee, agent or subscriber of a participant or former participant, of the recognized entity or the other recognized entity."*

Furthermore, this provision of the USL does not limit the jurisdiction to a certain time period but rather continues the jurisdiction in perpetuity.

Continuing jurisdiction over former members is common in the regulatory context. The following is a list of regulators that have jurisdiction over their former members.

- Law Society of Upper Canada
  - s. 30(1) Law Society Act, R.S.O. 1980, c.233
- Self Governing Health Professions of Ontario
  - s. 50 Schedule 2 S. 14 Regulated Health Professions Act S.O. 1991
- The College of Physicians and Surgeons of Ontario
  - adopts S. 50 Schedule 2 (i.e. Health Professions Procedural Code) of Regulated Health Professions Act S.O. 1991 - S. 2 Medicine Act S.O. 1991
- Recognized exchanges, recognized self-regulatory organization and recognized quotation and trading system in Alberta. Including: the IDA in Alberta and the CDNX.
  - s. 63(3) Alberta Securities Act
- The Alberta Association of Architects
  - s. 31(2), Architects Act R.S.A. 2000
- The Association of Professional Engineers, Geologists and Geophysicists of Alberta
  - s. 43(3), Engineering, Geological and Geophysical Professions Act R.S.A. 2000
- The Health Disciplines Board of Alberta
  - s. 28(3), Health Disciplines Act R.S.A. 2000
- Regulated Health Professionals in Alberta
  - s. 54(3), Health Professions Act R.S.A. 2000
- The College of Physicians and Surgeons of the Province of Alberta
  - s. 52, Medical Profession Act R.S.A. 2000

The five year period relied upon by the Association has been and is the status quo. In *Maurice v. Priel*, [1989] 3 W.W.R. 673, the Supreme court of Canada recognized that abuses could occur if persons were allowed to resign to avoid disciplinary proceedings and that it would be against public policy to allow that to occur. It is foreseeable, that in the most egregious of cases a person could avoid disciplinary action by simply resigning as soon as he/she is made aware of an allegation. Egregious cases are often complex and in many instances the two year period proposed in the comment could pass before the evidence is collected. The result would be that individuals who commit the most serious, egregious or complex type of activity might avoid disciplinary action. That is not in the interest of the public or the membership.

<u>Association's authority to regulate former members or employees [Chalmers vs. TSE]</u>

The comment questions the Associations' authority to regulate former members or employees. By-law 20.7(1) does not purport to regulate former employees, it only seeks to regulate former approved persons or members, as per the wording of *By-law 20.7(1).*

The IDA's jurisdiction over former members and registrants stems from *By-law 20.21* and *s. 6 of the IDA Constitution.* The jurisdiction over former members and registrants as set out in *By-law 20.7(1)* is not a new rule, but rather, a re-iteration of the existing rule found at *By-law 20.21.* The existing *By-law 20.21* is substantially the same as the former *s.17.19 (1) of the Toronto Stock Exchange By-laws* which dealt with retention of jurisdiction.

Domestic tribunals are held strictly to narrow jurisdictional confines for the purposes of discipline. The Court of Appeal in *Chalmers*[1] held *Section 17.19(1) of the TSE By-laws* to be ultra vires and of no force and effect. It was said that Courts will intervene where it appears that a domestic tribunal or a SRO has purported to confer on itself, through a by-law, jurisdiction not provided for in the statute which created or incorporated it. The Court held that domestic tribunals cannot make laws of general application and that their authority is restricted to those who have voluntarily submitted to the authority. As a result of this decision, the *TSE Act* was revised to extend jurisdiction to include former members and employees.

S. 6 of the IDA Constitution was amended subsequent to the *Chalmers* decision. The reasoning that was applied by the Ontario Court of Appeal in *Chalmers* where was declared ultra-vires would also apply to the IDA, the distinction lies in the fact that s.6 of the Constitution provides the IDA with authority to enact by-laws that deal with penalties against former members.

The Court in *Derivative Services Inc.* [2] affirmed the IDA's authority to investigate former members for business while a member, thus (current) *By-law 20.21*, which is carried through in the proposed amendments to *By-law 20*, would likely not be found to be ultra-vires as was the case in *Chalmers.* Therefore, the IDA has the necessary authority to extend its regulatory reach to impose penalties on former members/individuals in respect of conduct that arose prior to the lapse of membership or approval.

COMMENT 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.

Response

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[2] The Investment Dealers Association of Canada and Derivative Services Inc. and Malcolm Robert Bruce Kyle [1999] I.D.A.C.D. No.29

The function of considering persons for nomination to Hearing Committees belongs to the Nominating Committee and is ultimately a decision to be made by the District Council. The creation of a Nominating Committee specifically to consider the "suitability, fitness and qualifications" of potential Hearing Committee Members is a positive change to the current process as it will promote greater thought and deliberation prior to appointment of persons to serve on Hearing Committees. The Nominating Committee and the District Council should have the flexibility to make this decision within their discretion and within the parameters set out in By-law 20. While it may be beneficial to have persons with compliance experience sitting on hearing panels, having compliance experience should not be made a mandatory requirement for consideration of nomination to the Hearing Committee as such a mandatory requirement would preclude the ability of experienced and well-qualified individuals to sit on Hearing Panels, which ultimately would result in a disservice to Hearing Panels and all parties involved in cases. The same logic would apply to the issue of practicing versus retired industry members, it will be within the purview of the Nominating Committee and the District Council to assess the qualifications of each individual nominated and appointed to sit on a Hearing Committee.

COMMENT 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.

Response

The content of this comment is not at issue, however, the issue is whether a general policy statement outlining the purpose of enforcement hearings should be set out within By-law 20. It is understood at administrative law that the purpose of an enforcement hearing is to enable a Hearing Panel to make a fair determination based on clear and cogent evidence. Such a statement need not be incorporated in By-law 20 nor would it be appropriate to do so.

The Disciplinary panel process is a quasi-judicial process that by its very nature is subject to the principles of natural justice and fairness. Being a quasi-judicial process it is incumbent upon the panels to respect the law and the principles of law including the making of fair determinations, based on evidence and to act judiciously. Thus, it is inappropriate to include references such as those suggested. Compliance with the law by Hearing Panels should be inherent and obvious. Where the panel makes an error or fails to act judiciously, the appropriate response is to invoke the appeal process

COMMENT 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.

Response

The wording *"relating to trading or advising in respect of securities as applicable to the Member or approved person"* is wording that currently exists in *By-law 20.* In some jurisdictions, the Association has this authority through the powers delegated to it by securities commissions in certain provinces where it is recognized. This power to ensure compliance with securities laws is exercised only in those provinces where the Association has been granted this power. For instance, Appendix B, Term 1 of the Recognition Order whereby the Association is recognized in Alberta contains as a term of recognition that the IDA will:

> *"1. Enforce compliance by its members, their staff, and their approved persons, with the IDA Rules and securities legislation as a matter of contract between the IDA and its members..."*

Thus, the recommendation in the comment to remove the wording "a*ll federal or provincial statutes, regulations, rulings or policies relating to trading or advising in respect of securities.*" would render the provision inaccurate as the IDA currently has the ability, in some jurisdictions, to ensure compliance of more than simply its own By-laws, Regulations, Rulings and Policies. Furthermore, the Association has the authority to discipline Members and registrants for a violation of any IDA by-laws. By-law 29.1 provides that the Member and registrants "shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest". It is the Association's position that the breach of federal or provincial statutes, regulations or policies relating to trading or advising in respect of securities constitutes a "conduct or practice which is unbecoming or detrimental to the public interest." Although, the Association by virtue of By-law 20 has the authority to prosecute all such breaches, discretion and good judgement will be used in determining which such cases should be taken on.

COMMENT 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.

Response

Penalty hearings are a form of a disciplinary hearing. Thus, the wording of By-law 20.32(2) in no way precludes the holding of penalty hearings. At the disciplinary hearing the parties may present an agreed statement of facts which the trier of fact may choose to accept as proven, in which case, the process will proceed to the penalty stage.

COMMENT 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.

Response

A new rule which permits the respondent to raise any factual issues considered relevant at a Settlement Hearing should not be introduced. Settlements are the product of lengthy negotiations and they invariably involve significant efforts to draft the factual portion of the Agreement in a manner that is acceptable to both parties. The effect of one party, unilaterally, providing additional information will have only one purpose and that is to implicitly indicate to the Hearing Panel that the agreed upon sanctions are too draconian. If the information sought to be introduced is "inconsequential", it is unlikely that Enforcement Staff would object to its inclusion in the Settlement Agreement.

The only viable alternative, if a Respondent is permitted to disclose facts unilaterally, is for Enforcement Staff to have a similar right, to ensure that a balanced and fair presentation of the underlying facts is presented to the Hearing Panel. This would be counter-productive and would undoubtedly undermine the entire negotiation and settlement process.

If a Hearing Panel has specific questions about an issue not referred to in the Settlement Agreement, the parties should agree that the facts requested are appropriate to provide to the Panel. If a Hearing Panel is not satisfied with the agreed information presented, they are empowered to reject the Settlement Agreement.

COMMENT 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.

Response

Except in the province of Alberta under sections 63 and 64 of the Alberta Securities Act, the Associations' powers derive from contractual arrangements with registrants and Members. Thus, the Association does not have the authority to compel third parties, including complainants. As such, the recommendation to include a power of compulsion regarding complainants cannot be followed. Enforcement Staff does take into account, in the decision-making process regarding the route the case should take, whether there is sufficient evidence and cooperation from a complainant.

COMMENT 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.

Response

Rule 11.1(1)(b)(iii) is designed to deal with the rare circumstance where a non-controversial fact must be adduced to establish a specific allegation. Will-says (as witness summaries are commonly referred to) are even used in criminal proceedings, where there are strict Charter protections in place, for very minor witnesses. For example an administrative assistant may be called to authenticate a business document. It is not anticipated that subsection (iii) will be relied upon by Enforcement Staff in relation to key witnesses to a hearing. If such a circumstance arises, there will be no doubt that a Respondent would be successful in bringing a motion requesting a more detailed statement from witness. The concern that a Complainant will only have to provide a "summary of his or her evidence" is, as a practical matter, not going to arise. A complainant will be interviewed and a transcript provided in every case that proceeds to a formal hearing. As noted above, if a Complainant fails to cooperate with Enforcement Staff, it would be highly unlikely that the matter would be pursued.

With respect to the disclosure of a Complainant's statement and other related documentation, it has always been Enforcement Staff's policy to disclose such materials as soon as practicable after the issuance of the Notice of Hearing. While it is recognized that a Respondent has a right to disclosure once it is known that the matter will be prosecuted, as a practical matter, disclosure is not automatically provided to them prior to the issuance of the Notice of Hearing unless specifically requested by the Respondent. As long as Enforcement Counsel expressly advises the Respondent of his/her right to receive disclosure once it is known the Respondent will be the subject of a prosecution, then there has been no breach of their disclosure obligations. The onus will then shift to the Respondent to assess whether they in fact want disclosure prior to the issuance of a Notice of Hearing.

Rule 10.4 recognizes Enforcement Staff's common law obligation of disclosure. Furthermore, it has been decided that Rule 10.4 will be amended as follows:

> (1) The wording of R. 10.4 will be modified as follows: "Nothing in this Rule 10 derogates from the Association's obligation to disclose all materials as required by common-law, as soon as reasonably practicable after the issuance of the NOH."
>
> (2) R. 10.4 will be moved above the existing R. 10.1, so as to provide greater clarification of the import of the R. 10 provisions.

COMMENT 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.

Response

This comment was also raised in the Scotia McLeod comment letter dated December 3, 2003. The issue of "no contest pleas" was considered during the development of By-law 20 and it was determined that it was not appropriate, at this time, to implement "no contest pleas". The development of a diversionary program that may take the form of a voluntary undertaking is, however, being considered as part of the By-law 19 review.

COMMENT 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.

Response

It is not appropriate to incorporate a Policy Statement such as the one suggested within the body of a By-law. The purpose of a By-law is not to set out all administrative law principles. It is the practice of the Association to utilize the mechanisms of By-laws, Regulations, Policies and Bulletins to make any significant changes to industry standards or practices. However, the Hearing Panels also have an important role to play in the interpretation and application of the Associations' rules and Members and registrants should be aware of enforcement decisions to better understand their obligations and responsibilities pursuant to the Associations' rules.

COMMENT 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.

Response

Extensive consultation both internally at the IDA and externally with Members and District Councils was engaged in prior to making the determination that the accept / reject model should be adopted for settlements at the IDA. The accept / reject model proposed in By-law 20 is based on the OSC settlement model. However, unlike the OSC, reasons for settlement decisions are required to be given in all cases, as opposed to simply on the request of one of the parties.

As for the comment that a more flexible approach is preferred which could include penalty hearings, no contest pleas, suspended or conditional penalties, diversion programs etc. Penalty hearings are permitted and do not fall within the rubric of a "settlement hearing" to which the accept / reject model would apply. Please refer to the response to Comment number 12 regarding no contest pleas. Suspended or conditional penalties are a matter for negotiation Enforcement Staff in a particular case and are not precluded by the proposed settlement model. A diversionary program for low-risk enforcement matters is being considered as part of the By-law 19 Review Project.

The statement in the comment that states that negotiated settlements should be respected is agreed with. However, the statement to the effect that retired judges understand this and will only rarely disturb jointly proposed solutions may be true, however, the scope of persons that may act as Chair of a Hearing Panel is wider than simply retired judges. The accept / reject model is preferable to the current rule which allows Hearing Panels to decrease the terms and penalties of a settlement agreement at their discretion and increase them with consent of the parties. To properly respect the negotiated settlement agreement, the Hearing Panel should not have this discretion available to them.

The recourse where a settlement agreement is rejected is to enter into a subsequent settlement agreement. The likelihood is that this would be preferable from the perspective of a Respondent to the proposed consensual penalty hearing as the Respondent will be open to the imposition of any penalty or terms deemed appropriate by the Hearing Panel. In any event, it is always open to the parties after the rejection of a settlement agreement to agree to a specific set of facts and proceed to a penalty hearing that will be heard by a different Hearing Panel.

COMMENT 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.

Response

Enforcement Staff are aware of the principle expressed in *R.* v. *Kineapple*, and acknowledge that principle. It is, however, inappropriate to include such a "Staff Direction" in the Rules of Practice or By-law 20. It may form the basis for an internal memorandum, if necessary. However, it is reiterated that the *Kineapple* principle is well-known and Enforcement Staff endeavor to incorporate such considerations consistently when assessing the appropriateness of sanctions.

COMMENT 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.

Response

The language proposed in the comment letter of Wendy Kelley of BMO Nesbitt Burns dated January 7, 2004 will be incorporated with the existing language of the provision. The proposed amended language of Rule 13.3 is as follows:

> *"The Chair of the Hearing Panel shall exercise reasonable control over the scope and manner of questioning of a witness to protect the witness from undue harassment or embarrassment and may limit further examination or cross-examination of a witness where it is satisfied that the examination or cross-examination has been sufficient to disclose fully and fairly all matters relevant to the issues in the proceeding."*

This proposed language adequately addresses both concerns that witnesses not be harassed and the concerns you have raised that cross-examination not be unduly restricted.

COMMENT 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.

Response

Association Staff makes a request for the imposition of costs against a Respondent based on supporting documentation justifying the amount of costs sought. It is open to Respondent's counsel to seek disclosure of such information and to challenge the amount sought. There are internal controls to ensure that investigations are carried out in a focused, fair, efficient and cost-effective manner.

COMMENT 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.

Response

For the purposes of policy-making, the type of "consultative committees" discussed in the comment are already in existence in the form of the various CLS sub-committees. The development of consultative committees pertaining more directly to the regulatory enforcement function is a suggestion which can be explored, however, this is not a matter that is within the purview of By-law 20. Providing guidance by way of Compliance Bulletins is a practice that is followed by the Association (eg. Compliance Bulletin Re By-law 19 and Failure to Cooperate). Increased use of Compliance Bulletins can be explored for the purposes of standard setting, however, again this is not a matter that pertains directly to the By-law 20 proposal.

COMMENT 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.

Response

The amendment to By-law 28 is not a substantive amendment. The existing By-law 28 (d) provides that the Discretionary Fund may be used to: "pay the fees, expenses or other remuneration of the following members of a District Council:

> *(i) Members who have retired in good standing as employees of Members; and*
> *(ii) Public members appointed pursuant to By-law 11.1A".*

The proposed amendment to By-law 28 simply substitutes the term "District Council" with the terms "District Council Panel, Hearing Panel or Appeal Panel" so as to ensure consistency with the terminology utilized in the proposed By-law 20. The amendments do not alter the substance of the existing rule or practice.

Nowhere in By-law 28 does it state that the penalties, fines and costs imposed by a Hearing Panel flow into the Discretionary Fund. Therefore, a change to this practice to ensure that there is no perception of conflict of interest does not require a change to By-law 28 as currently worded.

Sincerely,

Belle Kaura
Enforcement Policy Counsel

cc. Katharine Evans, Legal Counsel , Market Regulation Department, OSC