Research Study

Critical Issues in Enforcement

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The Hon. Peter Cory is a retired Justice of the Supreme Court of Canada. Born in Windsor Ontario, he served as a bomber pilot in WWII, then graduated from the University of Western Ontario, studied Law at Osgoode Hall Law School, was called to the bar in 1950, and practiced as a litigator in Toronto. He was appointed as Queen's Counsel in 1963 and elected as a Bencher of the Law Society of Upper Canada in 1971. He also served as President of the Advocates' Society and as a National Director of the Canadian Bar Association. In 1974 he was appointed to the bench, first as a trial judge in the High Court of Ontario, and subsequently as an appellate judge in the Court of Appeal for Ontario (1981) and the Supreme Court of Canada (1989). Since his retirement from the Court in 1999, he has served as a senior adviser and mentor in the Department of Justice. He has also conducted a number of important public inquiries and studies on matters of public policy in Canada and abroad, and has arbitrated a number of significant disputes. He was appointed as Honorary Colonel of 426 (T) Training Squadron. He has been honoured as a Companion of the Order of Canada and a recipient of the Canada Decoration. He has also been awarded an honorary doctorate by York University and he currently serves as Chancellor of the University.

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Marilyn Pilkington is a member of the faculty and former Dean of Osgoode Hall Law School. Born in Edmonton Alberta, she studied at the University of Alberta and served as President of the Students' Union. She graduated in Law from the University of Toronto, served as law clerk to The Hon. Wilfred Judson, Supreme Court of Canada, and practiced law in Toronto before joining the Osgoode faculty in 1980. She has written on corporate law reform, and now teaches and writes in the fields of constitutional law, litigation and evidence. She has served as an elected Bencher of the Law Society of Upper Canada, as a member of tribunals dealing with discipline, human rights and international trade issues, as a consultant on legal education in Canada and abroad, as a member of public policy institutes and research projects, as a director of various not-for-profit institutions, as an arbitrator and mediator, and as independent chair of corporate meetings. She was awarded an honorary doctorate by the Law Society of Upper Canada.

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Executive Summary

Strengthening the enforcement of securities laws in Canada is a critical challenge. The vigour of the Canadian economy and the financial security of Canadians depend upon efficiency in capital markets, and market efficiency depends not only on effective laws but also on their effective enforcement. Enforcement requires competent, focused and efficient investigation of complaints and suspicious occurrences; fair, independent and highly skilled prosecution; independent adjudication of regulatory matters; knowledgeable adjudication of offences; appropriately onerous penalties; and accessible civil remedies.

It is widely perceived that securities enforcement processes in Canada are inadequate:

- that too many high profile cases have not been prosecuted;
- that insider trading is not deterred;
- that some prosecutions are unfair;
- that there are delays in taking action to prevent losses to investors;
- that investigations are not managed effectively;
- that integrating adjudication with the other functions of regulators creates an appearance of bias;
- that police, prosecution services and courts require more specialized knowledge of capital markets;
- that there are delays in adjudication in the courts;
- that the penalties imposed by the courts are inadequate and inappropriate;
- that the processes for obtaining compensation for losses caused by wrongdoing are inadequate; and
- that divided jurisdiction over securities laws and divided responsibility for their enforcement significantly impedes effective enforcement.

Concerted efforts are being made to improve securities regulation and enforcement in Canada. Reviews have been undertaken by highly-regarded committees. Provinces, Territories and securities regulators are seeking ways to harmonize and co-ordinate securities regulation or to establish a single Canadian regulator. Provinces are reviewing and strengthening securities legislation. The federal government has taken important initiatives to amend the *Criminal Code* to introduce new capital markets offences; create new investigative powers; establish concurrent federal authority to prosecute; provide increased sentences for breaches; and enact criteria to guide the sentencing of those convicted of capital markets offences. The federal government has also established, within the RCMP, Integrated Market Enforcement

Teams ("IMETs") to investigate high profile capital markets offences and has committed substantial funding to them. Regulators are also enhancing the resources they commit to enforcement.

These recent developments demonstrate willingness, at all levels, to confront the weaknesses that are perceived in the enforcement of securities laws. Much more remains to be done. The authors make recommendations to strengthen investigation, prosecution and adjudication of securities offences. In addition, they consider the processes by which wronged investors can recover compensation for their losses.

1. Priorities and Performance

- Regulators and agencies should establish enforcement priorities and a means of evaluating them. Performance results should be reviewed by an independent research body.

2. Investigation

- The resources needed for investigation, and the respective contributions to be made by various agencies, should be evaluated.
- Either the mandate of IMETs to investigate capital markets offences should be significantly expanded so that it can conduct all the necessary criminal investigations relating to capital markets, or the capacity of other police forces must be enhanced to enable them to do so.
- It is important that IMETs complete its current investigations expeditiously.
- IMETs should be structured to appropriately take into account provincial interests in the enforcement of securities laws to protect investors and capital markets.
- Processes must be established to provide for co-operation and co-ordination among agencies investigating capital markets offences, including protocols for sharing information.
- Priority in investigation should be given to early intervention when it is necessary to protect investors.
- Policies for police staffing must ensure the continued development and retention of individuals who are highly skilled in the investigation of capital markets offences.
- Investigators should have access to legal advice, and in order to protect the exercise of independent judgment by prosecutors, that advice should be provided by individuals who will not be involved in the prosecution of the case.
- The grand jury process is not appropriate in Canada, where procedural traditions and constitutional protections differ from those in the United States.

- Most importantly, a Senior Independent Review Officer ("SIRO") should be appointed for each IMETs locale and for each regulator. The role of the SIRO is to provide focus, supervision and a locus of accountability for strategic decisions in an investigation. A SIRO must have the ultimate authority to refer the matter for the appropriate prosecution, or to limit, curtail or eventually terminate the investigation.

3. Prosecution

- It may be appropriate to authorize counsel employed or retained by the securities regulators to prosecute provincial offences. They should do so in accordance with the guidelines of the provincial prosecution service.
- There should be a nationally co-ordinated program for the prosecution of capital markets cases, to ensure the development of a public prosecution service that has the requisite experience, capability and commitment.

4. Adjudication

- The adjudicative functions of securities commissions must be transferred to an independent tribunal. Membership in the tribunal should be structured so as to ensure that members possess the requisite expert knowledge of law, procedure and the operation of capital markets.
- Additional judicial appointments must be made to provincial courts and additional facilities must be established as required to ensure the capacity to prosecute and try capital markets offences.
- Programs must be established, possibly through the National Judicial Institute, to prepare judges to manage the adjudication of complex offences relating to capital markets and to understand the contexts in which they arise.
- In the assignment of judges, care must be taken to match interest, aptitude and preparation to the requirements of various types of cases.
- Only in the event that it is not possible to develop an effective process of adjudication relating to capital markets in the existing court structure, consideration must be given to the establishment of specialized provincial courts with unified jurisdiction.

5. Penalties and Orders

- Sentencing guidelines should be specified for provincial offences, as they now are for criminal offences relating to capital markets.
- Penalties and orders for the enforcement of securities laws should be harmonized across the country.

- Respondents should be eligible to recover costs of regulatory proceedings in appropriate cases. Policies should be developed for the award and calculation of costs, and for the independent review of costs orders. Costs should be awarded on the basis of the usual principles, rather than requiring full cost recovery.

6. Redress for Investors

- Regulators should exercise their jurisdiction to apply to courts for restitution or compensation on behalf of aggrieved persons. Procedures for doing so should be developed.
- Securities tribunals should have authority to order restitution or compensation in appropriate circumstances.
- Consideration should be given to authorizing courts adjudicating capital markets offences to make orders of restitution and compensation in appropriate circumstances.
- A statutory right of action should be established based on a finding of a tribunal or court that a respondent has engaged in specified misconduct.
- Consideration should be given to the effectiveness of special class action proceedings.

7. Self Regulated Organizations

- There should be a review of the appropriate roles, jurisdiction and powers of Self Regulatory Organizations ("SROs") in the enforcement of standards within the securities industry and the assessment of penalties.
- Regulators should consider whether processes which have been established by SROs to provide the options of arbitration and dispute resolution to claimants should now be required as a condition of recognition for all SROs.
- Consideration should be given to means of reducing legal expenses for complainants in ombudsman proceedings.

8. National Management of Enforcement:

- The enforcement of laws and regulations should be managed nationally to ensure the effective use of resources and the development and deployment of expert skill and knowledge across the country.
- Consideration should be given to the establishment of a national institute to facilitate research and education in the investigation, prosecution and adjudication of securities law.

List of Recommendations

1. Introduction

The need for data and analysis

1.01: A co-operative national program should be established and funded by securities regulators, SROs and law enforcement agencies

(a) to establish priorities for enforcement,

(b) to develop reporting systems that would provide a basis for assessing the effectiveness of enforcement processes in achieving their objectives,

(c) to identify and collect any additional relevant data, and

(d) to report the data and their qualitative analysis of it to an independent research body which will evaluate and issue public reports on the effectiveness of enforcement processes.

2. Investigation

Resources:

2.01: A study should be undertaken to assess the resources needed by police services for the investigation of capital market crime in various jurisdictions, and to inquire into the appropriate contributions that should be made by municipal, provincial and federal police services.

2.02: A study should be undertaken to assess the investigative resources needed by securities regulatory authorities in various jurisdictions, and the capacity to provide those services effectively.

Staffing of IMETs:

2.03: If IMETs is to succeed, there must be a renewed and continuing commitment to developing and retaining the expertise required to lead and conduct complex investigations of capital markets offences by

(a) identifying and reviewing the competencies that are required;

(b) recruiting officers and other staff with specialized backgrounds;

(c) providing professional development and mentoring programs;

(d) establishing and complying with policies that restrict secondments of these officers to other duties; and

(e) establishing and complying with promotion policies that enable investigators to establish long-term careers in the investigation of capital market crimes.

Mandate of IMETS

2.04: Either the capacity of IMETs should be expanded to conduct all the necessary criminal investigations relating to capital markets, or the capacity of other police agencies should be enhanced in order to address the kinds of cases that IMETs is not authorized or able to undertake.

2.05: The role of IMETs in each locale should be defined in accordance with the investigation needs in that locale, but without diluting the overall mandate and accountability of IMETs.

The need for enhanced integration, co-operation and co-ordination

2.06: To make the best use of limited investigative resources within each jurisdiction, it will be necessary to establish processes for consultation, co-operation and co-ordination among all levels of police forces and the enforcement staff of securities regulators.

Recognizing the priority of early intervention to protect investors

2.07: IMETs and other police forces should recognize the prime responsibility of securities regulators to intervene early in a securities matter to preserve assets, protect investors, and, if possible, protect the long-term viability of the corporation. They should co-operate in obtaining and sharing evidence and information both to support that responsibility, and, as appropriate, to investigate suspected crimes with a view to prosecuting those responsible.

Ensuring that investigations are focused: the role of a Senior Independent Review Officer

2.08: (a) What is needed, in each IMETs locale and each securities regulator, is a special kind of experienced lawyer, whom we refer to as a "Senior Independent Review Officer" ("SIRO") to provide focus, supervision and a locus of accountability for strategic decisions in an investigation.
(b) A SIRO must have the ultimate authority to limit or curtail or to eventually terminate the investigation, or to refer the matter to the appropriate prosecution service.
(c) A SIRO must have skills in supervision and management, and knowledge (or the ability to acquire it expeditiously) in the specialized field of capital markets.
(d) A SIRO should have a status equal or similar to that of a Securities Commissioner.

(e) Qualified persons might be found among the senior ranks of counsel in private practice or the prosecution service, or among individuals recently retired from those positions who remain at the peak of performance.

Legal advice in the course of the investigation

2.09: Investigators require and should have access to effective legal advice in the course of an investigation. However, it must be provided by individuals who will not be involved in the prosecution of the case.

Demonstrating the effectiveness of IMETs

2.10: Every effort should be made to enable IMETs to complete current investigations expeditiously and in a focused manner.

Structuring IMETs to take account of provincial interests

2.11: There must be an accountability structure set up for IMETs, which recognizes the need for a national enforcement strategy and takes into account the strategic importance of investigation to the effectiveness of securities regulation in the provinces.

Problems with sharing information

2.12: In light of the concerns expressed about constitutional hurdles to the sharing of information by regulatory investigators and police investigators, protocols must be developed to guide those who must determine and substantiate the point at which a regulatory inspection crystallizes into an investigation for the purpose of criminal or quasi-criminal prosecution, and specifying the investigatory techniques that can be employed at various stages of inspection and investigation.

Inappropriateness of the grand jury process in Canada

2.13: In light of different procedural traditions and constitutional protections in Canada and the United States, it would be inappropriate even to suggest that a grand jury process be introduced for the investigation of capital markets offences.

3. Prosecution

Prosecution of regulatory offences

3.01: The securities regulator's Senior Independent Review Officer, recommended in recommendation 2.08, should also have independent authority to determine whether a matter should be sent forward for hearing by the securities tribunal.

3.02: Processes should be instituted for identifying priorities in investigation and prosecution of regulatory matters, and ensuring that enforcement processes are being used effectively in addressing those priorities.

Prosecution of offences

3.03: The securities regulator's Senior Independent Review Officer, recommended in Recommendation 2.08, should have independent authority to determine whether a matter should be sent forward for prosecution as a provincial offence.

3.04: Where the Senior Independent Review Officer has authorized prosecution of a provincial offence, it will then be appropriate to authorize counsel employed or retained by the securities regulator to prosecute it. The provincial prosecution service should provide guidelines to assist in ensuring that such counsel are thoroughly familiar with the principles that govern the role of a prosecutor.

3.05: Every effort should be made to develop a nationally co-ordinated program for the prosecution of capital markets cases, with a view to ensuring the development of a public prosecution service that has the experience, capability and commitment to meet the difficult challenge of prosecuting capital market offences.

A role for legal education

3.06: Law Schools should be encouraged to advise students who are interested in careers in criminal law to consider the need for prosecutors and defence lawyers who are knowledgeable in the field of corporate, commercial and securities law.

4. Adjudication

Adjudication and the integrated securities tribunal

4.01: The adjudicative functions of securities commissions must be transferred to an independent tribunal or tribunals. Membership in the tribunal should be structured so as to ensure its expert knowledge of law, procedure and the operation of capital markets. A national tribunal should be established which could deploy hearing panels throughout the country as needed.

Adjudication and the courts

4.02: Additional judicial appointments must be made to the provincial courts and additional facilities must be established as required to ensure the capacity of provincial courts to try capital markets offences on a timely basis and to process lengthy trials with a minimum of interruptions.

4.03: Programs must be established, possibly through the National Judicial Institute ("NJI"), to prepare judges to manage the adjudication of complex offences relating to capital markets and to understand the contexts in which they arise. The Canadian Securities Administrators, SROs, and experienced counsel (for the prosecution and the defence) should participate in these programs.

4.04: Provincial court judges should be encouraged to identify their interest in capital market cases and participate in judicial education programs to enhance their preparation for presiding in these cases. In the assignment of judges, care must be taken to match interest, aptitude and preparation to the requirements of various types of cases.

4.05: In the event that it is not possible to develop an effective process of adjudication relating to capital markets in the existing court structure, consideration must be given to the establishment of a specialized provincial court with unified jurisdiction.

5. Penalties and Orders

Appropriate penalties and factors to be considered

5.01: Legislatures should consider enacting legislation similar to s. 380.1 of the *Criminal Code of Canada*, to specify the aggravating circumstances that must be taken into account in imposing a sentence for offences under securities legislation and the non-mitigating factors that must not be taken into account.

Range of orders and penalties

5.02: So far as possible, the penalties and orders available for the enforcement of securities laws should be harmonized across the country.

Costs orders

5.03: Ministries and regulators should review and harmonize provisions governing costs in securities matters, and consider adopting best practices of other jurisdictions, which should include

(a) authorizing the regulator to order costs in favour of the respondent in appropriate circumstances;

(b) developing policies and guidelines regarding the circumstances in which costs may be ordered, the basis upon which costs will be calculated and the manner in which the respondent may test their calculation;

(c) providing for review of costs orders by a person or body independent of the regulator; and

(d) providing for the recovery of costs on usual principles, rather than requiring the payment of costs on the basis of full cost recovery to fund the investigation, prosecution and adjudication of securities matters.

6. Redress for Investors

Applications to courts by regulators to seek compensation

6.01: (a) Securities regulators should consider utilizing their jurisdiction to apply to courts more frequently for restitution, compensation, and/or damages on behalf of aggrieved persons;

(b) regulators and ministries should seek the passage of any further statutory provisions or regulations which are required in order to provide the basis upon which these procedures may be invoked; and

(c) regulators should develop practice guidelines to facilitate the appropriate use of these procedures.

Authority of regulators to order compensation

6.02: Securities tribunals should be authorized to order compensation or restitution in appropriate circumstances.

Jurisdiction of courts adjudicating offences to order compensation

6.03: Consideration should be given to (A) authorizing courts adjudicating capital markets offences under provincial or criminal legislation, in appropriate circumstances, to make orders of restitution and compensation and (B) establishing rules to ensure the fairness of the process.

Statutory right of action

6.04: Claimants should be authorized to bring an action for damages, or seek an order for compensation or restitution from the civil courts, based upon a finding of a securities tribunal or a court, in regulatory, quasi-criminal or criminal proceedings, that the respondent has engaged in specified misconduct.

Class actions for secondary market liability

6.05: Securities regulators and Ministries should monitor developments in class actions for failures of disclosure, with particular attention to concerns about the effective management of class actions and the imposition of costs awards against plaintiffs.

7. Self Regulatory Organizations and Enforcement

Appropriate roles and jurisdiction

7.01: The appropriate roles and jurisdiction of SROs in the enforcement of standards within the securities industry and the assessment of penalties should be reviewed. In particular, consideration must be given to the following issues:

(a) whether SROs are exercising statutory powers of decision in their discipline jurisdiction and whether they are subject to the protections guaranteed by the *Charter of Rights and Freedoms*;

(b) in what circumstances and by what means, should SROs be able to obtain production of documents from, and the attendance as witnesses of, former members and other third parties;

(c) the means, if any, by which the decisions of SROs should be made enforceable against former members;

(d) the circumstances and process by which an SRO could apply to a court for the appointment of a monitor; and

(e) the provision of immunity from civil liability for those acting in good faith on behalf of SROs.

Dispute resolution processes as a condition of recognition

7.02: Regulators should consider the extent to which the new processes and requirements which have been established by SROs to provide arbitration and dispute resolution options to claimants should now be required, as a condition of recognition, for all SROs.

Legal representation in ombudsman proceedings

7.03: Regarding proceedings before the OBSI, consideration should be given to requiring (A) that a party who wishes to be legally represented must seek permission from the Ombudsman; (B) that if the member firm applies for and obtains permission to be represented, the firm must also pay the costs of the claimant for representation; and (C) that if the claimant is the one who seeks permission to be legally represented, both parties be required to bear their own legal costs.

8. The Need for National Management of Enforcement

8.01: Whether or not Canada adopts a unified or harmonized approach to securities regulation, it is fundamentally important that enforcement be managed on a national basis to ensure the effective use of resources, the development and deployment of expert skill and knowledge across the country, and the independence and accountability of enforcement processes.

8.02: Consideration should be given to the establishment of a national institute to facilitate research and education in the investigation, prosecution and adjudication of securities law.

1. Introduction

i. Mandate, Methodology and Acknowledgments

We have prepared this report, at the request of the Task Force to Modernize Securities Legislation in Canada,[1] to identify critical issues in the enforcement of laws relating to Canadian capital markets and to make recommendations to strengthen those enforcement processes. In particular, we have identified challenges arising in the processes of investigation, prosecution and adjudication, with respect to regulatory issues, provincial offences and criminal offences. In the limited time available to us, we have also noted the role of securities commissions in facilitating the compensation of victims of offences and the role of plaintiffs' actions for compensation as a means of deterring capital market misfeasance. Our report is one of several reports on enforcement and compliance with securities law that were commissioned by the Task Force.[2]

The challenges we have examined raise issues of process, jurisdiction, co-ordination and management in the context of capital markets. Since neither of us is an expert in the highly specialized and complex field of securities law and the operation of capital markets, we have consulted with specialists in the field to identify the challenges to be addressed. We have benefited from the discussions of enforcement issues in recent and important reports of the following special committees: the Insider Trading Task Force (2003),[3] the Wise Persons' Committee to Review the Structure of Securities Regulation in Canada (2003),[4] the

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[1] The Task Force to Modernize Securities Legislation in Canada is an independent task force established by the Investment Dealers Association ("IDA"). Information about its mandate and membership can be found at www.tfmsl.ca,

[2] S. Ben-Ishai (survey of the role and regulation of gatekeepers), U. Bhattacharya (impact of enforcement on the cost of capital), M. Condon & P. Puri (extent & effectiveness of tools for compliance), Cunningham (rules versus principles in the context of enforcement), H. Jackson (enforcement and competitiveness).

[3] Insider Trading Task Force, *Illegal Insider Trading in Canada: Recommendations on Prevention, Detection and Deterrence* (2003). The Task Force was established by the four major securities commissions (OSC, BCSC, ASC, CVMQ) and national SROs (IDA, RS and the Bourse de Montréal). <www.osc.gov.on.ca/PublicCompanies/InsiderTrading/iti_20031112_taskforce-report.pdf>

[4] The Wise Persons' Committee to Review the Structure of Securities Regulation in Canada, *It's Time* (2003). The WPC was established by the Minister of Finance, Government of Canada, to review the existing securities regulatory system and propose an appropriate model for the future. The WPC recommended a single regulator administering a single code in a cooperative approach involving the federal and provincial governments. Alternatively, the WPC recommended that the federal government should exercise its constitutional jurisdiction to create a national securities regulator. The WPC was composed of Michael Phelps (Chair), Harold MacKay (Vice Chair), Thomas Allen, Pierre Brunet, Wendy Dobson, Edwin Harris and Michael Tims. < http://www.wise-averties.ca/main_en.html>.

Five Year Review Committee (Securities Act, Ontario) (2003),[5] the Osborne Committee on Fairness (2004),[6] and the Crawford Panel on a Blueprint for a New Model (2006).[7] We have reviewed the websites of various regulators and academic literature, including, in particular, the recent papers on enforcement and compliance by Professor Poonam Puri[8] and by Professor Mary Condon.[9] In addition, we have reviewed with care the comments on enforcement in the written submissions made to the Task Force.[10]

We wish to express our appreciation to our Advisory Committee, leading securities lawyers drawn from across the country: George MacDonald, Q.C. from Halifax, Maryse Bertrand from Montreal, Ermanno Pascutto from Toronto and Hong Kong, Stanley Carscallen Q.C. from Calgary and Patricia Taylor from Vancouver. They generously agreed to review and comment on an early draft of our report. We are grateful for their advice and contributions, and we hasten to relieve them from responsibility for any positions taken in the final report. Since they assisted us as individuals, it follows that none of our recommendations can be attributed to them, the firms with which they are associated or the clients they represent.

We also appreciate the generosity of several distinguished specialists in the field of securities regulation who readily made their valuable skill and experience available to us in their often lengthy and always helpful interviews with us. These individuals are listed in Appendix C. As with the members of the Advisory Committee, we value their commitment to the effectiveness of capital markets in Canada, their acuity and their responsiveness. They serve, and have served, in a variety of capacities with great skill, and they set high standards for capital market operations.

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[5] *The Five Year Review Committee Final Report – Reviewing the Securities Act (Ontario)* (2003). The Committee was appointed by the Minister of Finance, Government of Ontario. The Committee was composed of Purdy Crawford (Chair), Carol Hansell, William Riedl, Helen Sinclair, David Wilson and Susan Wolburgh Jenah. The Committee issued a Draft Report for discussion in 2002, and a Final Report in 2003. Many of its recommendations were addressed in amendments to the *Securities Act*. www.gov.on.ca/FIN/english/enghome.htm or www.osc.gov.on.ca/en/regulation/html.

[6] The Hon. Coulter A. Osborne Q.C., Prof. David J. Mullan, Bryan Findlay Q.C., *Report of the Fairness Committee to David A. Brown, Q.C., Chair of the Ontario Securities Commission*, March 5, 2004. www.osc.gov.on.ca/en/regulation/html.

[7] The Crawford Panel on a Single Canadian Securities Regulator, Discussion Paper ("A Blueprint for a New Model"), December 2005; final report ("A Blueprint for a Canadian Securities Commission"), June 2006. The panel was established by The Hon. Gerry Phillips (Ontario Minister responsible for the OSC), with a mandate to recommend a securities regulatory framework that features a common securities regulator, a common body of securities law and a single fee. The Panel was composed of Purdy Crawford (Chair), Brian Canfield, Claude Lamoureux, John MacNaughton, Jacques Ménard, Gwyn Morgan and Dawn Russell.

[8] P. Puri, "Enforcement Effectiveness in the Canadian Capital Markets", Capital Markets Institute, December 2005.

[9] M. Condon, "Enforcement and Litigation in Ontario Securities Regulation: Time for a Rethink?", forthcoming, *Queen's L.J.*.

[10] The written submissions are accessible on the website of the Task Force, www.tfmsl.ca/submissions.

We know that the Members of the Advisory Committee and the individuals we consulted are but a representative sample of others, across the country, who specialize in the field of securities practice, regulation and the administration of justice. We invited them to speak with us on the condition that their individual positions would not be identified without their explicit permission. In our discussions, we endeavoured to provide individuals with an opportunity to respond to matters raised by others whose positions differed from their own. Nonetheless, it is likely that some of those we consulted will find assertions in this report which they would wish to rebut. We apologize in advance for any unevenness in our characterization of the issues and encourage them to contribute their responses to the debate. What is needed is a full and candid diagnosis of the current situation in enforcement and an effective, co-ordinated plan for the future.

We benefited, as well, from discussions with members of the Task Force, and from the assistance of the research directors of the Task Force, Professor Paul Halpern of the Capital Markets Institute, Rotman School of Business, University of Toronto, and Professor Poonam Puri of Osgoode Hall Law School, York University. We are grateful to the Executive Directors of the Capital Markets Institute, initially Ms Atanaska Novakova and then Ms Judie Thom, who very effectively arranged meetings and consultations.

The high level of commitment and skill in the field of securities regulation in Canada gives us confidence that solutions can be found to the critical issues that we examine in this report. The real challenge, in our view, will be one of political leadership and willingness to address the issues in the best interests of the country as a whole. We commend the Investment Dealers Association for creating and funding an independent Task Force and we wish the Task Force well in its contribution to the debate on issues that are of fundamental importance to the future of Canada.

ii. The Importance of Enforcement to the Efficient and Effective Operation of Capital Markets

We have been advised by Thomas Allen, Q.C., Chair of the Task Force, that its consultations have identified enforcement as one of the top priorities to be addressed in ensuring the effectiveness of securities regulation in Canada. Our interviews and research confirm that assessment. No matter how good the rules are for regulating the conduct of market participants, if the system of enforcement is ineffective – or perceived to be ineffective – the confidence of investors is undermined, the reputation of Canada in global markets suffers, and Canadian securities are devalued.

Governor David Dodge of the Bank of Canada has provided important leadership in drawing public attention to the importance of effective enforcement of securities laws. He has emphasized that "[w]hen everyone is playing by the rules – and everyone is confident that others have the incentives to do the same – then markets operate with greater efficiency."[11] The Governor has also emphasized the importance of capital markets efficiency to the economy:

> "With an efficient system, investors can get the highest risk-adjusted returns on their investments and borrowers can minimize the costs of raising capital. Inefficiencies can drive a wedge between what borrowers pay and what investors receive. I'll give you some examples of how inefficiencies can interfere with the saving and investment process that is so crucial to economic growth. If adequate information isn't available, potential investors can't tell whether a particular investment fits with their tolerance for risk. If financing costs are too high because of inefficiencies, borrowers won't be able to secure the funds they need to expand. If competition isn't encouraged, the various players in the financial system won't have the right incentives to innovate. This is why it's so critical for the financial system to work efficiently."[12]

The efficiency of Canadian markets is an issue that affects all Canadians. Too often "white collar crime" is dismissed as less serious than crimes of violence, as though it were "victimless" crime. In fact, however, securities offences have serious impacts on a great many Canadians and the society in which we live. Nowhere is that impact more significant than in the stability and growth of the pension funds of so many Canadians which are invested in the capital markets. As the Wise Persons' Committee reported,

> "Almost all Canadians today are investors in the equity markets, either directly or through mutual funds and pension funds. Debt markets are critical to the financing of infrastructure and public institutions. Capital markets underpin investment, support job creation and lead to higher standards of living. Fair and vibrant capital markets are vital for Canada to reach its full economic potential." [13]

In announcing proposed amendments to the *Criminal Code* to enhance enforcement of capital markets offences, the then Justice Minister warned that "[c]apital markets fraud hurts everyone. It can have a devastating impact on the investments and retirement savings of all Canadians, and can threaten the integrity of our financial markets."[14] David Wilson, Chair of the Ontario Securities Commission ("OSC") has warned that "a market that is perceived to be tainted by abuse and neglected by regulators will fail to attract domestic and foreign capital flows."[15] Thus, the vigour of the Canadian economy and the financial

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[11] Governor of the Bank of Canada David Dodge, "Financial System Efficiency: Getting the Regulatory Framework Right", Toronto, September 22, 2005, at p.3. <www.bankofcanada.ca/speeches/>.
[12] Governor of the Bank of Canada David Dodge,"Financial System Efficiency: A Canadian Imperative," Toronto, December 9, 2004, at p.1.
[13] WPC Report, *supra* n.4, at p.1.
[14] The Hon. Martin Cauchon, Minister of Justice, quoted in a Government of Canada press release, June 12, 2003, www.justice,gc.ca/en/news/n2/2003/doc_30926.html.
[15] "Enhancing Prosperity: Fair, Efficient and Balanced Regulation" Securities Superconference, Toronto, February 23, 2006. See, also, the conclusion of the Crawford Panel on a Single Canadian Securities Regulator, *supra*, n.7, in its Final Report, at p. 26.

security of Canadians depend upon efficiency in capital markets, and market efficiency depends upon having effective laws that are effectively enforced.

The prospect that breaches of securities laws will be monitored and investigated and that those responsible for them will be prosecuted and penalized creates discipline in the market, deters misfeasance and promotes efficiency. On the other hand, gaps and weaknesses in the enforcement process create opportunities for market pirates. Gaps and weaknesses in enforcement undermine the will of others to comply with the rules in the face of temptation and pressure for personal or institutional gain.

In a system that relies upon compliance and self-discipline, it is essential to have effective checks and counter pressures on self-interest and misfeasance. Thus, as Governor David Dodge reminds us, any system of securities regulation must constantly assess and improve its regulatory framework, its systems for monitoring compliance with rules, and its processes for effective enforcement.[16]

iii. The Goals of Enforcement of Securities Laws

We adopt the position of the Canadian Securities Administrators ("CSA") that the purpose of enforcement of securities laws is to "deter wrongdoing, protect investors, and foster fair and efficient capital markets in which investors have confidence."[17]

iv. Reality, Perceptions and Myths in Canadian Securities Regulation

a) Priorities and Performance

There has not yet been a thorough empirical study of capacity and performance in the enforcement of Canadian securities laws. Without such an analysis, it is difficult to assess the extent to which enforcement of securities regulation in Canada is effective and meets global standards. In our view, it is important that systems be in place for tracking, accessing and evaluating all relevant enforcement data. For example, we have been assured, on the one hand, that some of Canada's enforcement processes in securities regulation have been benchmarked against those in other jurisdictions and are second to none in

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[16] Governor David Dodge, "Financial System Efficiency: Getting the Regulatory Framework Right", *loc. cit*., n.11.
[17] CSA, "Report on Enforcement Activities from April 1 to September 30, 2005" (undated), <www.csa.ca>. The CSA is "is a voluntary umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets." Source: "Introduction to the Canadian Securities Administrators".

the world. On the other hand, we have heard from credible sources that those same enforcement processes are not well-regarded by others in the field. There is no data available which would enable one to assess the validity of these two conflicting opinions.

In any event, benchmarking tends to focus on quantitative results. For example, it reports and compares numbers of complaints, the time it took to process them, the number of proceedings taken, the number of settlements, the number of decisions, the number of appeals, and the number of open files on a continuing basis. This information may provide useful comparative information, but does not provide an adequate basis to evaluate the effectiveness of enforcement processes. What it does not disclose is whether the right matters are being investigated and pursued, and with what success and impact. In other words, it does not facilitate an analysis of the effectiveness, costs and benefits of the process. Qualitative as well as quantitative information is needed as a basis for evaluation of enforcement effectiveness. If such comprehensive information and analysis is presently available, it has not been disclosed. In order to satisfy public concern about the effectiveness of enforcement processes, comprehensive information should be generated and reported.

For the period beginning in April 2004, the CSA[18] has published three reports on enforcement activities, providing consolidated information on the activities of members of the CSA covering six month periods.

[18] The Canadian Securities Administrators is composed of the securities commissions and their counterpart in the province of Quebec, the Autorité des marchés financiers.

Information reported by the CSA on Enforcement Activity by securities regulators in Canada[19]

Period	Proceedings commenced[20]	Interim Orders[21]	Matters Concluded				Appeals	
			Finding Issued	Sanction ordered	Settled	With-drawn	Decision Appealed	Appeal Decision Rendered
Apr 04 – Sept 04	77	29	19	32	27	4	6	3
Oct 04-Mar 05	65	27	14	34	54	4	3	8
Apr 05-Sept 05	49	42	17	17	39	3	5	8

The CSA Enforcement Reports also provide brief descriptions of specific court rulings, commission or tribunal decisions, settlement agreements and appeals in the following types of matters: illegal distribution, insider trading, market manipulation and fraud, disclosure violations, misconduct by registrants and miscellaneous matters. In addition, the Reports provide brief descriptions of enforcement matters addressed by each Self Regulatory Organization ("SRO")[22], listing these by province rather than by type of matter.

In addition to the consolidated CSA Enforcement Reports, information on enforcement matters is now reported individually by securities regulators[23] and by SROs[24].

The CSA Reports on Enforcement do not disclose the number of matters identified for investigation as a result of surveillance or complaint. Nor do they disclose the length of time it takes to conduct investigations, the criteria used in determining which matters should be investigated or prosecuted in regulatory or criminal proceedings, or the benchmarks (if any) for assessing the time expended in processing varying types of matters, conducting investigations, prosecuting cases and rendering decisions. Nor is there data which would enable one to assess whether the resources invested in enforcement, by

[19] This composite table is based on the Enforcement Reports issued by the CSA for the specified periods. www.csa-acvm.ca/html_CSA/news_publications.html.
[20] Explanatory note provided in the Reports: "Proceedings before a CSA member Commission or Associated tribunal may be commenced by a Notice of Hearing. Court proceedings may be commenced by way of 'Information'."
[21] Explanatory note provided in the Reports: "Includes freeze orders and interim cease trade orders."
[22] See the discussion of SROs in Section 7.
[23] See the discussion in Section 2.vii.
[24] See the discussion in Section 7.

securities regulators, and other agencies, are appropriate in light of the numbers of matters addressed and the effectiveness of the enforcement process.

The information on enforcement now provided by the CSA and by individual regulators and SROs certainly constitutes a step in the right direction. However, since the effectiveness of enforcement is so critical to capital markets, it would be helpful if members of the CSA, and the other agencies involved in the enforcement of securities laws, would provide more information which would support qualitative assessment. In order to assess the whole picture with respect to enforcement, it would be important to include comprehensive information, distinguishing between matters that are dealt with in the regulatory process and in the courts as provincial or criminal offences. To complete the picture, it would also be useful to assess the extent and effectiveness of processes for dealing with claims for compensation, through regulators, SROs and actions in the courts. Comprehensive information about enforcement processes would provide a basis for strategic planning and accountability.

We emphasize the importance of qualitative assessment in addition to quantitative reporting. If the focus is only on numbers of matters investigated and successfully prosecuted, the incentive is to generate positive statistics by focusing on lesser infractions, such as late filing of reports, which can be processed quickly, and to shy away from more complex and important cases, which involve time-consuming investigations, are more difficult to prove and are less likely to be successful. It is thus important to produce data that tracks the priorities in enforcement, such as eliminating fraud, misrepresentation and insider trading. The system of reporting and assessment should provide incentives to eliminate these evils.

A comprehensive consultation involving relevant ministries, regulators, agencies, and associations, should establish the priorities for enforcement. Then, in consultation with experts, the data that is required in order to evaluate the effectiveness of enforcement processes could be defined and the processes for analyzing it, both quantitatively and qualitatively, could be developed. An independent research body should be established to study and report on enforcement processes and outcomes.

> **<u>Recommendation 1.01</u>: A co-operative national program should be established and funded by securities regulators, SROs and law enforcement agencies**
> **(a) to establish priorities for enforcement,**
> **(b) to develop reporting systems that would provide a basis for assessing the effectiveness of enforcement processes in achieving their objectives,**

(c) to identify and collect any additional relevant data, and

(d) to report the data and their qualitative analysis of it to an independent research body which will evaluate and issue public reports on the effectiveness of enforcement processes.

b) Available Research Indicates Weaknesses in the Enforcement of Securities Laws in Canada

In the meantime, we note that the research that is available uniformly supports the perception that there are weaknesses in the enforcement of securities laws in Canada. Thus, for example, in its submission to the Task Force, the Bank of Canada referred to "large-scale evidence of insider trading and reporting violations, based on a study of stock buyback programs and insider trading around significant news announcements."[25] The Report of the Wise Persons' Committee cites a finding that "profits made by corporate insiders in Canada prior to the announcement of acquisitions are the highest among 52 countries studied."[26] Other studies commissioned by the Task Force to Modernize Securities Legislation may provide both additional data and its analysis.

c) Perceptions of Ineffective Enforcement and Their Significance

In the absence of comprehensive data on the effectiveness of the various processes for enforcing securities law in Canada, we must rely on perceptions of their effectiveness. Unless enforcement is perceived to be effective, its deterrent value is undermined. In fact, perceptions of the effectiveness of an enforcement system are often as important as the reality. This is particularly important in a system which seeks to ensure that investors can have confidence in the capital markets. This common sense conclusion is overwhelmingly confirmed by experts and those well-versed in the functions of Canadian capital markets who spoke to us. There are some individuals who will not admit to any weaknesses in their own operations. Nonetheless, it is clear from publicly available sources and from our consultations as a whole, that credible and well-informed individuals sincerely believe that there have been, and continue to be, serious defects in Canada's securities enforcement systems.

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[25] David Longworth and Donna Howard, Submission of the Bank of Canada to the Task Force, February 19, 2006, p. 5, <www.tfmsl.ca/submissions>, citing William McNally and Brian Smith, "Do Insiders Play by the Rules?" (2003) *Canadian Public Policy.* See also Bank of Canada Deputy Governor David Longworth, "The Crucial Contribution of the Financial System and Monetary Policy to Economic Development", Montreal, May 5, 2006, at p.4, www.bankofcanada.ca/speeches.

[26] See Arturo Bris, Working Paper, Insider Trading Task Force, *supra,* n.3, cited in WPC Report, *supra* n.4, at p. 27, n.7.

The Bank of Canada submission to the Task Force states that the Bank "is particularly concerned about the *perception* among market participants that Canadian enforcement of insider-trading laws is not as strong as it could be."[27] The submission cites the Report of the Insider Trading Task Force[28], which

> "[n]otes that there is a public perception that illegal insider trading is prevalent and increasing on Canadian markets and, although many suspected incidences of illegal insider trading are being identified through market surveillance, there have been few successful enforcement actions." [29]

Governor David Dodge has also referred to the "widely held perception that Canadian authorities aren't tough enough in punishing fraud and enforcing insider-trading and other rules."[30]

The Wise Persons' Committee observed that "[t]here is a widely held view that enforcement in Canada is lax in comparison with the United States and other countries";[31] "[t]here is a perception both in Canada and abroad that serious misconduct in Canada too often goes unpunished";[32] and that "[w]e believe that inadequate enforcement is one of the most significant weaknesses of the current system".[33]

(1) Lack of Enforcement in High Profile Cases

In our consultations, the most commonly cited reason for the perception of weakness in Canadian securities enforcement is the apparent inability to enforce securities laws in high profile cases that have substantial links to Canada. The Bank of Canada submission to the Task Force observes that "[w]hile U.S. securities agencies have pursued a number of high profile cases under insider trading laws that have generated large penalties and even jail terms, similar evidence of enforcement has been lacking in Canada."[34]

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[27] David Longworth and Donna Howard, Submission of the Bank of Canada to the Task Force, February 19, 2006, p. 7, www.tfmsl.ca/submissions.
[28] Task Force on Insider Trading, *supra* n.3.
[29] David Longworth and Donna Howard, loc. cit., no. 28. at p. 7, n. 31.
[30] Remarks of Bank of Canada Governor David Dodge to the Empire Club of Canada and the Canadian Club of Toronto, December 9, 2004, at p.5; see also the Governor's remarks to the Toronto CFA Society, November 22, 2005, at p. 1; both available at www.bankofcanada.ca/speeches.
[31] WPC Report, *supra,* n.4, at p. 7.
[32] *Ibid.,* at p.26.
[33] *Ibid*., at p.30.
[34] David Longworth and Donna Howard, Submission of the Bank of Canada to the Task Force, *loc. cit*., n.27, at p. 6. See, also, the Final Report of the Crawford Panel on a Single Canadian Securities Regulator, supra, n.7, at p. 26, reporting "embarrassment regarding Canada's international reputation for being unable to successfully prosecute many egregious securities law violations".[34]

Doug Pearce, CEO/CIO of bcIMC submitted to the Task Force that negative perceptions of enforcement in Canada reflect two factors. The first factor is the lack of prosecution of high profile cases:

> "[The perceptions] are likely based on the many stagnant or long-dormant Canadian proceedings that are tantamount to no prosecution at all. It is shocking to examine the current state of investigations concerning certain former executives at Livent, Nortel and Royal Group Technologies, for example. Suspicions surrounding Livent surfaced in 1998 and it took another 6 years for Canadian authorities to get the principal offenders into court on fraud charges. Turning to more recent fraud allegations, Royal Group Technologies is not even listed under the enforcement proceedings on the Ontario Securities Commission's website and the latest enforcement proceedings on Nortel involve a request for OSC exemption from the requirement to deliver its interim financial statements and annual financial statements. Concerns about the effectiveness of Canada's enforcement record also derive from the high-profile cases such as Bre-X and YBM that have been subject to criminal law enforcement investigations and no one involved has yet gone to jail. Obviously, Canada does not lack for cases of financial dishonesty and market-related crime, but where are our tough jail sentences like those recently handed down to former executives of WorldCom, Tyco and Adelphia in the United States? There is clearly a problem on the prosecution side in Canada."[35]

The cases identified by bcIMC, and others such as Hollinger, were frequently cited in our consultations. We were advised that, in some instances there may be good reasons why proceedings were undertaken elsewhere rather than in Canada, but the lack of timely and effective enforcement in Canada in any of these high-profile cases drives the perception that Canada lacks the capacity or will to enforce its securities laws.

(2) Delays Between Detection and Action

The lack of prosecution in high profile cases is not the only indicia of weakness in the enforcement of Canadian securities laws. The second factor, cited by bcIMC and by others, is that there are "some disturbing examples of delays between detection of a possible problem and action by regulators."[36] The bcIMC submission refers to the following examples:

> "A recent class-action suit filed in the Crocus Investment Fund affair alleges that the Manitoba Securities Commission acted in a grossly careless and reckless manner: in its investigations of complaints regarding the valuation of the Crocus units.
>
> Last summer, allegations of financial misconduct/misappropriation of funds were levied at Norshield Financial Group, Portus Alternative Asset Management and Norbourg Asset Management. In all three cases, attempts apparently were made by members of the financial community to alert securities regulators in several provinces to serious disclosure problems. By

[35] Submission to the Task Force on behalf of bcIMC Investment Management Corporation**,** Doug Pearce CEO/CIO, November 14, 2005, at p.5, available at www.tfmsl.ca/pages/submissions.
[36] *Ibid*..

the time regulators shut down the operations, the money was gone, relieving retail investors of millions of dollars."

(3) Delays in Adjudication

A further concern is that adjudication is often unduly delayed.[37] Delays in criminal prosecutions may result from case backlogs and the difficulties of scheduling long cases. We also heard concerns that the proceedings of regulators are often interrupted and delayed by repeated applications for judicial review.

(4) Inadequate Penalties

We heard repeatedly that the penalties imposed for white collar crime have not reflected the seriousness of these crimes and their impact. We were told of a case in which a defendant charged with breaching orders made by a Commission was fined only $500 on each of several counts. Moreover, even when penalties are substantial, they may not constitute an adequate deterrent. Thus, for example, we were reminded that in a case in which penalties of $2 million were imposed, this amounted to less than 1% of the loss incurred by the corporation and its public shareholders.

(5) Concerns about Fairness of Enforcement Processes

Concerns about lack of fairness in enforcement processes have seriously undermined confidence in their effectiveness. There are at least five aspects to this concern:

(i) There are concerns about fairness in the use of information that can be obtained by a regulator for purposes of monitoring compliance and taking action to protect the interests of investors. It is essential that the more flexible information-gathering tools available to a regulator be used only for regulatory purposes. Once the intent to prosecute has been formed, the person or entity under investigation is entitled to constitutional protections.

(ii) Despite organizational attempts to keep enforcement and adjudication separate, the structural integration of policy-making, regulation, enforcement and adjudication in one agency has generated a reasonable apprehension that the adjudicators may be biased in favour of the positions advanced by commission staff.[38]

[37] WPC Report, *supra* n.4, at p.25.
[38] The Osborne Committee Report, *supra* n.6.

(iii) We were told that enforcement is uneven, that regulators and SROs sometimes use their powers in a draconian manner against some respondents, while other wrongdoers are not pursued.

(iv) We were also told that regulators have a tendency to come down hard on lesser infractions, such as late filing of reports, but to shy away from some more complex cases.

(v) We also heard concerns that proceedings before regulators are weighted against respondents, that there is tremendous pressure to settle in light of onerous costs provisions, and that one-way costs awards are unfair.

Concerns regarding the fairness, wisdom and integrity of enforcement processes generate apprehension, undermine the confidence of market actors, and may, in turn, undermine compliance with securities laws.

(6) Complexity and Duplication of Jurisdiction and Responsibility in Canada

The complexity and duplication of jurisdiction over securities enforcement in Canada undermines confidence that enforcement is effective and that those responsible for it are accountable. There are (1) no less than ten provincial and three territorial jurisdictions with responsibility for securities regulation, several with their own enforcement capacity and varying priorities; (2) national Self-Regulatory Organizations exercising disciplinary jurisdiction over their members and providing processes for investors to recover losses; (3) police forces at the municipal, provincial and national level; (4) prosecutions conducted directly by some regulators or by provincial or federal prosecutors; (5) overlapping offences at the provincial and federal levels; and (6) various tribunals and courts with relevant criminal, quasi-criminal and civil jurisdiction. In addition, some corporations and financial institutions have their own investigative capability to monitor compliance, and there are private firms that provide expert investigative services.

There has been competition among jurisdictions, as well as significant variation in enforcement priorities.[39] In its submission to the WPC, the Ontario Securities Commission ("OSC") observed that

> "the increasing complexity of financial transactions means that inter-jurisdictional activity is becoming more the rule than the exception. On occasion, businesses with national scope hide behind the fragmented regulatory system as an excuse not to cooperate with commission investigations." [40]

[39] See WPC Report, *supra* n.4, at p.29.
[40] *Ibid*., at p.28.

The enforcement orders of regulators are territorially limited, creating the possibility that a wrongdoer can avoid their application by moving to another Canadian jurisdiction.[41] Moreover, resources for enforcement vary significantly from one jurisdiction to another.[42] The total resources are spread thin and the costs of co-ordination further dilute the effective use of those resources.

The multiplicity of agencies involved in securities regulation and enforcement certainly results in confusion with respect to accountability. Accountability is compromised when responsibility is divided among so many jurisdictions and entities.

(7) Comparisons with Enforcement in the United States

The perceptions of ineffectiveness of Canadian enforcement processes are amplified by differences between American and Canadian approaches to the investigation and prosecution of offences. In an increasingly global economy, where a corporation is incorporated in one jurisdiction, carries on operations in other jurisdictions, raises capital in multiple jurisdictions and may be interlisted on various exchanges, allegations of wrongdoing may have a substantial connection to more than one jurisdiction. Mutual assistance agreements among members of the International Organization of Securities Commissions ("IOSCO")[43] commit one jurisdiction to co-operate with the investigations conducted by another. The procedures in one jurisdiction (for example, the availability of the grand jury process in the United States)[44] may possibly enable that jurisdiction to move forward more expeditiously to issue indictments and take carriage of the matter.

(8) Complaints by Investors

The Wise Persons' Committee reports that "[t]he most frequent complaint we heard from small investors was that the current enforcement system is inadequate and fails to protect their interests."[45] While securities regulation cannot guarantee the success of investments, it should do more to deter the wrongdoing that can undermine their value and to provide effective processes for claiming compensation

[41] See Crawford Panel on a Single Securities Regulator, *Discussion Paper: Blueprint for a New Model*, *supra*, n.7, at p. 3.
[42] *Ibid*., p.30.
[43] See www.iosco.org.
[44] See the discussion in Section 2.ix.
[45] WPC Report, *supra* n.4, at p.25.

when wrongdoing causes losses. The concerns of investors were vigorously expressed at an Investor Town Hall Meeting in Toronto in June 2005.[46]

(9) Summary

There are a number of issues in enforcement that have generated serious concern. They include the lack of effective enforcement in high profile securities cases in Canada; negative comparisons with the ability of U.S. authorities to bring timely and effective prosecutions; apparent delays in taking action to prevent loss to investors; perceived lack of fairness and integrity in some enforcement processes; complexity of jurisdiction and accountability; delays in adjudication; perceived inadequacy of some penalties imposed for capital markets crime; and perceived inadequacy in the remedies available to investors. All these issues have contributed to the widely shared perception that there are serious weaknesses in Canadian enforcement of securities legislation.

v. Recent Developments in Response to Concerns about Enforcement

Concern about the effectiveness of enforcement of securities laws in Canada has generated a number of responses.

a) Studies by Highly-Regarded Committees

As noted above,[47] several highly-regarded committees have examined ways of improving securities laws and their administration and enforcement.

b) Provincial-Territorial Securities Initiative

Through the Provincial-Territorial Securities Initiative, Ministers responsible for securities regulation are exploring opportunities for enhanced co-operation and co-ordination, through (1) harmonized and simplified securities laws, (2) mutual enforcement of orders made by regulators in other jurisdictions, and

[46] The Investor Town Hall started as an initiative of the OSC, but it also involved the IDA, the MFDA, and the OBSI. The OSC published a summary of the concerns raised at the meeting: "What we heard: A report on the Ontario Securities Commission Investor Town Hall, June 2005, available at www.osc.gov.on.ca. In July 2006, the OSC, IDA, MFDA and OBSI issued a joint paper, reporting on the progress they have made, independently and collectively, in examining the issues and developing solutions: available at www.osc.gov.on.ca, www.ida.ca.
[47] See the references in nn.3-7.

(3) a "passport system" providing a single point of access to capital markets in more than one province or territory.[48]

c) CSA Initiatives

As members of the Canadian Securities Administrators, the provincial and territorial securities regulators have made significant progress in co-ordinating and harmonizing securities regulation.[49] With respect to enforcement, the CSA maintains an Enforcement Standing Committee with the following mandate:[50]

> "The CSA Enforcement Standing Committee shares information and identifies gaps and trends in enforcement activities. The committee focuses on the inter-relationship and interplay between the various national and international organizations, agencies and self-regulatory organizations involved in the detection, investigation and prosecution of illegal market activities. It works collaboratively to identify known subjects who are operating in more than one jurisdiction and new or developing schemes that have cross-border implications. It identifies Commission and Court decisions which might have an impact on the regulatory regime and implements the consequent policies. It provides support to the bi-annual investigators Training Course sponsored by the OSC, and establishes and maintains cross-jurisdictional processes and coordinated interjurisdictional investigations. Finally, it develops and maintains a database of enforcement activity."

d) Amendments to Provincial Securities Legislation

Following the draft report of its Five Year Review Committee,[51] Ontario amended its securities legislation[52] (1) to create new offences for fraud and market manipulation and for making misleading statements; (2) to increase maximum fines to $5 million and terms of imprisonment to five years less a day; (3) to establish administrative penalties of up to $1 million; (4) to provide for orders to disgorge

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[48] A Provincial/Territorial Memorandum of Understanding Regarding Securities Regulation; Action Plan Timeline; Press Release, September 30, 2004; www.securitiescanada.org. Ontario has not signed the MOU although it continues to participate in discussions. Minister Gerry Phillips stated, in a speech on December 13, 2005, that Ontario has only three requirements: "that there be an effective common securities regulator, a common body of securities law, and a single fee structure." The Minister has indicated that Ontario will accept a head office location outside Ontario and a one jurisdiction/one vote partnership among equals without weighting for market share or capitalization. www.mgs.gov.on.ca/english/ministry/news_releases.html. The WPC expressed reservations about the passport system: *supra* n.4, at p.45 ff. See also the Crawford Panel Report, *supra* n.7.

[49] See "Introduction to the Canadian Securities Administrators", www.csa-acvm.ca. The CSA has developed a number of national or multilateral instruments, including a "Principal Regulator System"; implemented mutual reliance review systems for prospectus review and exemptive relief applications; established a central repository for registration across the country, an accessible database of all documents filed by public issuers in Canada and a central electronic system for insider reporting; and reported on uniform securities laws for Canada.

[50] *Ibid*., p.12.

[51] Five Year Review Committee, *supra*, n.5.

[52] *Keeping the Promise for A Strong Economy Act* (Budget Measures), S.O. 2002, part XXVI.

profits which were made from breaches of the Act; and to establish a regime of civil liability for secondary market disclosure[53].

e) Proposed Consolidation of Self Regulatory Organizations

Two of the national self-regulatory organizations, IDA and RS, have agreed in principle to the amalgamation of their regulatory functions into one organization.[54]

f) Proposals to Establish Independent Adjudicators

In Quebec, the adjudicative functions with respect to securities law are assigned to a separate and independent tribunal, and in other jurisdictions, following the Osborne Report,[55] there is a significant movement in favour of separating the policy-making and investigative/prosecution functions from the adjudicative function.[56]

g) Increases in Enforcement Staff

Enforcement staffs of securities regulators have been increased. We were advised that, in Ontario, the staff has doubled in the past few years to 100 members and that, in Quebec, there are plans to increase enforcement staff from 60 to 85 in the coming year.

h) Federal Funding and the Establishment of IMETs

One of the most significant responses to weaknesses in the enforcement of securities law is the federal government's commitment to provide funding of $120 million over five years to establish Integrated Market Enforcement Teams ("IMETs") to investigate high profile securities cases.[57] The measures were announced on June 12, 2003 by the Solicitor General of Canada and the Ministers of Justice and Finance.

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[53] Civil liability for secondary market disclosure provides a right of action for damages by those who acquire or dispose of securities between the time a misrepresentation is made relating to the affairs of the securities issuer and the time when the misrepresentation is corrected. See discussion in Section 6.v.
[54] The announcement was made on April 26, 2006. See the IDA Spring Report 2006, p.1, <www.ida.ca>.
[55] Osborne Committee Report, *supra* n. 6.
[56] See the discussion in Section 4.
[57] See Justice Canada, Backgrounder: Federal Strategy to Deter Serious Capital Market Fraud, June 2003, at www.justice.gc.ca/en/news/nr/2003/doc_30928.html.

The press release announcing the initiative reported that IMETs would be led by the RCMP and composed of

> "RCMP investigators, federal lawyers and other investigative experts dedicated solely to capital markets fraud cases. These highly skilled teams will enhance efforts to track down corporate criminals, and deter future occurrence of these crimes. The integrated, coordinated approach being taken – the defining feature of the IMETs - will help strengthen enforcement action in Canada."[58]

The Solicitor General noted that "[w]e are already working with the provinces' regulators, law enforcement and industry to ensure the integrity of Canada's financial markets. The dedicated RCMP-led teams will make certain that this work not only continues, but is strengthened."[59]

i) Amendments to the *Criminal Code*

In the same press release that announced the establishment of IMETs, the Minister of Justice announced proposed amendments to the *Criminal Code of Canada*, which were subsequently enacted,[60] to tackle capital markets fraud:

(a) creating a new *Criminal Code* offence of insider trading;

(b) creating a new offence for intimidating employees as a protection for employee whistle-blowers;

(c) increasing the maximum sentences for existing fraud offences and specifying aggravating factors (and non mitigating factors) to assist the courts in determining sentences commensurate with the seriousness of the crime;

(d) providing for production orders to enable investigators to obtain relevant documents or data from third parties who are not under investigation;

(e) authorizing federal prosecution of a narrow range of cases that threaten the national interest in the integrity of capital markets, thus increasing the resources available to tackle capital market fraud cases. The Minister announced that the "Government of Canada will work with the provinces to establish prosecution protocols that would ensure a coordinated and effective implementation of concurrent jurisdiction."[61]

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[58] Government of Canada Announces New Measures to Deter Capital Markets Fraud, June 12, 2003, at www.justice.gc.ca.
[59] *Ibid.*
[60] An Act to Amend the Criminal Code (capital markets fraud and evidence gathering), S.C. 2004, c.3 (Bill C-13).
[61] Government of Canada Announces New Measures to Deter Capital Markets Fraud, *supra*, n.58.

j) Conclusion

These recent developments demonstrate that there is a willingness, on the part of governments, their agencies, and industry regulators to take steps to enhance the capacity to enforce securities legislation in Canada. Unfortunately, the steps that have been taken do not appear to be sufficient to adequately address the weaknesses in the enforcement process. Moreover, some of the responses have created duplication which, unless the situation is carefully managed and co-ordinated, can only lead to further confusion about accountability for enforcement.

vi. The Focus of the Report: Investigation, Prosecution and Adjudication

Our consultation process has focused primarily on the investigation, prosecution and adjudication of regulatory and criminal offences relating to capital markets. We have also considered, to a lesser extent, the role of civil proceedings and civil claims as a deterrent and a means of redressing breaches of securities laws.

2. Investigation

We are convinced that effective investigation must be the priority in addressing weaknesses in the enforcement of securities laws. No matter how good the rules, no matter how effective the prosecutors, how conscientious the adjudicators and how appropriate the sanctions, there can be no enforcement without effective investigation. The investigation of securities cases can be particularly challenging. It will require the expert knowledge of specialists in various types of complex and evolving forms of securities, the skills of highly specialized forensic accountants, the careful analysis of masses of documents, and the consideration and application of sophisticated information technology and management systems. At every stage of the process it is important to focus the investigation through the careful, balanced exercise of judgment by an experienced person.

i. Jurisdiction, Capacity and Challenges

There are several agencies and organizations with an interest in monitoring and investigating the failure to comply with securities regulations and the commission of securities offences. [62] In a system of such complexity and diversity, where investigations are often highly sensitive and cut across provincial and

[62] See the discussion in Section 1.iv.c.(6).

national borders, there are clearly difficult challenges facing those who must make effective and efficient use of available resources. Through our consultations, we have identified four systemic challenges that impede the investigation of securities matters: resources, police capacity to investigate capital markets offences, co-ordination, and strategic focus. We will discuss those challenges, and then examine the extent to which they have been addressed in the federal initiative to establish Integrated Market Enforcement Teams (IMETs).

ii. Challenge #1: Resources

We have been told that, in some provinces, municipal and provincial police do not have the capacity to play a role in the investigation of securities offences. Increasingly, their priorities have become crimes of violence, public order, safety and security. Their recruitment and training is focused on these priorities. They are already stretched to the limit in dealing with domestic violence and sexual assaults, robberies, thefts, and the often fatal effects of gangs and guns in communities. They must as well investigate commercial crime. Generally they do not have the resources to undertake long and complex investigations requiring special knowledge of securities transactions and forensic accounting. We are not aware of any studies that assess the need for police resources to investigate criminal offences relating to capital markets or that assess the respective contributions that should be made to those resources by municipal, provincial and federal police services.

We were told that the Commercial Crime Branch of the RCMP has approximately 475 officers working in more than 30 units across the country. Concerns about the capacity of police forces to investigate capital markets crimes led to the establishment of IMETs.

The enforcement capacity of securities regulators and SROs is, of necessity, directed at monitoring compliance, investigating failures to comply with securities laws, and taking enforcement actions to protect investors and prosecute offenders. Some regulators have been enhancing their enforcement capability.[63] We understand that the adequacy of resources for investigation varies from one jurisdiction to another.[64] Some regulators apparently do not have access to adequate resources for investigation. Other regulators indicate that they have sufficient resources. Nonetheless, there is concern that even these regulators need staff with more experience, maturity and stature to focus, guide, and assist the course of

[63] See the discussion in Section 1.v.g.
[64] Crawford Panel, Discussion Paper: A Blueprint for a New Model, *supra* n.7, Background Paper A, at p.3.

investigations, to mentor inexperienced staff, and to provide greater accountability with regard to investigations.

Recommendation 2.01: A study should be undertaken to assess the resources needed by police services for the investigation of capital market crime in various jurisdictions, and to inquire into the appropriate contributions that should be made by municipal, provincial and federal police services.

Recommendation 2.02: A study should be undertaken to assess the investigative resources needed by securities regulatory authorities in various jurisdictions, and the capacity to provide those services effectively.

iii. Challenge #2: Police Capacity to Investigate Capital Markets Offences and the Problems of Diversion and Promotion

We were told that one of the difficulties facing police in the investigation of securities cases is lack of training and experience. Apparently, as the priorities of police forces have narrowed, the skill levels of officers have become more homogenous. The situation is exacerbated by the fact that policing in specialized fields requires increasingly sophisticated skills. We were told that there is a general lack of interest in pursuing careers in the investigation of commercial crime. Commercial crime cases, in comparison with crimes of violence, are not regarded as career builders. Investigations are lengthy and complex; offences are difficult to prove; results are uncertain; and the penalties for "white collar" crime have often been frustratingly inadequate.

We were told that it can take two years to prepare an officer to conduct investigations in securities matters, and that it may take another two years to complete an investigation. In these circumstances, two problems arise in the deployment of police resources. The first is diversion. During a lengthy investigation, an officer may be diverted to perform other functions which are temporarily assigned a higher priority. For RCMP officers, a secondment could include providing security for a visiting head of state. For other police officers, it might be reassignment to uniformed patrol in order to meet targets for numbers of officers on the street.[65] In the meantime, the officer's lengthy investigation into a commercial crime is delayed for indefinite periods.

[65] See, for example, Hayley Mick, "Plainclothes officers ordered into uniform, but say it's a PR sham", *The Globe and Mail*, May 31, 2006, p.1.

In addition to the problem of diversion, there is the challenge of promotion. Police forces are paramilitary organizations, with hierarchical command. Officers have an understandable interest in improving their rank and level of service to their community and country. To be promoted, an officer generally must move to a new position, often in a different field. The time it takes to demonstrate qualification for promotion is about the same length of time it takes to learn how to conduct an investigation in a securities matter. Accordingly, many officers complete the long learning curve just in time for a promotion that takes them out of the field. This phenomenon undermines and perhaps prohibits the development of an experienced cadré of officers in this highly specialized area of policing. It also inevitably creates delays as new investigators familiarize themselves with the case. We were told that what is needed to encourage the development of expert knowledge is a commitment that officers can build their career, and earn promotion, without moving out of such a specialized unit. We note that efforts were made to address this challenge when the federal government established the Integrated Market Enforcement Teams within the RCMP.[66]

iv. Challenge #3: Co-ordination with Other Investigative Units

While municipal and provincial police in most jurisdictions do not play a significant role in the investigation of complex securities matters, their commercial fraud, anti-rackets and organized crime units do have a role to play in investigating various commercial crimes. Moreover, they have access to relevant intelligence, and they may need to be aware of operations in securities investigations that may affect their areas of responsibility.

Thus, for example, we understand that the Commercial Fraud unit of the Toronto Police has had experience with capital markets investigations. They also receive from time to time intelligence that is pertinent to capital markets operations. They used to be involved in a Securities Enforcement Review Committee ("SERC"), which provided a focus for co-ordination among Crown Attorneys, RCMP, OPP, Toronto Police, the Canada Revenue Agency, the OSC, and SROs. They shared information, discussed methods of investigation, consulted on common problems and co-operated on investigations. For some time, it worked effectively, but over time it lost its focus and was no longer perceived as useful by any of the participants. A smaller group, the Joint Intelligence Unit, was formed, and appears to have worked quite effectively, with the exception that some former participants have been left outside the loop. They consider that this detracts from their ability to contribute and to obtain useful information.

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[66] See the discussion in Section 2.vi.c.(2).

The effectiveness of co-operation among investigative units within provincial and territorial jurisdictions varies from one jurisdiction to another. In order to make the best use of limited resources, every effort should be made to establish effective and appropriate means of communication among investigators. This will require mutual confidentiality agreements that are satisfactory to all concerned, and respect for constitutional limits on the sharing of specific information.[67] For all forces there should be assistance provided to and co-operation with other investigating forces. The need for co-operation which arises as a result of the establishment of IMETS will be discussed later.[68]

v. Challenge #4: Strategic Focus and Judgment

It is clear from our consultations that a major problem in police investigation of securities matters is the problem of focusing and, where necessary, curtailing, limiting or even terminating an investigation. Police are trained to conduct a thorough investigation by following all the leads. In securities matters, particularly when conspiracies are pursued, following all the leads may produce a web of ever increasing complexity with a concomitant increase in the perceived difficulty of bringing the investigation to a close. There was before, and with the establishment of IMETs there continues to be, [69] a real and pressing need to be able to focus investigations.

vi. Problems Facing the Integrated Marked Enforcement Teams ("IMETs")

a) Establishment of IMETs

In 2003 the federal government announced the establishment, within the RCMP, of the Integrated Market Enforcement Teams ("IMETs"), and the commitment of $120 million over five years to fund their operations. The mandate of IMETs is to "strengthen the law enforcement community's ability to detect, investigate and deter capital markets fraud by focusing resources on the investigation and prosecution of the most serious corporate frauds and market illegalities."[70] The federal government's objective in establishing IMETs was to "[send] the message that those who commit serious capital markets fraud

[67] See the discussion in Sections 2.vi.c.(4). and 2.viii.
[68] See the discussion in Section 2.vi.c.(4).
[69] See the discussion in Section 2.vi.c.(6).
[70] Justice Canada, Backgrounder, *loc. cit*., n.57, p.2.

offences will be brought to justice in an effective and timely fashion … [to] promote compliance with the law in the corporate community, and assure investors that Canada's markets are safe and secure."[71]

The IMETs are accountable within the RCMP structure and as well are required to make quarterly reports to an Executive Council comprised of Associate Deputy Ministers in the Departments of Finance, Justice, Public Security, and Solicitor General. We were told that, in the consultations that preceded the initiative, concerns were expressed as to whether the RCMP was the right organization to take on this responsibility and whether it could address some of the systemic challenges in policing that we have noted.

b) Operation

Building on the experience of the Joint Intelligence Unit in Toronto, the IMETs were "integrated" in the sense that they are composed of individuals who come from the RCMP, securities investigators working on criminal cases, the Canada Revenue Agency, SROs and the Department of Justice. They are also integrated in the sense that they are composed of police officers, forensic accountants, individuals experienced in securities investigations and information technologists. Nine teams have been established: three teams in Toronto, and two teams in each of Montreal, Calgary and Vancouver. There is also an office in Ottawa, and a capability to establish "quick-start" offices in other locations.[72]

In each locale, there is a forensic accountant plus *ad hoc* teams of up to ten accountants working on specific cases. The *ad hoc* staff members are retained in accordance with government procurement rules, which take into account experience, ability and cost. In addition, in each locale there is a market expert from the securities regulator, and a case management specialist. There are also thirty interns working with IMETs. They are recent graduates who have relevant educational backgrounds but are inexperienced in investigation. It is expected that these interns will develop a range of specified "competencies" during a three year training period.[73]

An important objective of IMETs was to assemble a team of investigators and experts who could "complete large and complex investigations … in a fraction of the time it would otherwise take."[74]

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[71] *Ibid*.
[72] Richard Vieira, "The RCMP Financial Crime Program" (2005), 67:2 (RCMP) *Gazette*, p.1 at p.2.
[73] Supt. John Sliter, "New HR process key to IMETs" (2005), 67:2 RCMP *Gazette* www.gazette.rcmp-grc.gc.ca. See also Sliter, Vouchard and Bellemare, "The Canadian Response to the Sarbanes-Oxley Act: Managing Police Resources: A Competency-Based Approach to Staffing (2005), 12 *J. of Financial Crime* 327-333.
[74] Evidence of Chief Superintendent Peter M. German, Director General, Financial Crime, RCMP, Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, May 18, 2005, at p.2.

Expectations were raised that investigations that previously would have taken several years might now be completed in one.[75] This optimism was not well founded. IMETs has grappled with a number of challenges.

c) Challenges

(1) **Establishing Infrastructure and Facilities:** It has understandably taken time for IMETs to develop its infrastructure. New and secure premises and systems were established in Montreal, Toronto, Calgary and Vancouver.

(2) **Staffing:** It also took time to staff the nine teams. IMETs needed to solve the twin problems of diversion and promotion.[76] Further, it had to "develop a strategy to attract and retain expertise."[77] One strategy for doing so was to staff the teams with RCMP officers and an equal number of civilians, who could not be seconded or promoted outside of the unit. With respect to the RCMP component, Commissioner Zaccardelli announced that IMET positions would be "staffed using a new, innovative process based on a competency model."[78] Superintendent Sliter has described the process in this manner:

> "A panel of experts, including RCMP members and external partners, developed competency profiles for the IMETs. The profiles were used to write work descriptions and establish selection criteria for staffing and promotion.
> …
> In addition, the RCMP implemented a staffing-to-level regime. As all investigative positions are at the sergeant or inspector level, successful candidates who are below the rank of sergeant were, depending on rank and service, promoted or paid at the sergeant level.
>
> This new staffing regime also permitted investigators to obtain promotions while remaining in an IMET, enabling continuity and retention of expertise while still facilitating promotions based on individual performance.
>
> **Understudy program**
> The understudy program was created in 2004 to provide a way for police officers who did not quite have all of the required competencies to enter into the IMET program to be further trained. They were assigned a coach and worked their way through all of the competencies on a learn-as-you-go approach.

[75] Janet McFarland, Paul Waldie, Karen Howlett, "Tensions build in market crime unit", *The Globe and Mail*, March 16, 2006.
[76] See the discussion in Section 2.iii.
[77] Supt. John Sliter, "New HR process key to IMETs" (2005), 67:2 RCMP *Gazette* www.gazette.rcmp-grc.gc.ca.
[78] *Ibid.*

Internship program
…the program recently created 30 investigative analysts positions. Analysts will provide operational support to the IMET investigators in a civilian member capacity. Similar to police officers in the understudy program, investigative analysts will be assigned a coach and will work their way through a number of functional competencies.

The IMET program has enjoyed some great success in its efforts to attract and retain the best of the most qualified. The RCMP is now poised to create entry-level positions that will allow it to in effect grow its own IMET experts."[79]

Nonetheless there has been a considerable turnover among the RCMP officers assigned to IMETs.[80] Some have retired. Despite the commitment that IMETs would constitute a separate career path, some IMETs officers have been seconded or promoted to other duties in the RCMP.

Moreover, turnover is not limited to IMETs. Since 2003 when IMETs was established, every rank between the Director of IMETs and the Commissioner of the RCMP has changed. There is thus a continuing need to educate new senior management as to the special role and needs of IMETs, and to secure its staff and resources. We heard from several sources who believe that the command and control of IMETs within the hierarchy of the RCMP poses problems for its effectiveness. The situation could not have been assisted by the fact that the Director was required to be away for six months of language training during what appears to have been a critical formative period.

<u>Recommendation 2.03</u>: : If IMETs is to succeed, there must be a renewed and continuing commitment to developing and retaining the expertise required to lead and conduct complex investigations of capital markets offences by
(a) identifying and reviewing the competencies that are required;
(b) recruiting officers and other staff with specialized backgrounds;
(c) providing professional development and mentoring programs;
(d) establishing and complying with policies that restrict secondments of these officers to other duties; and
(e) establishing and complying with promotion policies that enable investigators to establish long-term careers in the investigation of capital market crimes.

[79] *Ibid.*
[80] McFarland *et al, loc cit*. n.76.

(3) **The Limited Mandate of IMETs and the need to address the remainder of the challenge in investigating securities offences:** The establishment of IMETs raised expectations that exceeded its mandate. IMETs was intended to address only one aspect of the challenge with respect to the investigation of securities offences, namely, the need to prosecute high profile cases involving highly capitalized corporations.[81] Moreover, with eight cases on its plate, IMETs is now "full". It turned down the investigation of a ninth high profile case, and instead referred it to the Commercial Crime Branch of the RCMP. It may be noted that, to the extent that officers from Commercial Crime have been promoted into IMETs, the ability of Commercial Crime to undertake such investigations must also have been affected.

We were told of at least one instance in which private investigators handed over to IMETs the results of an extensive forensic investigation, but apparently nothing was done with it. This highlights a problem. Effective compliance, deterrence and enforcement cannot be achieved if investigation is limited to a small number of cases. The establishment of IMETs may provide a solution for the tip of the pyramid of securities crimes cases, but it remains important to build a capacity within the system for the investigation of all serious securities offences. Either the mandate of IMETs must be expanded, or steps must be taken to enhance the capacity of the Commercial Crime branch of the RCMP and other police forces to investigate alleged crimes that are not within the IMETs' mandate. As we have noted,[82] the strong existing perception that there is a need for enhanced investigative resources needs to be studied and addressed.

There may also be difficulty in matching IMETs' mandate with priority needs. We were told that in Calgary and Vancouver the mandate to investigate high profile offences does not fit well with the local and regional needs for criminal investigations relating to securities. In other words, it is thought that the case selection criteria for IMETs are "too rarefied" and that, as a result, IMETs has had little impact. In one of these provinces there is a sense that IMETs is marking time with the result that the types of illegal distributions and other fraud cases that need to be dealt with in that jurisdiction are not pursued by any police force. In response to the concern, the reporting requirement for each IMET was shifted to provincial RCMP offices rather than the RCMP national office,[83] but the concerns persist.

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[81] Evidence of Chief Superintendent Peter M. German, Director General, Financial Crime, RCMP, Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, May 18, 2005, at p.7.
[82] See Recommendations 2.01 and 2.02 in Section 2.ii.
[83] McFarland *et al, loc. cit*. n.75.

Recommendation 2.04: Either the capacity of IMETs should be expanded to conduct all the necessary criminal investigations relating to capital markets, or the capacity of other police agencies should be enhanced in order to address the kinds of cases that IMETs is not authorized or able to undertake.

Recommendation 2.05: The role of IMETs in each locale should be defined in accordance with the investigation needs in that locale, but without diluting the overall mandate and accountability of IMETs.

(4) **Co-operation with Other Investigation Agencies:** There is a need for enhanced co-operation and co-ordination among the various agencies involved in the investigation of capital markets offences. Unfortunately, it does not appear that IMETs has provided a means of addressing that need. The working relationships established by IMETs with securities regulators and other organizations vary from city to city. Some organizations that have contributed personnel to IMETs indicate that the co-operation is a one-way street and that they do not receive information that is of assistance in their work. Some police forces would welcome better communications and co-operation with IMETs.

It appears to us that, if IMETs can handle only a few of the high-profile cases that need to be pursued, then it is particularly important to ensure that other forces and investigating agencies are included in the strategic planning that must be undertaken in order to achieve effective resource allocation. In order to do this effectively, there must be an appropriate sharing of information among them. Superintendent Sliter, Director of IMETs, has reported that "[t]he vision was that these highly skilled teams would enhance the efforts of other RCMP units to detect and prevent corporate and capital markets crime."[84] By co-ordinating and sharing information, not only with other RCMP units, but also with other forces and agencies engaged in the investigation of offences, the desired mutual enhancement could be achieved.

Recommendation 2.06: To make the best use of limited investigative resources within each jurisdiction, it will be necessary to establish processes for consultation, co-operation and co-ordination among all levels of police forces and the enforcement staff of securities regulators.

[84] Supt. John Sliter, *loc. cit.*, n.77.

(5) **Recognizing the Priority of Early Intervention to Protect Investors:** Co-operation between an IMET and a securities regulator may be hampered in cases where they have different goals. In some cases, the goal of the securities regulator will be to move quickly to put a wrongdoer out of action, limit the losses and freeze the assets for the benefit of victims. The goal of the IMET is to investigate fraud with a view to preparing a case for prosecution. There may be tension between an IMET's goal of preserving evidence for prosecution and the commission's need to immediately disclose the evidence in order to obtain an interim remedy.

Recommendation 2.07: IMETs and other police forces should recognize the prime responsibility of securities regulators to intervene early in a securities matter to preserve assets, protect investors, and, if possible, protect the long-term viability of the corporation. They should co-operate in obtaining and sharing evidence and information both to support that responsibility, and, as appropriate, to investigate suspected crimes with a view to prosecuting those responsible.

(6) **Ensuring that Investigations are Focused - the Role of a Senior Independent Review Officer:** The length of time that is being expended on IMETs investigations raises the concern that IMETs may not have succeeded in bringing to its investigations the sharp focus needed in order to expedite results. Police investigations are managed by individuals, and thus the management is only as good as the supervisor. In complex forensic accounting cases, management and focus are essential to an effective investigation.

Norman Inkster is a former RCMP Commissioner, and the managing director of a firm providing investigative services to corporate clients in capital market cases. He observed that the practice of reporting to a client, with a cost-benefit analysis, before obtaining an authorization to proceed with the investigation, serves to focus the investigation and assists in achieving results. We understand that IMETs is generally accountable within the RCMP and to an Executive Council of Associate Deputy Ministers, and that it must work within budgets and is expected to produce results. Yet it is unclear whether there is sufficient operational accountability within individual investigations.

We were told that, in order to focus the investigative process, it is necessary to have the leadership of a good strategist, with the seniority, status and confidence to make judgments and

the ability to manage resources effectively. If there is sufficient evidence gathered which will prove serious offences in relation to two-thirds of the proceeds of the crime, there may be little point in delaying charges and investing more resources to build the case in relation to the remaining third. If a case becomes mired in an ever more complex investigation, it may become justice delayed and thus denied.

We understand that, in the United States, prosecuting lawyers often lead the investigation, but in our view this is not an appropriate solution for Canada. In the first place, some lawyers may have as much difficulty as investigators in exercising the discipline necessary in order to focus an investigation. They too may want to leave no stone unturned. More importantly, there is a well-established Anglo-Canadian policy against prosecutors directing the investigation of the cases they will prosecute.[85] The independence of prosecution services, both from police and from government, is considered to be an important protection against unfairness in our justice system. The prosecutor's role is not to secure conviction but to see that justice is done in the course of a fair process.[86] A prosecutor who has directed the investigation is more likely to take on an overtly adversarial role. A prosecutor's commitment to the investigation could compromise his or her independent judgment, thus undermining an important protection against the possibility of wrongful conviction.[87] We conclude that it would be inappropriate in our system of justice to put prosecutors in charge of investigations.

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[85] See W.H. Callaghan, Q.C., Deputy Attorney General of Ontario, Address on "Role of the Crown Attorney in the Administration of Justice", August 28, 1972 (Osgoode Law Library, York University); Brian A. Grosman, *The Prosecutor: An Inquiry Into the Exercise of Discretion* (University of Toronto Press,1969); Justice Canada, "Principles Governing Crown Counsel's Conduct", Part III of *The Federal Prosecution Service Deskbook*, (2006) http://canada.justice.gc.ca/en/dept/pub/fps/fpd/ch08.html; "Memorandum of Understanding between the Royal Canadian Mounted Police and the Federal Prosecution Service" http://canada.justice.gc.ca/en/dept/pub/fps/fpd/mou.html>; J. LL. J. Edwards, *The Law Officers of the Crown* (Sweet & Maxwell 1964), *The Attorney-General, Politics and the Public Interest* (Sweet & Maxwell 1984); Philip C. Stenning, *Appearing for the Crown* (Brown Legal Publications, 1986); Joseph A. Ghiz, Q.C., and Bruce P. Archibold, *Independence, Accountability and Management in the Nova Scotia Public Prosecution Service* (Minister of Justice for the Province of Nova Scotia, 1994,Osgoode Library, York University); Graham Mansfield and Jill Peay, *The Director of Public Prosecutions* (Tavistock Publications, 1987); J.E. Hall Williams (ed.) *The Role of the Prosecutor* (Avebury, 1988); Julia Fionda, *Public Prosecutors and Discretion* (Clarendon Press, 1995), at p. 57; *The Review of the Crown Prosecution Service*, Rt. Hon. Sir Iain Glidewell, Chairman, (The Stationery Office Limited (UK), 1998); Sir Theobald Mathew, *The Office and Duties of the Director of Public Prosecutions* (Athlone Press, 1950).

[86] As to the role of the prosecutor, see *Boucher v. The Queen*, [1955] S.C.R 16; *R. v. R.(A.J.)* (1994), 94 C.C.C. (3d) 168 (Ont. C.A.).

[87] Reference is made to the reports of inquiries into wrongful convictions, including Thomas Sophonow Inquiry Report (The Hon. Peter Cory) 2001 www.gov.mb.ca/justice/sophonow; Report of the Kaufman Commission on Proceedings Involving Guy Paul Morin 1996 www.attorneygeneral.jus.gov.on.ca/english/about/pubs/morin; Report of the Royal Commission to Review the Case of Donald Marshall (The Hon. A. Hickman, Chair) 1986.

Nonetheless, it is important that there be someone who provides a directing mind to supervise complex investigations. The lack of disciplined supervision and accountability has been identified by some as one of the key reasons why some high profile securities cases have not been brought to prosecution in Canada. Moreover, there are widely-held concerns that some investigations and prosecutions that have been undertaken have been unjustified. They resulted in unfair damage to individuals' careers and should not have been pursued.

In our view, what is needed, in each locale in which IMETs operates, and in each securities regulator, is a senior responsible individual who has acquired the requisite experience, wisdom, judgment and supervisory/management skills to serve as the locus of accountability for investigations. That person might be drawn from the ranks of distinguished, senior and qualified people who have taken retirement either as senior counsel in private practice, or as skilled and experienced prosecutors. For ease of reference, we designate the suggested position as the "Senior Independent Review Officer" ("SIRO").

The importance of a SIRO should be recognized by the prestige and status attaching to the office. A SIRO will not be a member of prosecuting teams for that might irreparably taint the prosecution itself. Rather, the SIRO must be regarded as an integral part of the investigation process. He or she must have the ultimate authority to limit or curtail or to eventually terminate the investigation, or to refer the matter to the appropriate prosecution service. This role will be demanding, sensitive and extremely important.

Recommendation 2.08:

(a) What is needed, in each IMETs locale and each securities regulator, is a special kind of experienced lawyer, whom we refer to as a "Senior Independent Review Officer" ("SIRO") to provide focus, supervision and a locus of accountability for strategic decisions in an investigation.

(b) A SIRO must have the ultimate authority to limit or curtail or to eventually terminate the investigation, or to refer the matter to the appropriate prosecution service.

(c) A SIRO must have skills in supervision and management, and knowledge (or the ability to acquire it expeditiously) in the specialized field of capital markets.

(d) A SIRO should have a status equal or similar to that of a Securities Commissioner.

(e) Qualified persons might be found among the senior ranks of counsel in private practice or the prosecution service, or among individuals recently retired from those positions who remain at the peak of performance.

(7) **Legal Advice in the Course of the Investigation:** It is important, during the course of a complex investigation to have access to legal advice on issues that arise in the course of an investigation. In our view, for the reasons noted above,[88] these advisers should not serve as prosecutors at trial. It was envisaged that the federal Department of Justice, a partner in IMETs, would provide advisers to work as members of the integrated teams, and funding had been allocated for that purpose. It appears that there were difficulties in securing their participation.[89] It is important that any such difficulties in access to and co-ordination of legal advice be resolved and that the requisite legal advice be given to the investigators. This advice will often be required with regard to the proper means of obtaining and gathering admissible evidence.

Recommendation 2.09: Investigators require and should have access to effective legal advice in the course of an investigation. However, it must be provided by individuals who will not be involved in the prosecution of the case.

(8) **Demonstrating Effectiveness:** The greatest challenge for IMETs, as presently structured, is to demonstrate its effectiveness. There is a need, not only for focus, but for results. Investigation is the foundation, but by itself it cannot meet the goals of enforcement. Without the prosecution of offences, and at least the potential for conviction, there is no deterrence. The nine teams have been working on eight major cases. So far, no charges have been laid in any of them.[90] Media reports and editorials are increasingly critical of the pace and quality of IMETs'

[88] See discussion in Section 2.vi.c.(6).
[89] See Dean Beeby, "Justice Department undermining fraud squads: docs", The Canadian Press, 2006. www.cp.org/premium/Online/Member/National/060319/n031911A.html, citing RCMP documents obtained under the *Access to Information Act*. The article reports that the Department of Justice was funded to provide legal advisers to IMETs; that the RCMP complained to the Department that the assistance was not being provided; and that the Department's lack of participation may have been motivated by concern regarding matters of federal/provincial jurisdiction or concern regarding the propriety of Justice lawyers participating in the management of investigations.
[90] It has been reported that IMETs has laid charges in two lesser cases (one involving theft of stock certificates from a client's account). See McFarland *et al, loc cit*., n.75.

work product.[91] Comparisons with the pace of prosecutions in the United States, and the recent completion of the Enron trial, have led to increasingly negative comments.

Several of those with whom we spoke rejected the pessimistic view of IMETs' performance to date, and cautioned that it is simply premature to evaluate its effectiveness. They observed that the start-up of the agency understandably took considerable time; that investigations are progressing; that the investigations are complex and time consuming; that some of them involve cross-border investigations which are subject to the timelines in place in the foreign jurisdiction; and that it is very likely that charges will be laid in some cases in the months ahead. We accept that IMETs has made a conscientious effort to set up educated and skilled investigative teams and to address structural issues that have hampered the investigation of serious capital markets offences. Moreover, we share the view of those who consider that it may be too early to draw conclusions as to the effectiveness of IMETs' ongoing investigations. However, media commentary and the concerns expressed to us by many of those with whom we consulted make it clear that the credibility of IMETs, for which there were such high expectations, is now at serious risk.

Recommendation 2.10: Every effort should be made to enable IMETs to complete current investigations expeditiously and in a focused manner.

(9) **Structuring IMETs to Take Account of Provincial Interest in the Regulation of Capital Markets:** There is a widely held perception that IMETs will never become a truly effective means of addressing the enforcement challenges in capital markets cases as long as securities regulation is within provincial jurisdiction. Critics express a concern that IMETs' accountability within the hierarchical structure of the RCMP and to federal Ministers undermines its effectiveness.

[91] An editorial in *The Globe and Mail* on May 22, 2006, p. A12, referred to (1) Justice Nordheimer's critical assessment of the IMET's investigative work as inadequate to support a search warrant that had been issued against Ontario Finance Minister Gregory Sorbara; (2) the fact that, after three years of operation, no charges have been laid in IMETs investigations into prominent cases; (3) staff departures; (4) lack of co-ordination between the Justice Department and the RCMP; and (5) tension between IMETs and some securities regulators. The editorial concludes that "If IMET can't live up to its promise, it should be fixed or replaced. It's a sad fact that criminals appear to have nothing to fear from Canada's big crackdown on securities crime." See, also the editorial in the *Toronto Star* on May 22, 2006, which concludes that "After almost three years, the [IMET] probe into Royal Group appears mired. But, as Sorbara's case shows, people's lives, jobs and reputations are at stake. No one disputes that complex investigations can take time. But in this case, the RCMP should either lay charges or declare the case closed."

In our view, it is important to revisit the structure of IMETs. Currently, IMETs reports quarterly to an Executive Council of Associate Deputy Ministers from various federal departments. Although the Ministries concerned have a strong interest in the efficiency of capital markets, they do not have the specialized knowledge that accompanies responsibility for the regulation of those markets. We understand that the Executive Council has met only once with the CSA. As long as the provinces retain jurisdiction over securities regulation, we consider it essential to establish a national enforcement body which reflects the federal and the provincial interest in the regulation of capital markets and the enforcement of that regulation.

Recommendation 2.11: There must be an accountability structure set up for IMETs, which recognizes the need for a national enforcement strategy and takes into account the strategic importance of investigation to the effectiveness of securities regulation in the provinces.

vii. Investigation and the Role of Securities Regulators

The securities regulators are responsible for conducting their own investigations to monitor compliance with statutory requirements and inquire into alleged offences under provincial securities legislation. We were told that the enforcement departments in some securities regulators have grown substantially in recent years.[92] Surveillance groups have intelligence units, access to databases and extensive contacts with industry. Investigations are managed in teams which have access to legal advice. The teams report as the investigations proceed. We were advised that, in the OSC and the ASC, briefings are provided to the Enforcement Director and to the Chair of the Commission, who oversees the enforcement process and plays no role in the Commission's adjudicative processes.

Although securities regulators publish data on their complaints processes,[93] the data disclosed does not include information on the number or nature of investigations undertaken, the criteria applied in determining what matters should be investigated, or the outcomes of matters identified for investigation. We understand that some regulators undertake a risk analysis in determining which matters to investigate.

[92] See the discussion in Section 1.v.g).

[93] For example, the OSC publishes data on the number of complaints it receives and resolves. The data indicates that, in the year ending March 31, 2006, the number of complaints received almost doubled over the preceding year (from 679 in 2004-05 to 1220 in 2005-06). In the same period, the number of complaint files that were closed rose from 672 to 1257. The number of complaint files open at the end of 2004-05 was 75, and the number open at the end of 2005-06 was 38. Data provided for the fourth quarter of 2005-06 indicate that the most common complaints (representing 76% of the total complaints) were related to administrative proceedings, hearings or investigations (64), customer service issues (42), reporting issuer matters (42), scams and fraudulent activities (36) and insider trading (36).

This includes taking into account the time required to investigate and prosecute the case. The published data, while interesting, do not provide a basis for evaluating the effectiveness or timeliness of investigations, the significance of the matters investigated, or the impact of regulatory enforcement.

The data provided by individual regulators should be viewed in the context of enforcement information provided for all regulators by the CSA, but it is difficult to match and interpret results. As we have observed, the enforcement information that is reported by securities regulators does not provide a basis for qualitative assessment or real accountability regarding the effectiveness of enforcement processes.[94]

See Recommendation 1.01.

viii. Problems with Sharing Information

We have been told repeatedly that information-sharing and co-operation between securities regulators and police is impeded by concerns about investigation processes, confidentiality[95] and the protection of constitutional rights. In particular, police are concerned that information obtained through regulatory processes will not be admissible in criminal proceedings and will "taint" their investigation. The problem is one that arises in many regulatory contexts and has recently been analyzed in two useful papers.[96] We recognize that this issue poses some challenges, but we are of the view that it should be possible to develop protocols that would limit evidentiary risks and facilitate co-operation.

There is and must always be an important distinction between (1) what is done in connection with licensing and the regulating of a licensee within a statutory framework and (2) the investigation and prosecution of criminal offences.[97] There can be no doubt that, if a person or corporate entity seeks to enter a regulated field, there must be an investigation to determine whether the applicant meets the

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[94] See the discussion in Section 1.iv.a).

[95] See, for example, the *Securities Act*, RSO 1990, s. S- 5, as amended, s. 16, which prohibits disclosure of information relating to investigations, and the effect of which is discussed in the Five Year Review Committee Final Report, *supra* n.5, at section 24.1, p.240. The Committee has recommended that the OSC "issue a policy statement providing interpretive guidance on the scope of the confidentiality provision in section 16 of the Act and clarifying the process for making an application for disclosure under section 17 of the Act, including the issue of standing to bring such an application."

[96] For detailed analysis of the relevant case law, see the following excellent papers presented at the Ontario Bar Association's CLE program on The Constitution in Regulatory Investigations and Proceedings, May 5, 2006: Michel Y. Hélie, "*Charter* Legal Rights and Regulatory Compliance / Prosecution"; David W. Stratas, "Sharing Documents and Information: Inter-jurisdictional Aspects and Constitutional Law".

[97] See *R. v. Wholesale Travel Inc.*, [1991] 3 S.C.R. 154, per Cory J. at pp.216-222, observing that "A *Charter* right may have different scope and implications in a regulatory context than in a truly criminal one."

requirements to do so. Moreover, applicants must continue to demonstrate that they remain qualified to operate in the area and have complied with all regulations. In these circumstances, the rights of the regulator to inspect and to require information are wide. Those seeking to operate within a regulated field must accept corresponding limits on their right to privacy and comply with the proper regulatory requirements for inspection and disclosure.[98]

It is of course very different in the investigation of a criminal offence. So soon as the regulator forms an intention to prosecute and to investigate for that purpose,[99] at that moment all *Charter* rights of the individual must be recognized and honoured. The evidence gathered thereafter must at all times comply with *Charter* standards.[100]

Nonetheless, it may well be that information that was gathered in the course of qualifying an applicant in the regulated field and in assuring that the applicant is complying with statutory requirements will become admissible in the prosecution of a criminal offence.[101]

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[98] *Hunter v. Southam*, [1984] 2 S.C.R. 145. at p.159; *Thomson Newspapers Ltd., v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission*, [1990] 1 S.C.R. 425, at p.643; *R. v. McKinlay Transport Ltd*., [1990] 1 S.C.R. 627 at p.643; *Comité paritaire de l'industrie de la chemise v. Potash*, [1994] 2 S.C.R. 406. See, also, *British Columbia Securities Commission v. Branch*, [1995] 2 S.C.R. 3, at para. 51-52.

[99] The key factors to determine are whether officials have formed the intent to prosecute and whether the predominant purpose of the inquiry has shifted from the verification of regulatory compliance to the determination of penal liability. *R. v. Jarvis*, [2002] 2 S.C.R. 757, at para. 88. See the discussion, at para. 94, of the factors to be considered in making this determination. See, also, *R. v. Ling*, [2002] 3 S.C.R. 814.

[100] Once the adversarial relationship has crystallized, constitutional protections apply, and regulatory powers generally cannot be used to compel statements or production of documents from the suspect for purposes of the prosecution: *R. v. Jarvis, supra* n. 99. Thus investigators must generally obtain prior judicial authorization for any search and seizure (*Charter*, s. 8). The authorization must be obtained from an independent judicial officer who can weigh the competing interests. Investigators must establish that they have reasonable grounds to believe that an offence has been committed and that the search will yield evidence of the offence under investigation. The warrant authorizes the seizure only of items relevant to the specified offence. *Hunter v. Southam*, *supra* n.98, at pp.160-68; *Thomson Newspapers Ltd. v. Canada*, *supra* n. 98, at p. 449.

In addition, individuals under investigation (but not corporations) have a right not to be compelled to answer questions or provide information (*Charter*, s.11(c), s. 7*): R. v. Hébert*, [1990] 2 S.C.R. 151; *R. v. Amway Corp.,* [1989] 1 S.C.R. 21, at 40; but note that the validity of statutory provisions authorizing interviews in aid of regulatory prosecutions has not been determined. See Hélie, *supra* n.96, at p. 31.

Evidence obtained in connection with the infringement of a guaranteed right may be excluded at trial if its admission would bring the administration of justice into disrepute. (*Charter*, s.24(2)).

[101] Records and other documents that were gathered by proper means prior to the crystallization of the intention to prosecute will generally be admissible in subsequent criminal proceedings: *R. v. Jarvis*, *supra* n.99, at para. 95; *British Columbia Securities Commission v. Branch*, *supra* n.99, at p. 42; *R. v. Fitzpatrick*, [1995] 4 S.C.R. 154. However, where testimony has been compelled in the process of a regulatory proceeding, s. 13 of the *Charter of Rights and Freedoms* will protect the witness from having the evidence used to incriminate him or her in a subsequent proceeding: *British Columbia Securities Commission v. Branch, supra* n.99. In addition to the subsequent use immunity, there is a derivative use immunity which excludes evidence that is discovered as a result of the testimony and which would not have been discovered but for the testimony.

The concerns about tainting of the evidence at a criminal or quasi criminal trial do require careful management and monitoring to identify the moment at which the intent to prosecute crystallizes. However, it should be possible to develop protocols for managing the process so as not to lose the overall benefits of appropriately sharing information and experience relating to the investigation of securities offences.

> **Recommendation 2.12: In light of the concerns expressed about constitutional hurdles to the sharing of information by regulatory investigators and police investigators, protocols must be developed to guide those who must determine and substantiate the point at which a regulatory inspection crystallizes into an investigation for the purpose of criminal or quasi-criminal prosecution, and specifying the investigatory techniques that can be employed at various stages of inspection and investigation.**

ix. Is There a Need for a Grand Jury Process to Facilitate Investigation in Canada?

It is widely perceived that some state Attorneys General in the United States are much more aggressive in launching criminal investigations and prosecutions in securities matters than is the case in Canada. Certainly they disclose their intentions earlier in the process. The administration of justice works differently in Canada. For example, we do not have a grand jury process, which, in the United States, enables prosecutors to compel and introduce sufficient evidence to obtain an indictment and then continue to investigate and prepare the case. In England, and in Canada, the role of the grand jury, which was initially charged with investigating, prosecuting and deciding criminal cases, was transformed into a body that tested the sufficiency of the evidence on which the accused was indicted for trial. The role of the grand jury in investigation fell into disuse as police forces were established to investigate crime and public prosecutors were appointed with the responsibility of determining whether there is a sufficient basis to justify prosecution. Even the role of the grand jury in issuing indictments was rendered redundant by the availability of preliminary inquiries. The grand jury was abolished in England in 1933, and was formally abolished in Canada in 1985 on the basis that it merely duplicated other processes and resulted in additional cost and delay.[102]

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[102] See the *Royal Commission of Inquiry into Civil Rights (Ontario),* Hon. J.C. McRuer, Commissioner, vol 2, chapter 50, at p. 772.

Another relevant and significant difference between the Canadian and American systems of justice is the nature of the protection against self-incrimination. In the United States, an individual called to testify before a grand jury could invoke the protection of the Fifth Amendment and refuse to testify on the grounds that his or her evidence might be self-incriminatory. The Canadian protection against self-incrimination is different. A witness in court proceedings must answer all proper and relevant questions, thus providing the information that may be relevant to the resolution of the issues before the court. However, the witness is protected in that the answers he or she has given cannot be introduced in evidence in subsequent proceedings taken against the witness.[103]

Accordingly, there are different constitutional protections and different investigative procedures in Canada and the United States. Any suggestion that Canada should reinstate the grand jury process and develop it into an investigative process with the power to compel testimony as part of the investigative process would require careful and detailed assessment of its impact on the context of investigative processes and constitutional protections. We do not support the adoption, in Canada, of an American-style grand jury process.

In any event, the fact that there are different processes in Canada for the investigation of crime (as there rightly must be) should not, in our view, preclude effective and expeditious investigation, prosecution and enforcement. It is essential to the efficiency of Canadian markets and the success of the Canadian economy that the capacity of Canadian processes for the enforcement of securities laws be enhanced to meet international standards. This must include the ability to investigate and prosecute difficult and complex cases as effectively as they are investigated and prosecuted elsewhere and in accordance with our constitutional and other values.

> **<u>Recommendation 2.13</u>: In light of different procedural traditions and constitutional protections in Canada and the United States, it would be inappropriate even to suggest that a grand jury process be introduced for the investigation of capital markets offences.**

[103] In other words, the witness receives "subsequent use immunity": *Canadian Charter of Rights and Freedoms*, s. 13; *Canada Evidence Act*, s. 5*; R. v. Dubois*, [1985] 2 SCR 350; *R. v. Mannion*, [1986] 2 SCR 272; *R. v. Kuldip*, [1990] 3 SCR 618; *R. v. Noël*, [202] 2 SCR 433. The witness is also protected by "derivative use immunity": any evidence that is discovered as a result of the witness' testimony, and would not have been discovered but for that evidence, cannot be introduced to incriminate the witness: *BC Securities Commission v. Branch*, [1995] 2 SCR 3.

3. Prosecution

Jurisdiction over the prosecution of capital markets offences is divided among regulatory, provincial and federal prosecution services. These overlapping responsibilities complicate the effective prosecution of securities offences. They may also raise the costs of enforcement, obscure accountability and dilute the expertise which is so essential to effective prosecution in this complex field.

i. Prosecution of Regulatory Matters

In each province, the securities regulator has jurisdiction to prosecute regulatory matters before the regulatory tribunal. We have already recommended that there should be a Senior Independent Review Officer ("SIRO") advising and supervising with respect to the investigation of securities matters.[104] The SIRO should also determine whether or not a matter should be sent forward for hearing by the securities tribunal. It is preferable that the SIRO, rather than the chair of the securities regulator, exercise this responsibility. Participation by the chair in both the investigation and prosecution can create a conflict of interest, precluding the chair from participating not only in the hearing of the matter but also in related policy development. The problem would be partially avoided by the establishment of an independent securities tribunal,[105] but the conflict of interest with respect to policy development would remain. In our view, as much as possible, the chair of the regulator should be available to participate in its deliberative processes. The SIRO could consult with the chair, but in that event, the chair should not and cannot take any part in related deliberations. In any event, even if the SIRO consults with the chair, it must be understood that the SIRO is to exercise independent judgment regarding decisions to prosecute.

> **Recommendation 3.01: The securities regulator's Senior Independent Review Officer, recommended in Recommendation 2.08, should also have independent authority to determine whether a matter should be sent forward for hearing by the securities tribunal.**

[104] See Recommendation 2.08 in Section 2.vi.c.(6).
[105] See Recommendation 4.01in Section 4.i.

We were told repeatedly that there is a need for securities regulators to determine priorities for enforcement and to identify the types of non-compliance issues that pose the greatest risks to the integrity of, and confidence in, the operation of capital markets. Too often, we were told, regulators conduct investigations where there is little at risk and apply a heavy hand when proceeding with lesser infractions, while more serious matters go unaddressed. We are not in a position to assess the information on which these opinions are based, but we note that they are held by well-informed and credible people. In assessing potential matters for investigation and prosecution, careful decisions will have to be made. They should be made with a view to achieving the important goal of ensuring that the effective operation of markets is not put at risk by those that breach securities laws and regulations.

Accordingly, we recommend that processes be instituted by regulators for identifying priorities in the investigation and prosecution of all matters, from fraud to the breach of Securities Act Regulations. These priorities should ensure that enforcement resources are being used effectively. The establishment of these priorities will assist in making the decisions to investigate and prosecute regulatory matters and offences.

> **<u>Recommendation 3.02</u>: Processes should be instituted for identifying priorities in investigation and prosecution of regulatory matters, and ensuring that enforcement processes are being used effectively in addressing those priorities.**

ii. Prosecution of Provincial Offences

In Ontario, Alberta and Quebec, enforcement counsel who are employed by the securities regulators generally conduct the prosecutions for provincial offences.[106] In Alberta, commission counsel are designated as *ad hoc* agents of the provincial crown for this purpose. In British Columbia, however, the *Crown Counsel Act*[107] requires that the Commission refer cases to the provincial prosecution service. We are advised that the approach adopted in British Columbia can result in delays and, in some cases, a decision not to proceed with a matter that the Commission considers should be prosecuted.

We are not aware of any difficulties arising from the arrangements in other provinces to delegate prosecution of provincial offences to enforcement counsel employed or retained by securities regulators. There is, of course, the concern that a prosecutor should be independent from the investigator. In our

[106] In some instances, enforcement counsel have prior experience as crown attorneys.
[107] RSBC1996, c.88, s.2. Note, however, the provision for appointment of special prosecutors: s. 7.

view, this concern can be appropriately addressed by the introduction of the Senior Independent Review Officer, who determines whether a matter should be sent forward for prosecution as a provincial offence. We further support a role for the provincial prosecution service in providing guidelines to assist in ensuring that lawyers who are authorized to conduct such prosecutions are thoroughly familiar with the principles that govern the role of a prosecutor.

> **<u>Recommendation 3.03</u>: The Senior Independent Review Officer of the securities regulator must have independent authority to determine whether a matter should be referred for prosecution as a provincial offence.**

> **<u>Recommendation 3.04</u>: Where the Senior Independent Review Officer has authorized prosecution of a provincial offence, it will then be appropriate to authorize counsel employed or retained by the securities regulator to prosecute it. The provincial prosecution service should provide guidelines to assist in ensuring that such counsel are thoroughly familiar with the principles that govern the role of a prosecutor.**

iii. Prosecution of Criminal Offences

The federal Parliament has jurisdiction over criminal law and procedure and thus over *Criminal Code* offences.[108] However, the provincial Attorneys General have jurisdiction over the administration of justice, including the prosecution of criminal offences.[109] The recent federal initiatives to strengthen enforcement in capital markets[110] assert a concurrent jurisdiction in the Attorney General of Canada to prosecute specified offences where the national interest in the integrity of capital markets is threatened.[111] The federal government announced its intention to "provid[e] additional resources to support prosecutions of capital market fraud offences under the Criminal Code" and to "work with the provinces to establish prosecution protocols that would ensure a coordinated and effective implementation of concurrent jurisdiction."[112] We were advised that the protocols establish that provinces have the choice of conducting the prosecution or referring it to federal authorities.

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[108] *Constitution Act, 1867*, s. 91(27).
[109] *Ibid.,* s. 92(14).
[110] See discussion in Section 1.v.h).
[111] Backgrounder, *loc. cit.*, n.57.
[112] *Ibid.,* at p.4.

IMETs is operated by the national police force and funded by the federal government with a mandate to investigate high-profile capital markets cases. It was therefore suggested to us that the federal authorities should take carriage of the prosecution of criminal offences. In particular, it was said, federal prosecution would be appropriate in those cases in which there are victims in more than one province.

We have been advised that at least some provincial prosecution services have the interest and resources to undertake prosecutions in complex securities matters through special prosecution units. For the most part, though, there is a concern that provincial crown attorneys share the understandable tendency of the police[113] to give priority to other types of crime, and particularly to crimes of violence. The prospect of prosecuting lengthy and complex capital markets cases, with their uncertain results, is generally less attractive to provincial crown prosecutors.

What appears to be needed is the development of a corps of prosecutors who specialize in capital markets cases, understand the operation of capital markets, and have the skills and experience to manage and prosecute complex cases. It would make sense to develop that expert corps under the authority of one entity, rather than dividing it among the attorneys general of the provinces, territories and federal government. Unless it is clear who is responsible for handling these cases, there is a danger that no one will develop the capability of doing so effectively. Both federal and provincial prosecution services would have, or could develop, the requisite skill, dedication and ability to prosecute complex capital markets cases. Yet it would be infinitely preferable that the responsibility be focused in one entity rather than divided among several.

In its submission to the Task Force, the IDA suggested that the responsibility for prosecuting criminal offences should be delegated to the securities regulators, who have the requisite expertise, experience, focus and interest.[114] Others suggested deputizing senior enforcement counsel working with securities regulators to conduct criminal prosecutions or retaining experienced outside counsel to lead prosecutions, using commission lawyers as juniors. These suggestions provide an *ad hoc* means of addressing some of the immediate needs in prosecution. However, in our view, every effort should be made to develop a nationally co-ordinated public prosecution service with the requisite resources, motivation and capability to prosecute capital markets cases effectively. The independence of the public prosecution service provides an important protection of the fairness and integrity in criminal prosecutions.

[113] See the discussion in Section 2.iii.
[114] Submission of the Investment Dealers' Association to the Task Force, at p. 5. www.tfmsl.ca.

<u>Recommendation 3.05</u>: Every effort should be made to develop a nationally co-ordinated program for the prosecution of capital markets cases, with a view to ensuring the development of a public prosecution service that has the experience, capability and commitment to meet the difficult challenge of prosecuting capital market offences.

iv. A Role for Legal Education

We have noted the tendency of those who are interested in careers in criminal law to focus on the prosecution and defence of crimes against the person. And yet, there is a great need for criminal lawyers who have specialist knowledge in the fields of corporate, commercial and securities law. The law schools should encourage students to consider this need when they plan their programs of study.

<u>Recommendation 3.06</u>: Law Schools should be encouraged to advise students who are interested in careers in criminal law to consider the need for prosecutors and defence lawyers who are knowledgeable in the field of corporate, commercial and securities law.

4. <u>Adjudication</u>

i. Adjudication and the Need for an Independent Tribunal

When Quebec established the Authorité des marchés financiers ("AMF") in 2005, it provided for a separate adjudicative tribunal to hear certain regulatory matters.[115] In other jurisdictions, however, adjudication is integrated with the other functions of the securities commissions (policy-making, rule-making, investigation, and prosecution). Reasonable and informed observers may reasonably conclude that the commission is biased if it adjudicates matters that have been investigated by commission staff, authorized for hearing by commission staff or in some jurisdictions by the chair of the commission, and prosecuted by counsel employed or retained by the commission.

The Ontario Securities Commission established a committee to consider and report on the alleged apprehension of bias. The Osborne Committee on Fairness[116] has thoroughly reviewed the matter and recommended that the adjudicative functions of the commission be transferred to an independent tribunal.

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[115] The tribunal, the "Bureau de décision et de révision en valeurs mobilières", has jurisdiction to review decisions of the AMF and of recognized SROs.

[116] Report of the Osborne Committee on Fairness, *supra*, n.6.

Others who have considered and reported on the matter support the establishment of independent tribunals.[117] Several of those with whom we consulted indicated that the need to ensure the independence and integrity of the adjudication process is a critical priority. In our view, the credibility of the process, and the principles of fairness, require that the adjudicative function be independent of the securities regulators.

Those who work within securities commissions may have confidence in their ability to curtail the flow of information within the organization and maintain the independence of the adjudicators, but that is not the relevant test. Rather the appropriate test is whether a reasonable and informed observer of the process would be confident of its fairness. In our view, the integration of adjudication with the other functions of securities regulators is inappropriate in that it gives rise to a reasonable apprehension of bias even when those within the commission exercise their best efforts to maintain separate spheres of activity and authority.

It is understandably difficult for commissioners to separate their adjudicative role from their commitment to the work of the commission. We were advised of instances in which members of a hearing panel have referred to the position of commission staff as being "our case", "our evidence", and "our position". We also note the apparent lack of neutrality between the interests of the commission and those of the respondent that was demonstrated in a hearing panel's approach to the awarding of costs against a respondent. Costs were awarded on the basis of a one page statement of total costs tendered by commission staff, with no opportunity for the respondent to examine or challenge the basis upon which it was calculated.[118] Instances such as these contribute to concerns about the independence and neutrality of the adjudicative process.

The attempt to ensure adjudicative independence by (1) protecting the flow of information, (2) involving only the chair of the commission in the review of investigation and (3) excluding the chair from adjudication, is a tacit recognition of the problems inherent in the current integrated structure. This approach does not, however, provide adequate protection for adjudicative independence. Moreover, it appears to create an artificial and potentially dysfunctional organizational structure.

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[117] See the Crawford Panel on a Single Canadian Securities Regulator, Final Report, *supra* n.7, at p.6. See, also, the recommendations of Stikeman Elliott LLP in its report to the Trinidad and Tobago Securities and Exchange Commission, chapter 3, executive summary available at www.ttsec.org.tt/research/index.php?pid_5003. In Hong Kong, there is a Market Misconduct Tribunal, separate from the regulator. See, *infra*, n.120.

[118] See *Donnini v. Ontario Securities Commission*, 2005 CanLII 1622 (ON C.A.), per MacPherson JA.,at paras. 77-87.

In our view, the independence of adjudication should be protected by the structure itself, and should not depend on the ability of commissioners and staff to keep their various functions separate and distinct. This is essential in light of the expansion in the powers and penalties available to regulators. The need for an independent adjudication process has become an urgent priority. The public, and those who are regulated, must be confident in the independence and fairness of the adjudication process.

In establishing an independent tribunal, it is important to retain the expert knowledge that securities commissions now bring to the task of adjudication. One interesting model is that which has been adopted in Hong Kong. There, the Market Misconduct Tribunal is composed of a judge or former judge, assisted by two market practitioners appointed for the particular hearing.[119] Such practitioners could be appointed from a roster of panel members. We further observe that the objectives of ensuring the independence, fairness and expert knowledge of hearing panels would be enhanced by establishing one national tribunal which could hold hearings, as needed, in different locations throughout the country.[120]

> **Recommendation 4.01: The adjudicative functions of securities commissions must be transferred to an independent tribunal or tribunals. Membership in the tribunal should be structured so as to ensure its expert knowledge of law, procedure and the operation of capital markets. A national tribunal should be established which could deploy hearing panels throughout the country as needed.**

ii. Adjudication and the Courts

Securities regulators often have a choice to prosecute a breach of the statute before the regulatory tribunal, or to prosecute provincial offences before the provincial court, or to refer a case for prosecution under the *Criminal Code*. No doubt the decision as to whether to prosecute an offence in court or proceed before the securities regulator will be based on a number of factors, the primary one being the gravity of

[119] The Market Misconduct Tribunal has jurisdiction to hear and determine market misconduct matters on a civil basis, with jurisdiction to impose disgorgement orders, disqualification orders, orders prohibiting participation in the market, and cease and desist orders. The Tribunal may also refer a person found to have engaged in market misconduct to a body with disciplinary jurisdiction. The Tribunal does not have authority to impose fines or imprisonment. The Securities and Futures Commission makes an initial decision whether to refer a matter to the Financial Secretary for possible referral to the Market Misconduct Tribunal or to the Secretary of Justice for possible referral for criminal prosecution. Both Secretaries have the power to redirect the matter to the other regime. Sources: Commentary to legislation 2002, ch.11, at www.sfc.hk/sfc/doc/EN/legislation/securities/others/condoc-e.pdf; Loh, Timothy, *Financial Intermediaries Guide to Securities and Futures Laws,* Legal and Professional Publications Ltd. 2003 ISBN 988-97153-1-7. Securities and Futures Ordinance, Hong Kong, ss. 251-61.

[120] See the discussion in Section 8. See the Final Report of the Crawford Panel on a Single Canadian Securities Regulator, *supra* n. 7, at p.27.

the offence. The more serious the offence and the greater the penalties sought, the more likely it will be that the proceeding should be before the court.

From an enforcement perspective, there are disadvantages to proceeding in court rather than before the regulator. Some of these disadvantages are inherent and serve other important interests. Thus, the prosecution must meet a higher standard of proof in the prosecution of an offence. As well, an accused charged with an offence is guaranteed constitutional protections which can result in the exclusion of evidence.[121]

There are other disadvantages to proceeding in court which do not serve other interests. These concerns can and must be addressed. First, there are serious concerns about the delays in getting to trial in some provincial courts. Much of the work of provincial courts does not involve lengthy proceedings. As a result, it is difficult to schedule and proceed with complex securities cases without there being significant interruptions. Second, the level of knowledge about securities matters and capital markets is much higher among securities regulators than it is among members of courts. Moreover, securities tribunals appreciate the serious impact of the failure to comply with securities laws. From several sources, we heard that the sentences imposed by courts often are inappropriate to the seriousness of the offence.

There is considerable concern about the capacity of provincial court judges to try complex capital market offences. Some have suggested that we need a new specialist court. We note, however, that the jurisdiction of the provincial courts now extends to increasingly complex cases. Most criminal offences, including the most serious, are tried in the provincial courts.[122] In fact, the exclusive criminal jurisdiction of superior courts is limited to a narrow range of cases.[123] Moreover, some apparently minor cases heard by provincial courts involve significant and complex *Charter* issues. Accordingly, the work of provincial courts has become increasingly challenging and the courts' capacities must expand to meet those challenges across the board.

We were told that, as the jurisdiction and the complement of judges on provincial courts increases, so too does the quality and diversity of expert knowledge of those appointed. Moreover, we were told that there

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[121] See the discussion in Section 2.viii.
[122] Statistics for 1985 establish that provincial courts dealt with 96% of *Criminal Code* offences in Ontario, 97% in Quebec and 99% in Saskatchewan: Law Reform Commission of Canada, *Towards a Unified Criminal Court* (Working Paper 59, 1989, at p. 7 (cited in Hogg, *Constitutional Law of Canada*, Carswell 2005 looseleaf edn., s.19.2(c), n.7.)
[123] *Criminal Code of Canada*, s. 469: treason, alarming Her Majesty, intimidating Parliament, mutiny, sedition, piracy and murder.

is sufficient flexibility to make judicial assignments pragmatically in order to respond to the challenges of different types of cases. No doubt judges can be assisted, through programs offered, for example, by the National Judicial Institute, to better understand the context of capital markets and the serious impact of commercial crime. Moreover, they can be assisted in their task of assessing appropriate penalties through sentencing guidelines enacted in legislation.[124]

Most judges are generalists, and it is well recognized that one of the important roles of counsel is to present the case in a manner that assists and educates the judge with regard to the subject matter of the case. The judge is required to decide the case on the basis of the evidence before the court, not on the basis of the judge's individual expertise. Where expert assistance is required, it is tendered through expert witnesses. It is also recognized, however, that in some fields, it is useful to develop a special list of judges who either have or develop their expert knowledge beyond that of the generalist. The availability of such court services can be of significant assistance in the administration of justice, in part, by providing expeditious access to the courts. It was drawn to our attention that the experience with the commercial list in the Superior Court of Ontario demonstrates the value of a specialist list of judges.[125]

An assessment must be made of the resources required to develop, within the various provincial courts, the requisite specialist knowledge and the processes to provide effective and expeditious adjudication of offences relating to capital markets. To a large extent, recent changes in the jurisdiction of provincial courts derive from federal legislation. However, we were told that the impacts of new federal legislation on judicial resources all too often are not taken into account. There are thus added pressures placed on the courts' resources. In these circumstances, the capacity of provincial courts to undertake any increased case load in offences concerning capital markets depends primarily upon the appointment of additional judges and the provision of the additional facilities that are needed to meet the requirements of such cases.

We were assured by the Chief Justice of the Provincial Court in Ontario that, with a few additional appointments and facilities, the court would be prepared and ready to hear all the criminal and provincial offences relating to the regulation of capital markets in Ontario. It is our view that a concerted effort should be made by governments to ensure that the provincial courts have the capacity to hear, manage and decide complex capital markets offences.

[124] See the discussion in Section 5., Penalties.
[125] The expeditious hearing and decision-making of the specialized Delaware court that made rulings in the Hollinger matter was also the subject of comment in our interviews.

The alternative would be to establish unified capital markets courts as superior courts in the provinces. In each case, this would require federal-provincial co-operation. The provinces have the exclusive constitutional authority to establish courts of criminal jurisdiction.[126] It appears to be possible for provinces to specify that provincial offences relating to capital markets are to be tried in the superior court (although it would be anomalous to do so). Further, Parliament can specify which criminal courts have jurisdiction over specific criminal offences. It thus appears that both civil and criminal jurisdiction in relation to capital markets could be vested in the superior courts of the provinces.

However we emphasize that it is not, in our view, possible to create a unified federal capital markets court that would operate nationally. Parliament may have the constitutional authority to establish a federal securities regulation regime,[127] establish a regulatory tribunal, and provide for the prosecution of regulatory offences in a federal court. It might provide for civil rights of action that are integrated with the purposes of the regulatory regime.[128] What it cannot do, in our view, is establish a federal court to exercise jurisdiction over criminal offences relating to capital markets. As noted above, the constitutional capacity to create courts with criminal jurisdiction is conferred exclusively on the provinces. In any event, from a practical point of view, we anticipate that there would be very strong opposition from the provinces to any federal initiative to establish a national unified court with comprehensive jurisdiction in matters relating to capital markets. Moreover, we are not aware of any federal interest in pursuing such an initiative.

There is no doubt of the need to take action to ensure that the provincial courts are well-equipped to manage, hear and decide complex provincial and criminal offences arising from the operation of capital markets. A concerted effort must be made by governments to assess and meet the needs of the provincial courts to fulfill their mandate in complex capital markets cases. Governments should provide the resources to enhance the capacity of the provincial court, rather than making the greater investment that would be required to establish and equip a new unified court. In our view, a new regime is not justified until a real effort has been made to equip the provincial courts to undertake the mandate that is currently within their jurisdiction.

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[126] *Constitution Act, 1867*, ss.92(14) and 91(27).
[127] Report of the Wise Person's Committee, Research Studies: Constitutional Opinions and authorities cited therein (November 2003) available at www.wise-averties.ca.
[128] *General Motors of Canada Ltd. v. City National Leasing Ltd.*, [1989] 1 S.C.R. 641.

Recommendation 4.02: Additional judicial appointments must be made to the provincial courts and additional facilities must be established as required to ensure the capacity of provincial courts to try capital markets offences on a timely basis and to process lengthy trials with a minimum of interruptions.

Recommendation 4.03: Programs must be established, possibly through the National Judicial Institute ("NJI"), to prepare judges to manage the adjudication of complex offences relating to capital markets and to understand the contexts in which they arise. The Canadian Securities Administrators, SROs, and experienced counsel (for the prosecution and the defence) should participate in these programs.

Recommendation 4.04: Provincial court judges should be encouraged to identify their interest in capital market cases and participate in judicial education programs to enhance their preparation for presiding in these cases. In the assignment of judges, care must be taken to match interest, aptitude and preparation to the requirements of various types of cases.

Recommendation 4.05: In the event that it is not possible to develop an effective process of adjudication relating to capital markets in the existing court structure, consideration must be given to the establishment of a specialized provincial court with unified jurisdiction.

5. Penalties and Orders

i. Appropriate Penalties and Factors to be Considered

We have heard repeatedly that the penalties for capital markets offences have often been inadequate. We were told that the maximum penalties may be generally adequate but that courts have tended not to apply maximum penalties unless they are dealing with what appears to be a "worst case". Moreover, it appears that courts, whose dockets include serious crimes of violence, tend to consider that "white collar" crimes, perpetrated by otherwise respectable accused, are less serious than other crimes and merit less onerous sentences. They may not be fully aware of the devastating effects fraud can have on vulnerable people, and the critical impacts of capital market offences on the confidence of investors, the valuation of Canadian securities, the consequent impact on the value of pensions, and the efficiency of the economy as a whole.

Significant steps have already been taken to address the challenge of appropriate sentences for capital markets crimes. As part of the federal initiative to deter serious capital market fraud, Parliament amended the *Criminal Code* to increase maximum sentences for relevant offences.[129] In addition, it added sentencing instructions with respect to those offences. Rather than simply relying on the usual standard, that a sentence should be appropriate to the offence and the offender, Parliament has specified the factors to be considered:[130] the aggravating circumstances that must be taken into account,[131] and the non-mitigating factors which must not be considered.[132] These sentencing directions will very likely counteract the assumptions that have resulted in inadequate sentences in some cases.

As noted above,[133] penalties for offences under the Ontario *Securities Act*, have also been substantially increased. It would be helpful to include instructions in provincial legislation, similar to those now incorporated into the *Criminal Code*, to guide sentencing in the prosecution of provincial securities offences. In the absence of such instructions, it may be that provincial court judges will take into account, by analogy, the relevant factors identified in the *Criminal Code*.

> **<u>Recommendation 5.01</u>: Legislatures should consider enacting legislation similar to s. 380.1 of the *Criminal Code of Canada*, to specify the aggravating circumstances that must be taken into account in imposing a sentence for offences under securities legislation and the non-mitigating factors that must not be taken into account.**

ii. Range of Orders and Penalties

Both the Wise Persons' Committee[134] and the Five Year Review Committee[135] observed that there is

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[129] Maximum prison terms for existing offences of fraud and fraud affecting the public market were increased from 10 years to 14 years. The maximum prison term for fraudulent manipulation of stock exchange transactions was increased from 5 to 10 years. The maximum prison term for the new offence of insider trading was set at 10 years. *Criminal Code of Canada*, ss. 380(1) & (2), 382, 382.1.

[130] *Criminal Code of Canada*, s.380.1. The sentencing factors apply not only to the offences listed in n. 125, *supra*, but also to the offence of issuing a false prospectus: s. 400.

[131] Aggravating circumstances: "(a) the value of the fraud committed exceeded one million dollars; (b) the offence adversely affected, or had the potential to adversely affect, the stability of the Canadian economy or financial system or any financial market in Canada or investor confidence in such a financial market; (c) the offence involved a large number of victims; and (d) in committing the offence, the offender took advantage of the high regard in which the offender was held in the community."

[132] Non-mitigating factors: "the offender's employment, employment skills or status or reputation in the community if those circumstances were relevant to, contributed to, or were used in the commission of the offence."

[133] See Section 1.v.d).

[134] WPC Report, *supra* n.4, at p.29, and works cited therein.

[135] Five Year Review Committee, Final Report, *supra*, n.5, at section 23.1 B), at p.236.

considerable disparity between the types of orders that can be made and penalties that can be imposed in securities matters from one jurisdiction to another. We agree with their conclusion that such disparities can create needless complexity, unevenness and perceived unfairness. So far as possible, the provinces should seek to harmonize the orders and penalties available for the enforcement of securities laws.

> **Recommendation 5.02: So far as possible, the penalties and orders available for the enforcement of securities laws should be harmonized across the country.**

iii. Costs Orders

Securities legislation in Ontario authorizes the Commission to order a respondent to pay the costs of the investigation and the hearing if it is satisfied that the respondent has not complied with Ontario securities law or has not acted in the public interest, and can order the respondent who is guilty of an offence to pay the cost of the investigation.[136] The quantum of costs can be substantial. It has now been established[137] that principles of fairness require that the tribunal develop a procedure for providing adequate information pertaining to the calculation of costs and a fair opportunity to the respondent to test the claim for costs. We agree with the Five Year Review Committee that the Commission should develop policies and guidelines regarding the circumstances in which costs may be ordered against the respondent, the basis upon which costs will be calculated and the manner in which a respondent may test their calculation and secure their assessment by an independent process. As the Committee observes, the approaches taken in British Columbia and Quebec provide useful examples.[138]

The decision in Ontario that the process of investigation, prosecution and adjudication should be self-funded means that costs must be assessed against and collected from respondents. In our view, this raises the apprehension of a conflict of interest for the regulatory tribunal, since its funding depends on its making orders against respondents and further ordering respondents to pay the costs incurred. At the very least, the respondent is entitled to know and to test the evidence relating to the costs claimed in order to make submissions as to their reasonableness. In our view, decisions about the quantum of costs to be awarded should be made or reviewed by an independent tribunal or by an officer who has no stake in the decision.

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[136] *Securities Act,* RSO 1990, c. S-5, as amended, s.127.1.
[137] *Donnini v. Ontario Securities Commission*, 2005 CanLII 1622 (ON C.A.), per MacPherson J.A.,at paras. 77-87.
[138] Five Year Review Committee, Final Report, *supra*, n.5, section 24.6, at p.252, citing the British Columbia and Quebec legislation.

We note, as well that, pursuant to the Ontario legislation, costs of regulatory proceedings can be awarded to regulators but not to successful respondents. We consider that this one-sided approach is unfair. It assumes that all regulatory investigations and prosecutions are justified. In our view, the regulatory tribunal ought to have discretion to award costs to a respondent in an appropriate case. Respondents have a great deal at stake in these matters. Their reputations and financial positions may suffer significantly simply from the issuance of a notice of hearing. The cost of mounting a defence can be prohibitive. In these circumstances, where it is determined that the respondent should not have been put to that defence, it is unfair that the respondent be left to bear the costs.[139]

> **<u>Recommendation 5.03</u>: Ministries and regulators should review and harmonize provisions governing costs in securities matters, and consider adopting best practices of other jurisdictions, which should include**
>
> **(a) authorizing the regulator to order costs in favour of the respondent in appropriate circumstances;**
>
> **(b) developing policies and guidelines regarding the circumstances in which costs may be ordered, the basis upon which costs will be calculated and the manner in which the respondent may test their calculation;**
>
> **(c) providing for review of costs orders by a person or body independent of the regulator; and**
>
> **(d) providing for the recovery of costs on usual principles, rather than requiring the payment of costs on the basis of full cost recovery to fund the investigation, prosecution and adjudication of securities matters.**

6. <u>Redress for Investors</u>

Regulatory law focuses on protecting societal interests through regulating actions, and criminal law focuses on prohibition and punishment of an individual's wrongful act.[140] Deterrence is a key objective of both regulatory and criminal law. While this report focuses on investigation, prosecution and adjudication in regulatory proceedings and criminal prosecutions, we recognize that civil liability can also be an effective deterrent in the enforcement of the laws governing capital markets. Investor confidence

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[139] Not only are the provisions with respect to costs pursuant to Ontario securities legislation out of step with the practice in other jurisdictions but also with the general statutory approach to costs in regulatory proceedings in Ontario. See *Statutory Powers Procedure Act*, RSO 1990, c. S.22, s. 17.1, and see discussion in the Five Year Review Committee, Final Report, *supra*, n.5, at p.253, n.580

[140] *See Committee for the Equal Treatment of Asbestos Minority Sharholders v. Ontario (Securities Commission*, [2001] 2 S.C.R. 139 per Iacobucci J. at para. 42.

will be enhanced in a system which facilitates the recovery of compensation through appropriate processes.

We have been advised that there is a strong need to enhance procedures for compensating unwarranted shareholder losses as part of the effort to enhance investor confidence in securities regulation.[141] We have considered six processes which may facilitate compensation claims: applications to court by regulators seeking restitution or damages on behalf of claimants; jurisdiction of regulatory tribunals to order restitution or damages to claimants; jurisdiction of courts adjudicating offences to order compensation; statutory rights of action conferred on claimants; dispute resolution services for compensation claims; and special class action proceedings.

i. Authority of Regulators to Apply to a Court Seeking Redress for Persons Who Have Suffered Loss

Historically, the role of securities regulators has been to regulate the market, rather than to seek or order redress for those who have suffered losses. On the other hand, securities legislation in Canada generally authorizes regulators to apply to the court for a declaration that a person has not complied with securities law and to seek remedial orders. The court's extensive remedial powers[142] may include orders to pay compensation or make restitution to those aggrieved, to pay general or punitive damages, and to require any profits to be disgorged to the Minister. We understand that regulators seldom invoke this process.[143] Nonetheless, its availability may be important to the negotiation of settlements with respondents that will include the payment of compensation to claimants.

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[141] See, for example, the submissions to the Task Force by bcIMC Investment Management Corporation, November 14, 2005, and by the Investment Dealers Association, January 26, 2006 at p. 5 ff, available at www.tfmsl.ca/submissions. The IDA submission refers, at p. 6, to a recommendation by the Ontario Standing Committee on Finance and Economic Affairs in October 2004 that the provincial government work with the OSC to establish timely and affordable restitution processes.

[142] See the *Securities Act*, RSO 1990, c.S-5, s.128. These remedial orders include orders to comply with securities law; to submit to a review by the regulator; to provide, refrain from providing, or amend a document; to rescind a transaction; to issue, cancel, purchase, exchange or dispose of securities; to prohibit voting or exercising any other right attaching to securities; to prohibit acting as officer , director or promoter; to appoint officers and directors; to purchase securities; to repay money paid for securities; to produce financial statements; to rectify records; to compensate or make restitution to an aggrieved person or company; to pay general or punitive damages; to disgorge to the Minister any amounts obtained through non-compliance; to rectify past non-compliance; to appoint a receiver; to freeze assets.

[143] In Ontario, the Commission has applied to the court for a restitution or compensation order in *Ontario (Securities Commission) v. Sides* (1996), 19 OSCB 2056 (Ont. Ct. of Justice (Gen. Div.)), cited in the Five Year Review Committee, Final Report, *supra* n.5, at n.493.

We agree with the Five Year Committee,[144] that securities regulators should consider using this remedial process more frequently. We suggest

(1) that regulators and ministries seek the passage of any further statutory provisions or regulations which are required in order to settle the basis upon which these procedures may be invoked,

(2) that regulators develop practice guidelines for utilizing the procedures in appropriate cases, and

(3) that regulators bring cases to develop the case law on the appropriate uses of remedial procedures.

Recommendation 6.01:

(a) Securities regulators should consider utilizing their jurisdiction to apply to courts more frequently for restitution, compensation, and/or damages on behalf of aggrieved persons;

(b) regulators and ministries should seek the passage of any further statutory provisions or regulations which are required in order to provide the basis upon which these procedures may be invoked; and

(c) regulators should develop practice guidelines to facilitate the appropriate use of these procedures.

ii Authority of Regulators to Order Restitution

Consideration should also be given to the costs and benefits of authorizing regulatory tribunals to make compensation orders in appropriate cases. The Manitoba Securities Commission has statutory authority to make compensation orders of not more than $100,000 for a claimant's financial loss provided that

(1) the respondent's contravention or failure caused the loss in whole or in part,

(2) the amount of loss can be determined on the evidence, and

(3) the claimant has not commenced a civil action for damages.[145]

The jurisdiction to make compensation orders was conferred in 2003. We are advised that a compensation order has been made in only one matter.[146]

The British Columbia Securities Commission, in its *New Concepts for Securities Regulation*, recommends that legislation be amended to authorize the Commission to make restitution orders.[147] In

[144] Five Year Review Committee, Final Report, *supra* n.5, at section 21.6 (p.224).
[145] *Securities Act*, R.S.M. 1988, as amended in 2003, c.S50, s.148.2.
[146] See the submission to the Task Force by the Investment Dealers Association, January 26, 2006, at p. 7.
[147] *New Concepts for Securities Regulation*, B.C.S.C. Notice 2202.12, Concept 5.

the United Kingdom, the Financial Services Authority has authority to order restitution or to seek a restitution order from the court.[148] In some instances Canadian regulators have required compensation as a condition of settlement, even in the absence of authority to order restitution. [149]

The Investment Dealers Association ("IDA") takes the position that its hearing panels have authority to impose restitution in that they may impose "any other fit remedy or penalty". On this basis, its hearing panel ordered member firms to provide restitution to investors in the market-timing cases.[150]

The appropriateness of restitution orders by regulators may depend on the circumstances of the case. The IDA submits that restitution orders are appropriate only in circumstances where

(1) "there is a fund available to fulfill the order",

(2) "it has been established that the cause of the investors' loss is directly attributable to the misconduct alleged and proven",

(3) "the individuals entitled to restitution can be easily identified",

(4) "the amount to be distributed to each individual can be readily ascertained" and

(5) "the funds can be easily and efficiently distributed to the eligible clients". [151]

In assessing the viability of authorizing securities tribunals to order compensation or restitution, it will be important to consider the impact on regulatory and adjudicative resources. It will, as well, be necessary to establish procedures that will best enforce a fair process. This will include a consideration of the impact of a restitution order on an investor's other possible avenues of redress.

<u>Recommendation 6.02</u>: Securities tribunals should be authorized to order compensation or restitution in appropriate circumstances.[152]

iii. Jurisdiction of Courts Adjudicating Offences to Order Compensation

The jurisdiction of courts that are adjudicating provincial offences arising from securities transactions

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[148] *Financial Services and Markets Act 2000*, United Kingdom, c. 8, s. 384.
[149] The OSC obtained restitution for investors as part of the settlement in recent market-timing cases, even though it did not assert jurisdiction to impose restitution. See the submission to the Task Force by the IDA, January 26, 2006, at p. 6.
[150] *Ibid.*, at p.7.
[151] *Ibid*., at p.7.
[152] Cf the Five Year Committee, Final Report*, supra* n.5, at s.21.6 (p.223).

should also be expanded to authorize them to order compensation in appropriate circumstances.[153] As an example, under the Alberta *Securities Act,* a court that finds a defendant guilty of a provincial offence may order the defendant to compensate or make restitution to an aggrieved person or company.[154] While there are constitutional issues to be considered, it may also be possible to confer authority to order restitution in the adjudication of criminal offences.[155] Grafting restitution or compensation applications onto the trial of provincial or criminal offences would require the development of criteria for determining when the process would be appropriate and the development of procedures to ensure fairness.

Recommendation 6.03: Consideration should be given to

(a) authorizing courts adjudicating capital markets offences under provincial or criminal legislation, in appropriate circumstances, to make orders of restitution and compensation, and

(b) establishing rules to ensure the fairness of the process.

iv. Statutory Right of Action

In cases where it would be inappropriate for the court hearing the offence charged to deal with the issue of compensation, a statutory right of action in the civil courts, based on findings of culpability made by the court dealing with the offence, would expedite determination of the claim. Such a right of action for restitution or compensation could also be based on findings of misconduct by a securities tribunal in appropriate circumstances. The respondent would have had an opportunity to defend the matter before the tribunal or the court. A claimant who seeks to rely on the finding, could then focus on issues of causation[156] and quantum of damages.

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[153] See the discussion in the Five Year Committee, Final Report, *supra* n.5, at s. 23.2 (p.238).
[154] *Securities Act*, RSA 2000, S-4, subs. 194(7).
[155] The *Criminal Code* currently provides for restitution orders in limited circumstances: see s. 738.
[156] The extent to which a claimant should be required to prove causation would require careful consideration. As Timothy Loh observes, "requiring the plaintiff to prove actual reliance would be an 'unnecessarily unrealistic evidentiary burden'". Courts in the United States "have interpreted the fraud on the market theory as supporting a rebuttable presumption of causation in relation to private lawsuits arising from the dissemination of false information." Loh, *loc. cit*, n.119, at E1.01500 and E1.01700, citing *Basic, Inc. v. Levinsons* (1988) 485 U.S. 224, per Blackmun J. at 245 and 250.

In Hong Kong, investors have a statutory right of action for compensation for any pecuniary loss sustained as a result of market misconduct. The findings of the Market Misconduct Tribunal or the criminal courts are admissible to establish the commission of market misconduct. [157]

Securities legislation should be amended to authorize a claimant, in appropriate circumstances, to seek compensation from a respondent on the basis of a finding of wrongdoing made by the regulator or by a court in the adjudication of a provincial or criminal offence.

> **<u>Recommendation 6.04</u>: Claimants should be authorized to bring an action for damages, or seek an order for compensation or restitution from the civil courts, in appropriate circumstances, based upon a finding of a securities tribunal or a court, in regulatory, quasi-criminal or criminal proceedings, that the respondent has engaged in specifed misconduct.**

v. Class Actions for Secondary Market Liability

New provisions have been introduced into the securities legislation of some provinces[158] to create a right of action for damages by those who acquire or dispose of securities between the time a misrepresentation is made relating to the affairs of the securities issuer and the time when the misrepresentation is corrected. These provisions impose a significant civil liability for failures to make continuing disclosure. They are intended both to deter these failures and to compensate those who incur losses in securities transactions during the period of misrepresentation.

The provisions create a specialized class action. While some welcome this development as an additional means of holding corporations to account, others express concern that the liability is really borne by other shareholders rather than by the actual wrongdoers.[159]

Where the class action procedure is available, there are significant obstacles in the path of those who wish to use it. To discourage class actions brought solely for nuisance value, leave of the court must be obtained to commence the proceeding even before the class is certified. A concern has been expressed that the procedure will be impractical if plaintiffs are required to litigate the case before they can start the

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[157] *Securities and Futures Ordinances*, Hong Kong, ss. 281 and 305. See discussion at Timothy Loh, *loc. cit*., n. 19, at E1.01200 – E1.012400.
[158] See *Securities Act*, RSO 1990 as amended, Part XXIII.1, ss. 138.1 ff.
[159] See submission to the Task Force of Jarislowsky Fraser Limited (Investment Counsel), October 12, 2005 at www.tfmsl.ca.

action. Even if the plaintiffs could obtain leave and then certification, they may be deterred by the possibility that costs may be awarded against them if they are unsuccessful. There is a concern that the potential liability to significant costs is unnecessary in light of the requirement of leave to commence the proceeding. These concerns should be addressed through the appropriate use of discretion in the awarding of costs in claims that were legitimate, but unsuccessful.

In addition, there are caps on the amounts that can be recovered through the class action procedure. We were advised that caps are imposed in recognition of the fact that the recovery will benefit those who sold their securities at the expense of those who continued to hold their investment in the company. Moreover, if there has been active trading in the secondary market, full recovery might destroy the company and the interests of its shareholders.

There is concern regarding the viability of the class action procedure both on the part of plaintiffs and on the part of defendants. Whether or not the new procedure will be useful as a means of redressing and deterring wrongs will depend to a large extent on the approach taken by the courts in managing the cases and in their decisions. As long as nuisance-value suits are deterred and defence tactics of delay and attrition are effectively managed, class actions could be a useful means of providing access to justice, particularly in cases where there is an imbalance of power and resources.

The class action proceeding applies only to continuing disclosure. It does not provide redress for losses incurred as a result of wrongful acts in the distribution of securities. It is thus no more than a partial solution to part of the problem of redress. The impacts of the proceeding will need to be carefully assessed, and its utility in other contexts evaluated.

> **<u>Recommendation 6.05</u>: Securities regulators and ministries should monitor developments in class actions for failures of disclosure, with particular attention to concerns about the effective management of class actions and the imposition of costs awards against plaintiffs.**

vi. Dispute Resolution Services for Compensation Claims

Self-Regulatory Organizations ("SROs") provide various processes by which clients may obtain compensation for losses resulting from non-compliance with SRO rules. These processes include (1)

restitution orders made in disciplinary proceedings, (2) arbitration and (3) ombudsman services, which are discussed in the following section of this report.[160]

7. Enforcement by Self Regulatory Organizations

i. Introduction

Self Regulatory Organizations ("SROs") are national industry organizations that are recognized and subject to review by securities regulators.[161] They perform important enforcement functions in relation to their members. Their investigative work is funded by member firms and can fulfil an important role in protecting investors. Accordingly, we have recommended that their capacity to monitor and enforce compliance with market regulation should be welcomed and included in the comprehensive assessment of enforcement data suggested in recommendation 1.01.

There are three national SROs:[162] the Investment Dealers Association ("IDA")[163], which regulates the securities industry; Market Registration Services Inc. ("RS")[164], which provides regulation services to the Toronto Stock Exchange ("TSX") and other equity markets in Canada; and the Mutual Fund Dealers Association ("MFDA")[165], which regulates the distribution side of the Canadian mutual fund industry. The Boards of the IDA and the RS have recently announced their intention to consolidate into one organization.[166] The discussion that follows focuses primarily on the enforcement processes of the IDA.

The IDA maintains offices in Montreal, Toronto, Calgary and Vancouver. While it has exercised a combined mandate, to regulate and to advocate on behalf of the industry, it has now separated those functions. It establishes rules to regulate the actions of member firms and their registered employees (nearly 28,000 individuals). The Enforcement Department monitors information provided by its

[160] See the discussion in Section 7.iv.
[161] See, for example, the *Securities Act*, RSO 1990, c. S-5 as amended, Part IX, s. 21, which provides for the recognition and regulation of stock exchanges, self-regulatory organizations, quotation and trade reporting systems and clearing agencies.
[162] Note, as well, the Chambre de la sécurité financiére, which regulates the practices and promotes the ongoing development of skills of financial sector professionals in Québec, www.chambresf.com.
[163] For further information, www.ida.ca.
[164] For further information, www.rs.ca.
[165] For further information, www.mfda.ca.
[166] The announcement was made on April 26, 2006. See the IDA Spring Report 2006, p.1, available at www.ida.ca.

members. It also receives approximately 1200 complaints a year, which result in the opening of approximately 150 files for investigation.[167]

The IDA resolves at least 80% of complaint files within 75 days and 60% of investigation files within a year. It is seeking to improve the timeliness of investigations and to ensure that it is addressing the cases that are important both to firms and to consumers. The complaints relate primarily to unauthorized or discretionary trading, unsuitable investments, service issues and supervision. The IDA has authority under its rules[168] to reprimand its members, to impose very substantial fines, to require the disgorgement of profits, to order the suspension of members, to revoke approval status (temporarily or permanently), to attach conditions to continued membership, and to impose "any other fit remedy or penalty." The IDA has ordered restitution to investors under its authority to order a "fit remedy".[169]

ii. Jurisdiction

SROs derive their authority from their members, subject to recognition and review by securities regulators. There are significant limits on their enforcement jurisdiction.[170] First, while SROs have authority to compel their members to produce documents and attend as witnesses, they do not have power to compel production from, or subpoena the evidence of, former members or third parties. Second, SROs have no authority to file the decisions of their discipline panels as decisions of the court for purposes of enforcement. Third, they have no power to seek a court-ordered monitor when, for example, a firm is in chronic and systemic non-compliance, when a firm is close to insolvency or when the public interest otherwise requires the appointment of a monitor.

In some cases, these limits on their authority significantly reduce the ability of an SRO to inquire into and prosecute alleged infractions or to enforce their decisions. In addition, SROs and their staff have no statutory immunity from civil liability that might arise from acts done in good faith in the conduct of their regulatory responsibilities.

To the extent that SROs are trade associations, it is reasonable that they exercise their powers only with respect to the conduct of their members. However, they have become more than trade associations. Legislation authorizes securities regulators to recognize SROs and to review their by-laws, rules, financial affairs and decisions. In effect, it appears that SROs, subject to the review of regulators, are exercising

[167] IDA Enforcement Annual Report 2005, pp. 7-8, www.ida.ca.
[168] See Rules 20.33 and 20.34, available at www.ida.ca.
[169] See the submission to the Task Force by the IDA, January 26, 2006, at p.7.
[170] *Ibid.,* at p. 5.

delegated regulatory authority over the conduct of their members. If they are hampered from doing so effectively by limits on their jurisdiction, the gaps must be addressed.

It appears that, if SROs make decisions without access to relevant information, or their decisions cannot be enforced, the problem cannot be corrected on review. Either additional powers must be provided to the SROs or a different system of regulation must be put in place. In light of the importance of the work undertaken by the IDA and other SROs, and the seriousness of the matters they investigate and prosecute, it is important to address and resolve their appropriate role and jurisdiction within the system of securities regulation. Any ambiguity as to whether SROs are exercising statutory powers of decision, and are thus subject to the protections guaranteed by the *Canadian Charter of Rights and Freedoms*, should also be resolved.

> **<u>Recommendation 7.01</u>: The appropriate roles and jurisdiction of SROs in the enforcement of standards within the securities industry and the assessment of penalties must be reviewed. In particular, consideration should be given to the following issues:**
> **a) whether SROs are exercising statutory powers of decision in their discipline jurisdiction and whether they are subject to the protections guaranteed by the Charter of Rights and Freedoms;**
> **(b) in what circumstances and by what means, should SROs be able to obtain production of documents from, and the attendance as witnesses of, former members and other third parties;**
> **(c) the means, if any, by which the decisions of SROs should be made enforceable against former members;**
> **(d) the circumstances and process by which an SRO could apply to a court for the appointment of a monitor; and**
> **(e) the provision of immunity from civil liability for those acting in good faith on behalf of SROs.**

iii. Fairness and Information-Sharing

We note that SROs, in exercising their enforcement jurisdiction have a responsibility to ensure that investigations and prosecutions are conducted fairly and in accordance with the principles of natural justice. Moreover, it is important that their broad powers to compel members to disclose information

should only be used in appropriate circumstances,[171] and not as a surreptitious means of obtaining evidence in connection with the investigation of an alleged infraction or offence. We emphasize, as well, the importance of ensuring fair and independent adjudication of complaints and allegations, in light of their potentially serious consequences. The effectiveness and credibility of enforcement processes depend not only on getting results but doing so in a fair and just manner.

iv. Claims for Compensation and Dispute Resolution Mechanisms

SROs provide for various means by which clients of their members may seek compensation as alternatives to bringing civil claims in court proceedings. Concerns have been expressed about the clarity and accessibility of information about these processes, and those concerns are being addressed.[172]

a) Compensation as a Remedy in the Discipline Process

When an IDA hearing panel finds that a member has failed to comply with its rules, it is authorized to order disgorgement of profits and to impose "any other fit remedy or penalty". Pursuant to this authority, an IDA hearing panel has ordered member firms to make restitution in the amount of $7.2 million, being the revenue earned by the firms in market timing activities.[173] The IDA, as we noted earlier,[174] has submitted that a restitution order is appropriate as part of the discipline process only when certain requirements are met.

b) Arbitration

The IDA also provides for resolution of claims for compensation under $100,000 through arbitration.[175] Before a client invokes the process, he or she must exhaust internal complaint processes provided by the member firm. The member firm must notify the claimant that the arbitration service is available. Proceeding by arbitration rather than by court action is likely to produce a quicker decision, which is not subject to appeal, and which is generally confidential. The costs of pursuing a claim through arbitration

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[171] See the discussion in Section 2. viii.
[172] See "A Followup to the Investor Town Hall: Reporting on our progress", July 25, 2006, a joint report of the OSC, IDA, MFDA and OBSI, available at www.osc.gov.on.ca, at www.ida.ca and other websites.
[173] Submission to the Task Force on behalf of the IDA, January 26, 2006, at p.7.
[174] See the discussion in Section 6.ii.
[175] See www.ida.ca/Investors/Arbitration_en.asp, See also discussion in the Five Year Review Committee, Final Report, *supra*, n.5, at section 2.7.B), at p.227.

are likely to be less than the costs of civil litigation, but the cost of the arbitration service, unlike the cost of court services, is borne by the parties.[176]

In response to a recommendation of the Five Year Review Committee, the IDA is seeking to make the arbitration process more transparent, by reporting on the process in a format that maintains confidentiality in that it "does not create a disincentive to clients to seek arbitration, and that complies with all federal, provincial and territorial privacy laws".[177]

c) Ombudsman Services

The IDA and other SROs participate in the dispute resolution services provided nationally through the Ombudsman for Banking Services and Investments ("OBSI").[178] Before a client invokes the process, he or she must exhaust internal complaint processes provided by the member firm. A client then has the option of seeking a recommendation from the Ombudsman that the SRO member pay compensation in an amount not exceeding $350,000.[179] Member firms of the IDA are required to inform clients of the availability of this service. The OBSI process is provided to claimants free of charge and is funded by member firms. The OBSI advises claimants that they may ask a friend or relative to help in handling the complaint, and that it is seldom necessary to retain a lawyer, accountant or other professional adviser to assist with representation.[180] The OBSI investigates the complaint and makes a recommendation for its resolution. A claimant who is dissatisfied with the OBSI's recommendation may pursue other remedies. A member who declines to settle in accordance with the OBSI recommendation faces the impact of adverse publicity.[181]

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[176] The IDA reports that "Total costs (including a filing fee, the arbitrator's hourly rates, room rentals and other disbursements) can be expected to range between $3,000 to $4,000 for a typical dispute. Costs are generally split equally between the parties, but the arbitrator can make a different determination. Moreover, as with the costs for arbitration, the arbitrator, at his or her discretion, may assign one party's legal costs to the other party in the arbitration." www.ida.ca/Investors/Arbitration_en.asp.

[177] Five Year Review Committee, Final Report, *supra*, n.5, at section 2.7.B), at p.228.

[178] www.obsi.ca. See, also, www.ida.ca/Investors/Ombudservice_en.asp.

[179] Submission to the Task Force on behalf of the IDA, January 26, 2006, at p.5.

[180] Complaints Process, Frequently Asked Questions, #5 at www.obsi.ca.

[181] A claimant who is dissatisfied with the recommendation can proceed to arbitration or commence a civil action. We were told that the IDA is not aware of any claimant who has successfully sought a remedy in the face of a negative recommendation by the OBSI. We note that, in the comparable process in Australia, the member is bound by the ombudsman's decision in those cases where the amount involved is less than $100,000, but is not bound by the recommendation in cases where the amount exceeds $100,000. See Guidelines to the FCDRS Terms of Reference, sections 8.6 "Investigation" and 8.7 "Determination" (December 2005), at www.fcdrs.org.au.

Even though professional advisers may not be necessary, the claimant may feel at a disadvantage if the respondent member is represented and the claimant is not. We were advised that SRO members are concerned about the impact that an OBSI recommendation can have on their reputations and thus may be inclined to "over-lawyer" their defence. In these circumstances, the claimant may feel pressured to retain lawyers and other professional advisers to represent them in the process.

We recommend that consideration be given to the approach used in the Australian Financial Co-operative Dispute Resolution Scheme (Ombudsman's Office), in which a party who wishes to be legally represented in a dispute must seek permission from the Ombudsman. If the member firm applies for and obtains permission to be represented, the firm must also pay the costs of the claimant for representation. If, however, the claimant is the one who seeks permission to be legally represented, both parties bear their own legal costs.[182] The OBSI process and its Australian counterpart both proceed by way of investigation and report, rather than by holding hearings.

Considerable progress has been made by SROs in establishing a national complaint system,[183] and in developing dispute resolution processes, including arbitration and ombudsman services. SROs are working with regulators to improve the effectiveness of their responsiveness to investor concerns and complaints.[184] The Five Year Review Committee has recommended, and we agree, that regulators should consider the extent to which the new processes and requirements which are being established by SROs to provide arbitration and dispute resolution options to claimants should now be required, as a condition of recognition, for all SROs.[185]

> **<u>Recommendation 7.02</u>: We recommend that regulators should consider the extent to which the new processes and requirements which have been established by SROs to provide arbitration and dispute resolution options to claimants should now be required, as a condition of recognition, for all SROs.**
>
> **<u>Recommendation 7.03</u>: Regarding proceedings before the OBSI, consideration should be given to requiring (a) that a party who wishes to be legally represented must seek permission from the Ombudsman; (b) that if the member firm applies for and obtains permission to be represented, the firm must also pay the costs of the claimant for**

[182] Guidelines to the FCDRS Terms of Reference, section 4.2 Legal Costs (December 2005), at www.fcdrs.org.au.
[183] See the Five Year Review Committee, Final Report. *supra* n. 5, at section 21.7, at p.225.
[184] *Loc cit*, n.167.
[185] *Ibid.,* at p. 227, para. 2; at p.228, Recommendations 1 and 3.

representation; and (c) that if the claimant is the one who seeks permission to be legally represented, both parties be required to bear their own legal costs.

8. The Need for a Unified Approach to Enforcement

Canada is virtually the only country in which securities transactions are regulated provincially rather than nationally. The weaknesses that result from this divided jurisdiction have been clearly and compellingly identified by the Wise Persons' Committee[186] and the Crawford Panel on a Single Canadian Securities Regulator[187]. We emphasize that, in the matter of enforcement, the weaknesses arising from divided jurisdiction have now become critical. Divided jurisdiction over the enforcement of securities laws dilutes resources, encourages competition among jurisdictions, confuses accountability, increases costs, creates unnecessary delays, and generally impedes effective enforcement. It can result in unfairness to an individual or entity seeking to resolve a matter in more than one jurisdiction. If this situation is continued it will eventually have a serious detrimental effect on the operation of Canadian capital markets.

While activity in capital markets is concentrated in a very few centres in Canada, the enforcement process is fragmented among (1) no less than thirteen provincial and territorial jurisdictions, each with its separate regulatory regime, tribunal and approach to enforcement powers, priorities, processes and sanctions; (2) various police forces at the municipal, provincial and federal levels, each with its own priorities and capacities; (3) various prosecutorial authorities, regulatory, provincial and federal; (4) court systems with varying civil and criminal jurisdictions, some with provincial judicial appointments, and others federal. The permutations and combinations create a complex jurisdictional maze in which there can be significant duplication and gaps.

Canada is too small a capital market to enforce securities laws effectively within the current fragmented system. There are significant discrepancies in enforcement experience and capability from one province to another. Some provinces do not have sufficient expertise to mount investigations and prosecutions of complex securities cases. The volume of cases in those jurisdictions simply does not warrant it. In other provinces, as the WPC has observed, there is continuing "need for more specialization at every stage of the enforcement process to combat the increasing complexity of securities violations".[188]

[186] See the WPC Report, *supra*, n.4, at p. 25.
[187] See the *Crawford Panel Report*, *supra*, n.7, at p.26.
[188] *Ibid.*

We were told by one expert that, in relation to enforcement, there is a tremendous gap between the experience and expertise of the Ontario Securities Commission ("OSC") and that of other securities regulators in Canada, and that there is as big a gap again between the OSC and the U.S. Securities and Exchange Commission. We agree with the WPC that "more centralized enforcement would allow for development and deployment of specialized staff throughout the country".[189]

We have earlier recommended that a nationally co-ordinated prosecution service be established for the prosecution of criminal capital markets offences.[190] A single national enforcement task force with regional operations could develop specialist experience and skill in the investigation of a wide range of securities matters and deploy that skill and knowledge as and where it is required. We have also recommended that consideration be given to the establishment of a national tribunal, independent of securities regulators, to adjudicate on regulatory matters.[191]

In our view it is critical that Canada and the provinces and territories concentrate their resources, experience and special knowledge in a national enforcement process for securities matters. It would then be possible to develop the capacity to address effectively the full range of securities cases, including the kinds of complex cases which, when left unprosecuted, undermine confidence in Canadian capital markets.

The federal government's establishment of Integrated Market Enforcement Teams ("IMETs") and the commitment of funding for investigation and prosecution is an important contribution to enforcement capacity, but the accountability of IMETs to federal authorities, divorced from regulatory expertise, creates yet another level of jurisdictional complexity. In our view, IMETs as presently structured is an insufficient response to the over-all challenge of enforcement. In fact, it was not intended to constitute a comprehensive response. There are concerns that it may not be effective even in its narrower focus on high-profile criminal cases. The enforcement capacity of regulators and police must not only be enhanced, but they must also, to the extent possible, be integrated into an overall strategy which harnesses and enhances the capacity to enforce securities laws.

In recent years, there has been more co-operation within the Canadian Securities Administrators ("CSA"), the umbrella organization of the provincial securities regulators. There have also been helpful initiatives

[189] The WPC Report, *supra*, n.4.
[190] See discussion in Section 3.iii.
[191] See discussion in Section 4.i.

by provincial ministers, and significant efforts by the federal government to enhance the capacity to investigate capital market offences. Nonetheless, enforcement remains fragmented and the resources for monitoring, investigating, prosecuting and adjudicating complex, sophisticated and evolving securities offences are widely believed to be insufficient to the task. The Crawford Panel on a Single Canadian Securities Regulator has recently laid out a structure through which provincial and national interests can be accommodated within a single regulator with a co-ordinated approach to enforcement.[192]

Whatever the results may be of the negotiations to establish a unified or harmonized approach to securities regulation, it remains fundamentally important that the approach to enforcement be managed on a national basis. A centralized approach would facilitate the efficient use of resources in the development and deployment of the special knowledge and skills that are required for the effective investigation, prosecution and adjudication of complex securities matters.

> **Recommendation 8.01: Whether or not Canada adopts a unified or harmonized approach to securities regulation, it is fundamentally important that enforcement be managed on a national basis to ensure the effective use of resources, the development and deployment of expert skill and knowledge across the country, and the independence and accountability of enforcement processes.**

The recommendations we have made for the evaluation of enforcement processes and for the development of special knowledge in the field of capital markets for police, prosecution services and courts, could be effectively pursued or co-ordinated through a national institute for research and education on capital markets.

> **Recommendation 8.02: Consideration should be given to the establishment of a national institute to facilitate research and education in the investigation, prosecution and adjudication of securities law.**

[192] *Loc.cit., supra*, n.7.

Appendix A: List of Abbreviations

AMF	Autorité des marchés financiers (Quebec)
ASC	Alberta Securities Commission
BCSC	British Columbia Securities Commission
CSA	Canadian Securities Administrators
IDA	Investment Dealers Association
IOSCO	International Organization of Securities Commissions
IMETs	Integrated Market Enforcement Teams
FCDRS	Financial Co-operative Dispute Resolution Scheme (Australia)
NJI	National Judicial Institute
OBSI	Ombudsman for Banking Services and Investments
OPP	Ontario Provincial Police
OSC	Ontario Securities Commission
MFDA	Mutual Fund Dealers Association
RCMP	Royal Canadian Mounted Police
RS	Market Registration Services Inc.
SEC	Securities Exchange Commission (United States)
SERC	Securities Enforcement Review Committee (Ontario)
SROs	Self Regulatory Organizations
TSX	Toronto Stock Exchange
WPC	Wise Persons' Committee

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Appendix C: Individuals Who Were Interviewed or Consulted

Bank of Canada
- Governor David Dodge
- Deputy Governor David Longworth (Financial Markets)

Canadian Securities Administrators
- Autorité des marchés financiers, Québec:
  - Jean St-Gelais, Chair
  - Nathalie G. Drouin, Executive Director, Legal Affairs and Secretary
- Ontario Securities Commission:
  - David Wilson, Chair
  - Michael J. Watson Q.C., Director of Enforcement
- Alberta Securities Commission:
  - William S. Rice, Q.C., Chair
- John P. Petch, Director of Enforcement
- British Columbia Securities Commission:
  - Douglas M. Hyndman, Chair
  - J.A. (Sasha) Angus, Director of Enforcement

Investment Dealers Association
- Joseph J. Oliver, President and CEO
- Paul C. Bourque, Senior Vice-President, Regulation
- Alex Popovic, Vice President, Enforcement

Ministry of the Attorney General (Ontario)
- Murray D. Segal, Deputy Attorney General
- Paul S. Lindsay, Chief Prosecutor

Royal Canadian Mounted Police, Integrated Market Enforcement Teams
- Superintendent John M. Sliter, Director, IMETs

Toronto Police Service, Fraud Squad
- Detective Staff Inspector Stephen Harris
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A draft of this report was discussed with members of the Task Force on the Modernization of Securities Legislation.

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