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Chapter 7

Enforcement of Securities Laws

7.1 The central question in the minds of many investors in Canada's capital markets is whether Canada's securities laws are enforced to the extent that they should be. Indeed, the issue most commonly mentioned by those who made submissions to the Task Force was the perceived lack of *vigour* with which securities laws in Canada are enforced.

7.2 While improving enforcement (assuming that to be necessary, for the moment) is difficult to shoehorn into a mandate to modernize securities laws, there is no difficulty addressing the subject in the context of the second branch of our mandate – enhancing the competitiveness of Canada's capital markets. As noted by The Honourable Peter Cory and Professor Marilyn Pilkington:

> 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 upon having effective laws that are effectively enforced.[1]

"[A]n effective regulatory framework is one where the rules are enforced and perceived to be enforced. Even the most coherent and efficient regulatory framework won't be effective unless it is followed. Participants must be appropriately monitored. And when rules are broken, offenders must be prosecuted, and adequate penalties must be strictly applied. A framework with strong monitoring, prosecution, and application of penalties provides the incentives for firms to follow the rules, and this adds to the framework's credibility. When everyone is playing by the rules – and everyone is confident that the others have the incentives to do the same – then markets operate with greater efficiency."

– Remarks by David Dodge, Governor of the Bank of Canada, to the Toronto CFA Society, September 22, 2005.

Enforcement and the Cost of Capital

7.3 We have spoken earlier in this Report of the risk premium or so-called "Canada discount" attached by international investors considering investing in Canadian equities. There is little doubt in our minds that ensuring the credibility of securities regulation in Canada through vigorous enforcement will reduce this premium, attract risk averse investors to our markets, and thereby increase liquidity and correspondingly reduce the cost of capital to Canadian issuers.

7.4 Research with regard to this issue was commissioned by the Task Force (regardless of how intuitive the answer might be to some). We refer to the

[1] P. Cory & M. Pilkington, "Critical Issues in Enforcement" in Volume VI at 171.

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study by Professor Utpal Bhattacharya entitled "Enforcement and its Impact on Cost of Equity and Liquidity of the Market".[2] We requested that Professor Bhattacharya first prepare a global survey summarizing the extant literature documenting the effect on the cost of capital and liquidity of enforcing securities laws. In the second part of his study Professor Bhattacharya was requested to analyze the effect of enforcement on Canada's capital markets.

7.5 A conclusion of Professor Bhattacharya's research is that the enforcement of securities laws reduces the cost of capital and in turn increases liquidity in the capital markets:

> Measured against the U.S. benchmark, enforcement of securities laws is weak in Canada. As there is overwhelming global evidence that enforcement of securities laws improves liquidity – the effect is stronger in emerging markets, but the effect still exists in developed countries like Canada – Canada can strengthen its capital markets by increasing enforcement of its existing securities laws.[3]

Understanding How Improvements Can be Made

"Even if we were to conclude that two countries – say Canada and the United States – had the same goals for their oversight of capital markets and had decided to achieve those goals through substantially similar means, it does not follow that Canada should emulate U.S. regulatory intensity for the simple reason that the United States may not be pursuing an optimal policy in this area. Cost benefit analysis in the area of financial regulation is notoriously difficult, and there is no compelling evidence that the United States is striking the correct balance."

- Professor Howell Jackson, "Regulatory Intensity in the Regulation of Capital Markets: A Preliminary Comparison of Canadian and U.S. Approaches" in Volume VI at 84.

7.6 The goal of improving the enforcement of securities laws is clear in our minds. The means of improvement requires careful thought, however. Before considering the means of improving securities law enforcement, some consideration of the need for change is appropriate.

7.7 Even when there are many clamouring for change, one needs to be careful to understand fully what one is asking for. The old expression – "be careful, you may get what you ask for" – has been in the back of our minds. As we have posited in Chapter 3, the Canadian approach to securities regulation should naturally be guided by the unique attributes of Canada's capital markets. By extension, the enforcement of securities regulations should also be guided by those unique attributes as well as Canada's legal traditions. For example, looking at the enforcement successes in the United States should not lead us simply to emulate their enforcement practices if it risks importing much of the litigious atmosphere of which securities law enforcement is a part.

7.8 The Task Force sought in-depth academic research on several questions which it regarded as central to understanding how best to improve the enforcement of securities laws in Canada.

[2]See U. Bhattacharya, "Enforcement and its Impact on Cost of Equity and liquidity of the Market" in Volume VI.
[3]*Ibid* at 138.

The Canadian Securities Law Enforcement Apparatus

7.9 How can the enforcement of existing securities laws in Canada be improved? This of course is a question which may beg the answer in that there is not a Canadian system but rather a system which is provincial and territorial, with some federal overview pursuant to the *Criminal Code*. Is the public perception of Canadian enforcement as inadequate a misperception fuelled by the well publicized enforcement successes in the United States? Or is that perception (in whole or in part) warranted? Does the Canadian enforcement system suffer from under funding? Does it lack adequate staffing? Are the various levels within the enforcement apparatus sufficiently knowledgeable of securities laws? Is there a lack of co-ordination among the various securities regulators in Canada?

"…if someone abuses the regulations, they should lose the profit made as well as a jail sentence, because no one wins when the reputation of the capital markets is tarnished."

– Doug Lowry (written submission to the Task Force in Volume VII)

7.10 It was important to the Task Force that these central questions be addressed by experts who were no strangers to judicial and quasi-judicial enforcement proceedings in Canada. Hence research was commissioned from The Honourable Peter Cory and Professor Marilyn Pilkington.[4] Their views have been formed with the assistance of an advisory board of experienced securities practitioners from across Canada.

7.11 In particular, these researchers were requested to address the following issues:

- Factors giving rise to the heightened public concern about enforcement mechanisms.
- Initiatives that have been introduced in response to enforcement concerns.
- The public policy "goals" of enforcement.
- The processes involved in the enforcement of securities laws and regulations, including the investigation of offences, the prosecution of offences, the adjudication of offences and civil claims.
- The appropriate balance which should be maintained between public and private enforcement in the Canadian context, and between regulatory and criminal enforcement proceedings.
- The existing regulatory and criminal enforcement mechanisms in Canada, including issues stemming from multiple provincial jurisdictions, co-operation and co-ordination with regulators in foreign jurisdictions, investigative tools, prosecutorial and adjudicative challenges, the adequacy of sanctions and the means of assessing the effectiveness of investigation and enforcement.

[4]See Cory & Pilkington, *supra* note 1.

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- The effect of *Criminal Code* offences on the securities law enforcement landscape.
- Developments in the United States and the United Kingdom, and their applicability in the Canadian context.

Issues Associated with the Manner in which the Enforcement Function is Handled

7.12 There have been many voices raised in concern with regard to a variety of issues pertaining to the manner in which (as opposed to the frequency of or vigour with which) securities laws are enforced. These concerns include:

- Concern with regard to the settlement process being used to extract penalties under threat of draconian penalties being sought if the settlement is rejected.
- Concern that undue deference is given by courts to securities commissions, making a right of appeal somewhat academic.

These issues are also among the issues examined by the Honourable Peter Cory and Professor Pilkington.

7.13 We have also heard concern that there are sometimes abuses of the "contrary to the public interest" section of securities law as a basis of sanctioning behaviour which violates no specific section of the law and where no advice has been given to the market that a particular course of conduct is thought by the regulator to be offensive (so-called "gotcha" enforcement).

7.14 Whether the principle of "contrary to the public interest" is a useful regulatory tool (due to its lack of specificity) or a regulatory tool which, when abused, brings the entire securities regulatory process into disrepute, is not a debate we need to have. In our view, both statements are true.

7.15 We believe that securities regulators in Canada are conscious of this dilemma and strain not to abuse the breath of "public interest" tool. With that clear regulatory consciousness in mind we make the following recommendations.

Recommendation: *The Task Force recommends that when regulators identify a course of conduct that breaks no specific provision of securities laws, but arguably contravenes a declared principle of the law and is considered to be contrary to the public interest, they notify the capital markets that the course of conduct is unacceptable and will, if repeated, attract prosecution.*

Recommendation: *The Task Force recommends that the "contrary to the public interest" regulatory tool be used sparingly and only with the greatest care if the behaviour which is criticized has not been publicly identified in advance as unacceptable. Where the behaviour that is criticized has not been publicly identified, the contrary to the public interest provision should only be used if the conduct is egregious and a reasonable person in the circumstances would view it to be contrary to the public interest. If the conduct is not egrogious, it should be publicly identified before any enforcement action is taken. The risk that so-called "gotcha" enforcement brings the entire securities enforcement apparatus into disrepute must not be overlooked.*

Enforcement and the "Rules vs. Principles" Debate

7.16 What role does the "principles versus rules" debate have in the ability of regulators to enforce effectively? Does principles based securities regulation give greater latitude to enforcement staff to address conduct which does not violate a specific rule but which cries out for sanction? If so (which would seem intuitive) does such enforcement lead to the system attracting disrepute as unfairly targeting conduct which has not been singled out, in advance, as offensive? One must remember that enforcement, to have credibility, must not merely be visible and forceful but must also be fair to those whose livelihood is under constant jeopardy through the risk of regulatory intervention. The public opprobrium focuses on the former but only infrequently on the latter. Professor Lawrence Cunningham[5] produced for the Task Force a study that looked into these questions and others both on a conceptual level and quantitatively.

7.17 In particular, the Task Force requested that Professor Cunningham look into the following matters:

- An analysis of how the form of securities law standards (including legislative, regulatory and private articulations) influences enforcement effectiveness in a securities law regime. The "form of securities law standards" refers to two classifications: (a) those that articulate broad overarching principles to provide private actors with guidance (called "principles-based") and (b) those that contain highly detailed, specific rules to direct what private actors must do (called "rules-based").

Compliance and Enforcement

7.18 Securities law enforcement is an *ex post facto exercise*. One question in our minds was whether more could be done to encourage compliance with securities laws, and thereby minimize the need for enforcement?

7.19 This question, and others, was posed to Professors Mary Condon and Poonam Puri.[6] The Task Force requested that these academics focus their attention on the following issues:

- The development of "compliance cultures" within market participants in Canada and an investigation of the complementary role of various regulatory entities in that task.
- Identifying and assessing useful regulatory techniques for fostering compliance, including any currently in use in various provincial jurisdictions in Canada. These might include: the development of internal codes of conduct, including methods for fostering internal information flow; external reviews of firm practices and procedures undertaken by self-regulatory organizations ("SROs") or the public regulator; whistle blowing policies and other forms of regulation of management functions.
- International comparative research to uncover compliance-oriented strategies employed by securities regulators in other jurisdictions, such as the United Kingdom and Australia.
- The complementary roles that can be played by SROs and public enforcement in the development of "compliance cultures".

[5]See L. Cunningham, "Principles and Rules in Public and Professional Securities Law Enforcement: A Comparative U.S.-Canada Inquiry" in Volume VI.

[6]See M. Condon & P. Puri, "The Role of Compliance in Securities Regulatory Enforcement" in Volume VI.

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Comparing Enforcement Action in Canada and the United States

7.20 Due to geographic proximity, the level of enforcement activity in Canada is invariably compared to that in the United States. This has been especially so in recent years due to the prevalence and the apparent effectiveness of enforcement actions in the United States. Securities law enforcement in the United States has been highly visible on both sides of the border due to press coverage, due to the size and impact of the market abuses in question, and due perhaps to the search for profile by some involved.

> One would hope that the enforcement of securities regulation in Canada would never be characterized by a search for profile. We have seen no evidence of that to date and applaud securities regulators for refusing to be caught up in a virility competition in the face of much public pressure to emulate activity in the United States. But more can be done without any risk of that outcome.

7.21 The high visibility of securities law enforcement action in the United States has led many Canadian investors (justifiably or not) to conclude that Canadian regulators are failing in this area. There has been great concern expressed in the Canadian press with respect to what is perceived as the tepid reaction of Canadian securities regulators to the vigorous American reaction in cases of alleged securities law violations involving cross-border listed Canadian companies. However, it is important to understand the difficulties in trying to make a useful comparison between the enforcement activities in the two countries. This is not to say that such a comparison has no utility. Rather, the issues central to such a comparison must be understood.

7.22 In this regard, the Task Force commissioned research relating specifically to the appropriate comparisons to be drawn between the enforcement apparatus in the United States and that in Canada. Professor Howell Jackson[7] compared the budgets and staffing levels for securities regulators in the United States and Canada, collected data on enforcement activity in Canada and followed that with a comparison of enforcement activity between the United States and Canada. Professor Jackson's study resulted from the Task Force's request for research regarding the following issues:

- A comparison of United States and Canadian regulatory activity in securities regulation on three dimensions: staffing, regulatory budgets, and enforcement actions, both public and private. These measurements were requested to be as comprehensive as possible, including federal enforcement efforts (as applicable), stock exchange and SRO enforcement efforts, state or provincial enforcement efforts, and judicial actions as well as other forms of dispute resolution such as arbitration.
- To the extent possible, an analysis of the distribution of enforcement actions was requested – for example, distinguishing between enforcement actions that address issuer disclosure as opposed to broker dealer oversight or market regulation.

[7]See H. Jackson, "Regulatory Intensity in the Regulation of Capital Markets: A Preliminary Comparison of Canadian and U.S. Approaches" in Volume VI.

Professor Jackson's Findings

7.23 It is fair to say that there is a general perception that the budgets and staffing levels of Canadian securities regulators are low relative to the United States. Professor Jackson's study indicates that this is not necessarily the case:

> Adjusted for by most measures of economic scale – population, GDP, or market capitalization – Canadian budgets and staffing may actually be somewhat more intensive than those in the United States. The level of Canadian supervisory budgets and staffing do not, however, seem wildly out of line as compared to the United States once one takes into account plausible estimates of economies of scale.
>
> One area in which Canada does differ somewhat from the United States is regulatory budgets per staff member. For the most part, Canadian costs per staff member are lower than their counterparts in the United States. Only costs per personnel in US state agencies seem to be lower than average Canadian costs; costs per staff member at [Regulatory Services] is roughly comparable to costs per staff member at the NYSE. But financial support for staffing among provincial authorities and two major SROs – the [Investment Dealers Association of Canada and the Mutual Fund Dealers Association of Canada] – seem to be lower than what exists in the [United States]. Although data of this sort is difficult to interpret, these differences may speak to the relative quality of – or at least support for – Canadian supervisory personnel.[8]

7.24 Professor Jackson has estimated that the differential between Canadian and U.S. budgets per staff member is as follows, which shows that, on average, U.S. budgets per staff member are over 60 percent higher than in Canada:[9]

Estimated Budget Per Staffing Level

(US Dollars)

	U.S. Cost	Canadian Cost	Differential
U.S. State Agencies versus Canadian Provincial Agencies	$86,789	$123,308	70.38%
Total U.S. Public State Agencies versus Canadian Provincial Agencies	$186,379	$123,308	151.15%
NASD versus IDA & MFDA	$239,035	$111,397	214.58%
NYSE Regulation versus RS	$230,769	$227,313	101.52%
Total US versus Total Canadian	$202,544	$125,054	161.97%

*Based on 5/23/06 Exchange Rate of 1.12211

[8] *Ibid.* at 81.
[9] *Ibid.* at 95.

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7.25 In respect of levels of enforcement activity in Canada compared to the United States, Professor Jackson notes that enforcement activity in Canada has been in the process of dramatic (positive) change in recent years:

> If one focuses on the earliest periods for which I obtained data for each Canadian agency (ranging from 2002 to 2004 depending on the agency), the level of public enforcement activity in Canada was much lower than that in the United States and the differences are so huge that they swamp any possible scaling adjustment. So, it seems that public enforcement activity in Canadian securities markets used to be much less intensive than U.S. enforcement activity.
>
> If one focuses instead on the more recent data, enforcement activity in Canada has jumped up considerably, at both the level of provincial authorities and SROs, particularly if one focuses on monetary sanctions imposed. Comparisons based solely on public enforcement sanctions in these latter periods show Canadian public enforcement activity as roughly comparable to U.S. public enforcement activity, taking into effect plausible scaling factors. (Note, however, that private enforcement is still much lower.)[10]

7.26 However, Professor Jackson notes that comparing Canadian and U.S. enforcement activities is a difficult task:

> If one wanted to ask the question, 'Are Canadian regulatory personnel as efficient in bringing enforcement actions as their U.S. counterparts?', one might focus on the ratio of Canadian budgets and staffing to U.S. budgets and staffing to see whether Canadian regulators achieve the same relative number of enforcement actions and sanctions as their U.S. counterparts. This approach would imply that Canadian officials should be expected to bring one action for every 5 to 9 U.S. actions. On the other hand, if one thought the right question to ask is whether Canadian authorities are bringing as many actions as U.S. regulators per billion dollars of market capitalization or annual turnover, one might focus on those ratios – suggesting that Canadians might only need to impose $1 dollar of sanction for every $11 to $30 dollars imposed in the United States. Or if one thought that enforcement activity enjoys some sort of economies of scale – because, arguably, many potential violators learn from the instigation of a single action – one might think that regulators with smaller markets (like Canada) should bring proportionately more actions than regulators from larger jurisdictions and a ratio of one to eleven or twelve would be too high. Or one might ask the question in terms of listed companies, perhaps the ratio of U.S. to Canadian enforcement actions should be more in the range of about three to one to be roughly equivalent.[11]

7.27 Accordingly, Professor Jackson is of the view that "in the greater scheme of things, what is truly noteworthy is the similarity between the regulatory intensities of securities market oversight between Canada and the United States – not their differences."[12]

[10] *Ibid*. at 83.
[11] *Ibid*. at 115.
[12] *Ibid*. at 98.

7.28 Professor Jackson has compiled the following table summarizing enforcement actions in Canada:

Summary of Canadian Enforcement Actions

	Actions		Monetary Sanctions					
	Number of Enforcement Actions		Annualized Data (US Dollars)		Annualized Last Period (US Dollars)		Annualized First Period (US Dollars)	
Agency	(annualized)	Percentage		Percentage		Percentage		Percentage
Provincial Authorities*	124	59.0%	$219,316,143	89.1%	$9,154,152	14.7%	$5,633,807	27.4%
IDA	56	26.7%	$15,758,916	6.4%	$39,299,983	63.1%	$5,374,490	26.1%
MFDA* **	12	5.7%	$9,357,985	3.8%	$9,357,985	15.0%	$9,357,985	45.4%
Subtotal	68	32.4%	$25,116,900	10.2%	$48,657,967	78.1%	$14,732,925	71.5%
RS	18	8.6%	$1,844,706	0.7%	$4,503,772	7.2%	$225,472	1.1%
Total	**210**	**100.0%**	**$246,277,750**	**100.0%**	**$62,315,892**	**100.0%**	**$20,592,204**	**100.0%**

* Data from 2004 – 2005.

** MFDA data is available for only a single period.

7.29 Professor Jackson draws the following conclusions from the above data:

> If one shifts over to the "last period" and "first period" annualized data on monetary sanctions presented in [above table], some interesting nuances emerge. If one focused only the first period for which data is available – 2002 for IDA data and mid 2004 for provincial authorities – the total level of sanctions imposed in Canada was only a fraction of the average sanction level for the full period, only US$20.6 million in the first period versus nearly US$250 million annualized sanction level for the all periods. In addition, during the first period columns, the total amount of IDA sanctions was roughly equal that of all provincial authorities. So, the preeminence of provincial enforcement actions seen in the overall data does not appear to be present in the first period analysis. Moreover, if one looks to the last period analysis, the relative importance of provincial enforcement actions again drops down and – through this lens at least – the SROs emerge as the dominant forces of regulatory sanctioning in Canada. One should, I think, not be too quick to [leap to a] conclusion that SROs have actually eclipsed provincial authorities as the primary source of capital market oversight in Canada. The misalignment of periods of observation may be skewing this data. The [Canadian Securities Administrators'] data runs into 2005 – when enforcement activity may be dropping off for all authorities – whereas the SRO data – at least for the IDA and RS – ends in 2004, which may be a high-water mark for all agencies. Accordingly, I think the lessons that one can draw from [the above table] are a bit more modest. First and most clearly, there has been a fair amount of volatility in Canadian sanctioning practices in the past few years. Quite clearly, the level of enforcement activity has been on an upward trend. While the very high levels of sanction observed in 2004 dominate the analysis presented in this study, the rate of increase – perhaps a ten fold increase in sanctioning – may not reflect long-term trends.

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> The three fold increase between first period and last period analysis shown in [the above table] (total sanctions of US$62 million as compared with US$20 million) may be more plausible indicators of long term trends.[13]

7.30 Securities law enforcement is not merely in the hands of regulators but also in the hands of private litigants. In the United States, the "partnership" between private sector enforcement and public sector enforcement has been highly visible. Many observers believe that private litigation exceeds the level which is appropriate (hence the *Private Securities Litigation Reform Act of 1995* enacted in the United States). It is early in Canada to have a useful assessment of the enforcement implications of the recently enacted civil liability provisions of securities legislation in some provinces. Nonetheless, with these limitations, the following observations of Professor Jackson have utility:

> So if one accepts, as I think reasonable, that private litigation in Canada is substantially less intensive than in the United States, what are the implications…? Inasmuch as Canadian public enforcement activity has traditionally been lower than U.S. public enforcement, the gap in overall enforcement activity must become larger when one adds in private actions. Moreover, to the extent that recent increases in Canadian public enforcement action is largely based on a relatively small number of cases, the absence of robust private enforcement mechanisms, means that the chances of Canadian issuers being subject to some sort of enforcement action in Canada is even lower than in the United States. Recall that issuers were one area in which provincial authorities appear to be spending less effort than the SEC. So the absence of private enforcement with respect to issuers in Canada may be further evidence that enforcement oversight of Canadian issuers is less stringent than that facing U.S. issuers.[14]

7.31 This being said, Professor Jackson cautions against following the U.S. lead in securities class actions too closely:

> An implication that I would not necessarily draw is to conclude that Canada should necessarily move dramatically towards the U.S. system of class actions, as there are many reasons to believe that [the U.S.] litigation system in this area is inefficient and inequitable. In addition, there is some evidence that much U.S. private class action litigation largely piggy-backs off of public investigations and may in some sense be redundant of public oversight. Accordingly, a possible response to the absence of strong class action traditions in Canada might be the expansion of public enforcement apparatus, especially with respect to issuers, and not the introduction of a new class of judicial proceeding. While there are also those who are critical of the level of individual arbitration rates in the United States, I would be more inclined to investigate this area to ensure that adequate mechanisms exist for redress of individual injuries caused by securities firms or other intermediaries.[15]

[13] *Ibid*. at 111.
[14] *Ibid at 125*.
[15] *Ibid*.

7.32 Professor Jackson's paper ends with a series of policy recommendations which he states are worthy of further study:[16]

> In terms of the overall size of Canada's regulatory apparatus, I do not see strong evidence for suspecting that more personnel is needed. Indeed, by international levels, total Canadian staffing and budgets seems to be on the high end. I do, however, think that some attention might be given to budgetary levels (mostly salaries) for Canadian regulators. My analysis suggests that, at least in the United States, the allocation of budgetary resources to staff are higher.
>
> In terms of sanctioning policy, I think more work needs to be done to understand whether the trends noted in my paper are permanent or temporary. To the extent that Canadian public sanctions – particularly monetary sanctions – fall back to the level suggested in some of my first period analyses, I would be concerned that enforcement oversight would be too lax. While I recognize that I lack strong normative foundations for this claim, I do think that common sense suggests that Canadian sanctioning efforts should not be set at a small fraction of the sanctions imposed in its large neighbor [sic] to the South. If nothing else, such a disparity would encourage fraud to migrate across the 49th parallel.
>
> To the extent that enforcement activity stabilizes at levels suggested by my full period analyses, the policy implications are less clear. My preliminary review of the distribution of Canadian sanctions suggests that a more even distribution of sanctioning – rather than a very few large sanctions – could enhance deterrence. Also, I think more attention should perhaps be given to the oversight of issuers, as that area of enforcement activity seems to be shortchanged in Canada, at least with respect to the United States. Some more careful consideration of supervisory specialization between provincial authorities and SROs may also be useful.
>
> The more difficult issues concern private litigation in Canada. One fairly straight-forward policy recommendation would be for Canadian authorities to do a better job collecting data on private litigation – arbitration, ombudsman actions, and also class action suits. (Though I didn't touch upon the issue in my analysis, I think it would also be useful to have data on enforcement actions – both public and private – against Canadian issuers in other jurisdictions.) If, as I suspect, the data confirms that private enforcement activity in Canada is quite low compared to the United States, the Task Force has several choices: (1) recommending the enhancement of private enforcement (either individual arbitration or judicial class action) to more closely approximate the U.S. model; (2) a recommendation to pump up public enforcement (perhaps with greater reliance on providing private compensation) in order to match U.S. oversight efforts without replicating U.S. litigation; or (3) accepting that Canada will not attempt to replicate the effect of U.S. style private enforcement activity.

[16] *Ibid*. at 127-128. Professor Jackson states that he would not ordinarily conclude a paper of this sort with detailed policy recommendations, as the data are still fragmentary and his study addresses only one facet of regulatory policy. However, as the Task Force requested his views on policy implications, he suggested several issues for further study.

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> Improving the efficacy of criminal prosecution seems also to be an important issue of reform for Canadian securities markets. Again, having access to better data on criminal prosecutions would be useful. And most of what I heard from my interviewees suggested that further improvements at the [Integrated Market Enforcement Teams (IMETS)] is needed, though I also was lead to believe that this process may already be underway.

Improve Securities Law Enforcement, But How?

7.33 It is very simple to say that the enforcement of securities laws in Canada must be improved. The question is how this can be done. We certainly do not possess the silver bullet answer. Indeed, the more time the Task Force spent studying the topic of securities law enforcement, the more we became aware of its seemingly intractable complexities. Faced with these complexities, it became obvious that the only viable path forward would be to recommend measures for incremental change. In that regard, we have been fortunate to have received from The Honourable Peter Cory and Professor Marilyn Pilkington an excellent comprehensive study of the current issues in securities law enforcement in Canada (the "Cory and Pilkington Report").[17]

7.34 The Cory and Pilkington Report contains a series of recommendations to improve securities law enforcement in the areas of: investigation, prosecution, adjudication, penalties, redress for investors, the role of self-regulatory organizations and national management of securities law enforcement activities.

7.35 Apart from a few exceptions, we find ourselves in agreement with the recommendations put forward in the Cory and Pilkington Report. Accordingly, what follows is a summary of the analysis behind those recommendations as well as the recommendations themselves, which relies very heavily on the executive summary and list of recommendations presented in the Cory and Pilkington Report. A detailed consideration of the issues and analysis leading to each recommendation can be found in Volume VI.

Priorities and Performance

- Securities regulators and other enforcement agencies, such as the IMETs established within the Royal Canadian Mounted Police (RCMP), should establish enforcement priorities and a means of evaluating whether those priorities have been met. The performance of securities regulators and other agencies in the area of enforcement should be reviewed by an independent research body.

Recommendation: *The Task Force recommends that a co-operative national program be established and funded by securities regulators, SROs and law enforcement agencies: (1) to establish priorities for enforcement, (2) to develop reporting systems that would provide a basis for assessing the effectiveness of enforcement processes in achieving their objectives, (3) to identify and collect any additional relevant data, and (4) 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.*

[17]Cory & Pilkington, *supra* note 1.

Investigation

- The resources needed for the investigation of possible breaches of securities laws, and the respective contributions to be made by various investigative agencies, should be evaluated.
- Either the mandate of IMETs to investigate capital markets offences should be significantly expanded so that they 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 their current investigations expeditiously.
- IMETs should be structured to appropriately take into account provincial interests to protect investors.
- 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 highly skilled individuals.
- Investigators should have access to legal advice. In order to protect the exercise of independent judgment by prosecutors, the 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.
- It is our observation that securities law enforcement suffers from a lack of centralized control both at the macro and micro levels.[18] At the micro level, a Senior Independent Review Officer ("SIRO") should be appointed for each IMET locale and for each securities 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 to the appropriate prosecution, or to limit, curtail or eventually terminate the investigation. At the macro level, we are very concerned that the fragmentation of securities law enforcement activities across Canada saps the energy of any attempt to prosecute inter-provincial or international offences. In this regard, we also refer to the recommendation below regarding the national management of enforcement activities.

Recommendation: *The Task Force recommends that a study be undertaken to assess the needs for police services in 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.*

[18]This is an observation of the Task Force.

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Recommendation: *The Task Force recommends that a study be undertaken to assess the needs for investigative services by securities regulatory authorities in various jurisdictions, and the capacity to provide those services effectively.*

Recommendation: *The Task Force recommends that if the IMETs are 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: (1) identifying and reviewing the competencies that are required, (2) recruiting officers and other staff with specialized backgrounds, (3) providing professional development and mentoring programs, (4) establishing and complying with policies that restrict secondments of these officers to other duties, and (5) establishing and complying with promotion policies that enable investigators to establish long-term careers in the investigation of capital market crimes.*

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

Recommendation: *The Task Force recommends that 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.*

Recommendation: *The Task Force recommends that IMETs and other police forces 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 issuer. 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.*

Recommendation: *The Task Force recommends that consideration should be given to processes for focusing and expediting investigation, and ensuring quality control and the exercise of good judgment. What is needed, in each IMET locale and each securities regulator, is an experienced lawyer with the seniority, status and confidence to exercise independent and sound judgment, a record of skills in supervision and management, and expertise (or the ability to acquire it expeditiously) in the specialized field of capital markets regulation. The role of this individual, whom we refer to as a "Senior Independent Review Officer", would be to provide focus, supervision and a locus of accountability for strategic decisions in an investigation. He or she should have status similar to that of a Securities Commissioner. Such persons might be found among the senior ranks of counsel in private practice or the prosecution service. In particular, they may be found among individuals recently retired who remain at the peak of performance, and can bring their abilities and experience to bear.*

Recommendation: *The Task Force recommends that investigators 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.*

Recommendation: *The Task Force recommends that every effort be made to enable IMETs to complete current investigations expeditiously and in a focused manner.*

Recommendation: *The Task Force recommends that consideration be given to the accountability structure for IMETs, and the need to develop a national enforcement strategy that takes into account the strategic importance of investigation to the effectiveness of securities regulation in the provinces.*

Recommendation: *The Task Force recommends that in light of concerns expressed about constitutional hurdles to the sharing of information by regulatory investigators and police investigators, protocols be developed to guide those who must determine and substantiate the point at which a regulatory investigation 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.*

Prosecution

- It may be appropriate to authorize counsel employed or retained by the securities regulators to prosecute provincial securities law 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 (akin to an office of "special prosecutor") that has the requisite experience, capability and commitment.

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Recommendation: *The Task Force recommends that the securities regulator's Senior Independent Review Officer, recommended above, should also have independent authority to determine whether a matter should be sent forward for hearing by the securities tribunal.*

Recommendation: *The Task Force recommends that processes should be instituted for identifying priorities in the investigation and prosecution of regulatory matters, and ensuring that enforcement processes are being used effectively in addressing those priorities.*

Recommendation: *The Task Force recommends that the securities regulator's Senior Independent Review Officer, recommended above, should also have independent authority to determine whether a matter should be sent forward for prosecution as a provincial offence.*

Recommendation: *The Task Force recommends that where the Senior Independent Review Officer has authorized prosecution of a provincial offence, it may 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.*

Recommendation: *The Task Force recommends that every effort 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.*

Adjudication

- Québec has taken the lead in separating the investigative and adjudicative functions of securities commissions. Ontario has also begun this process. In provinces where it has not already been done, the adjudicative functions of securities regulators should be transferred to an independent tribunal. Membership in the tribunal should be structured so as to ensure that they possess the requisite expert knowledge of law, procedure and the operation of capital markets.
- The National Judicial Institute (the "NJI") should develop programs to prepare judges to manage the adjudication of complex offences relating to capital markets and to understand the contexts in which they arise.
- We recommend the establishment of a separate capital markets court to which jurisdiction, both provincial and federal, is ceded. Such a court would have jurisdiction with respect to all capital markets regulatory offences and could potentially be granted jurisdiction over civil liability cases arising from capital markets regulatory violations.

- Such a capital markets court would be populated by specially selected judges trained in, and with direct experience in, capital markets issues.
- We are, however, mindful of the more gradual recommendations in the Cory and Pilkington Report in this regard, which stated that every reasonable effort should be made to accomplish the same result within the current court system.

Recommendation: *The Task Force recommends that the adjudicative functions of securities commissions 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. Consideration should be given to the establishment of a national tribunal which could deploy hearing panels throughout the country as needed.*

Recommendation: *The Task Force recommends that the NJI develop programs to prepare judges to manage the adjudication of complex offences relating to capital markets and to understand the contexts in which they arise. The NJI should call upon the Canadian Securities Administrators, SROs, and experienced counsel (for the prosecution and the defence) to participate in these programs.*

Recommendation: *The Task Force recommends the establishment of a separate capital markets court to which jurisdiction, both provincial and federal, is ceded. Such a court would have jurisdiction with respect to all capital markets regulatory offences and could potentially be granted jurisdiction over civil liability cases arising from capital markets regulatory violations.*

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. This, we hasten to say, does not mean that uniform penalties must be uniformly applied. Regional differences must be carefully considered in their fair application.

"So the key point is that, while the application of rules needs to take into account the size and complexity of firms, there is no need for different rules to be applied based on the province or territory of the issuer or investor."

– Remarks by David Dodge, Governor of the Bank of Canada, to the Toronto CFA Society, September 22, 2005.

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- 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 the independent review of costs orders. Costs should be awarded on the basis of the usual principles, rather than requiring full cost recovery.

Recommendation: *The Task Force recommends that legislatures 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.*

Recommendation: *The Task Force recommends that so far as possible, the penalties and orders available for the enforcement of securities laws should be harmonized across the country, yet applied with regional sensitivity.*

Recommendation: *The Task Force recommends that ministries and regulators review and harmonize provisions governing costs in securities matters, and consider adopting best practices of other jurisdictions, which should include: (1) authorizing the regulator to order costs in favour of the respondent in appropriate circumstances; (2) 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; (3) providing for review of costs orders by a person or body independent of the regulator; and (4) 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.*

Redress for Investors

7.36 A constant theme of investors has been the failure of regulators to provide financial redress for investors. Putting a wrongdoer out of the industry is cold comfort to the injured investor. Regulators have been at pains to remind investors that their function has historically been investor protection through regulation and enforcement, not investor redress. This is, to say the least, a difficult proposition – rendered more difficult as the right to seek redress on behalf of investors has been added to the arsenal of some regulators. Clarity of purpose is needed both for regulators and the public. Accordingly:

- 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.
- Consideration should be given to authorizing securities tribunals and courts to order restitution or compensation in appropriate circumstances.

Recommendation: *The Task Force recommends that (1) securities regulators consider utilizing their jurisdiction to apply to courts more frequently for restitution, compensation, and/or damages on behalf of aggrieved persons, (2) regulators and ministries should consider whether any further statutory provisions or regulations are required in order to provide the basis upon which these procedures may be invoked, and (3) regulators should develop practice guidelines to facilitate appropriate use of these procedures.*

Recommendation: *The Task Force recommends that consideration be given to authorizing securities tribunals to order compensation or restitution in appropriate circumstances.*

Recommendation: *The Task Force recommends that consideration be given to (1) authorizing courts adjudicating capital markets offences under provincial or criminal legislation, and in appropriate circumstances, to make orders of restitution and compensation, and (2) establishing rules to ensure the fairness of the process.*

Recommendation: *The Task Force recommends that securities regulators and Ministries monitor developments in class actions for failures of disclosure, with particular attention to concerns about the effective management of class actions.*

Self-Regulatory Organizations

- Any consideration of the adequacy of enforcement in Canada would of course be incomplete without a consideration of the role of SROs in that task. Such a review would need to address not only the effectiveness and fairness with which they perform their enforcement role but also the tools with which they are armed for the performance of that role. As noted in the introduction to this Report, the Task Force deliberately did not engage in a debate as to the SRO function in view of our sponsorship by the IDA, itself the pre-eminent SRO in Canada. However, that potential conflict being clearly disclosed, we endorse the analysis and recommendations put forth in the Cory and Pilkington Report, which are noted below.
- There should be a review of the appropriate roles, jurisdiction and powers of 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 establishing means of reducing legal costs in ombudsman proceedings.

Recommendation: *The Task Force recommends that the appropriate roles and jurisdiction of SROs in the enforcement of standards within the securities industry and the assessment of penalties be reviewed. In particular, consideration should be given to (1) whether SROs are exercising statutory powers of decision in their discipline jurisdiction and are subject to the protections guaranteed by the Charter of Rights and Freedoms, (2) in what circumstances and by what means, SROs should be able to obtain production of documents from, and the attendance as witnesses of, former members and other third parties, (3) the means, if any, by which the decisions of SROs should be enforceable against former members, (4) the circumstances and process by which an SRO could apply to a court for the appointment of a monitor, and (5) the provision of immunity from civil liability for those acting in good faith on behalf of SROs.*

Recommendation: *The Task Force recommends that regulators 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.*

National Management of Enforcement

- Enforcement of securities laws 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.

Recommendation: *The Task Force recommends that regardless of whether 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.*