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January 16, 2012

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West, Box 1903  
Toronto, ON M5H 3S8

Dear Mr. Stevenson,

**Re: OSC Staff Notice 15-704 – Request for Comments on Proposed Enforcement Initiatives.**

As members of the Ontario Securities Commission's Investor Advisory Panel ("IAP"), we enclose in this letter our submission regarding OSC Staff Notice 15-704 – Request for Comments on Proposed Enforcement Initiatives ("Notice").<sup>1</sup> As you are aware, the IAP is an independent body that was appointed by the Ontario Securities Commission in August, 2010. We are charged with representing the views of investors and providing input on the Commission's policy initiatives, including proposed rules and policies, the annual Statement of Priorities, concept papers and other issues. Thus, this submission, like our others, examines the Notice from the perspective of the investor and in particular the retail investor.

**OVERVIEW**

On October 21, 2011, the Commission published for public comment Staff Notice 15-704 which announces proposed changes to enforcement procedures by the Commission. In particular, the Notice introduces: no-enforcement action agreements; a no-contest settlement program; and, changes to the credit for cooperation program, including enhanced public disclosure of credit granted under the program.

Although robust enforcement policies are important to the public's perception of market integrity, we believe that individual investors are primarily concerned with being compensated and secondarily concerned about general deterrence and penalties for securities violations on a broader level. An enforcement program which focuses only on

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<sup>1</sup> We extend our thanks to Chava Schwebel, J.D. student at the Faculty of Law, University of Toronto for her valuable assistance in the research and preparation of this letter.

market integrity without addressing investors' interests in compensation is one-sided, in our view. A robust enforcement program should be based on both preventative and remedial measures. We believe that the Commission could do more in this general area to advance investor interests.

In substantive terms, we believe that some of the proposed measures, such as enhanced credit for cooperation and a whistleblowing policy (if forthcoming), have the potential to benefit Canadian investors in keeping with extra-territorial jurisdictions. However, we have reservations about the proposed no-contest settlement program and the absence of investor compensation measures, in particular.<sup>2</sup> Specifically, the no-contest settlement program undermines civil claims by retail investors for compensation, yet does not provide a substitute mechanism for investor restitution. Furthermore, the absence of a proposed policy regarding restitution stands as a conspicuous gap in the Commission's proposal for reform, in our view.

We believe that the Commission should have the power to order restitution as part of any settlement or enforcement action under its public interest power.<sup>3</sup> The Commission and the Province of Ontario have yet to develop formal mechanisms for investor restitution which do not rely on an application by Staff to provincial courts for their fulfillment. The current law is unsatisfactory because a restitutionary remedy is available only under the quasi-criminal power as opposed to the more-widely used administrative law power. Outside of the quasi-criminal power, the main alternative for investors to be compensated is the civil court system, which is costly, complicated, and lengthy. For seniors, in particular, this is not a viable solution.<sup>4</sup> If regulators proceed with no-fault settlements without a restitutionary remedy available, investors' chances of obtaining restitution will be further eroded.

Moreover, rules and/or guidelines for protecting and encouraging whistleblowers should be developed and issued for comment. A whistleblowing policy would likely enhance enforcement as it would lead to information being revealed to regulators, thereby facilitating regulatory investigations of fraud and misconduct.

Finally, harmonization of enforcement practices across provincial and territorial jurisdictions is also significant: how effective can these measures be if Ontario is the only

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<sup>2</sup> Our concerns are underscored by recent activity in the United States, where the S.E.C. seems to be softening, if not reversing, its position regarding the suitability of no-contest settlement agreements: see e.g., Edward Wyatt, "S.E.C. Changes Policy on Firms? Admission of Guilt," *New York Times* (January 6, 2012). Online: [http://www.nytimes.com/2012/01/07/business/sec-to-change-policy-on-companies-admission-of-guilt.html?\\_r=1&hp](http://www.nytimes.com/2012/01/07/business/sec-to-change-policy-on-companies-admission-of-guilt.html?_r=1&hp).

<sup>3</sup> We note that in the U.S., in certain cases the SEC has the authority to order civil monetary penalties as well as disgorgement of financial gains. These civil penalties are collected by the S.E.C., which administers the "Fair Fund" for the benefit of investors who suffer losses resulting from fraud or other securities violations: see section 308(a) of the Sarbanes-Oxley Act Pub. L. 107-204. 116 Stat. 745. July 30, 2002; and, S.E.C., "2011 Performance and Accountability Report" (2011) 62 (for description of this process).

<sup>4</sup> For example, the Laflamme case took ten years to resolve through the courts: see *Laflamme v. Prudential-Bache Commodities Canada Ltd.*, [2000] 1 S.C.R. 638. Mr. Laflamme started the battle when he was 61 years old and, even though the first judgment was in the plaintiff's favour and he was clearly victimized, he obtained a Supreme Court decision when he was 71. He died at age 74.

jurisdiction that adopts them?

## SUBMISSIONS

According to section 1(1) of the *Securities Act* (Ontario), the explicit purposes of securities regulation are investor protection and the promotion of fair and efficient capital markets.<sup>5</sup> The Notice states somewhat different policy objectives, which are “resolving enforcement matters more quickly and effectively,” and increasing the amount of “protective orders made in the public interest.”<sup>6</sup> The connection between administrative efficiency and the crucial policy goal of investor protection seems strained, especially when we consider that the deterrence value<sup>7</sup> of the proposed enforcement measures is debatable.<sup>8</sup> A key question is whether the expected enhanced efficiency will strengthen enforcement in Canada and thereby benefit investors.<sup>9</sup> A propos of this question, we have the following concerns regarding the Notice.

**Impact on private enforcement mechanisms.** The new no-contest settlement agreements were designed to offset the perceived negative impact of concurrent or potential civil litigation on the Commission’s investigations and settlement procedures.<sup>10</sup> Class action litigation is not only an important deterrent threat to public issuers, but also a primary vehicle for investor compensation.<sup>11</sup> The removal of an explicit requirement for admissions in Commission settlement agreements may make class actions more difficult, potentially undermine the deterrent value of civil litigation, and dilute the reputational costs, i.e., in terms of public censure, which are associated with public admissions of misconduct or violations of securities laws. We fear that the proposed no-contest settlement policy could undermine investors’ interests.<sup>12</sup>

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<sup>5</sup> *Securities Act* (Ontario) R.S.O. 1990, Chapter S.5, s. 1(1) (“Act”).

<sup>6</sup> OSC Staff Notice 15-704 – Request for Comments on Proposed Enforcement Initiatives, 1 (“Notice”).

<sup>7</sup> Cory and Pilkington note that “effective compliance, deterrence and enforcement cannot be achieved if investigation is limited to a small number of cases”: The Hon. Peter de C. Cory, C.C. & Marilyn L. Pilkington, “Critical Issues in Enforcement” (2008) 6 *Canada Steps Up* 165, at 209. Online: Task Force to Modernize Securities Legislation in Canada <http://www.tfmsl.ca> (“Cory & Pilkington”).

<sup>8</sup> See e.g., Douglas M. Worndl and A. Dimitri Lascaris, Siskinds LLP, “Response to Request for Comments on Proposed Enforcement Initiatives” (December 6, 2011) at 8 (commenting on the low deterrence value of the proposed initiatives). We agree with this position.

<sup>9</sup> The Wise Person’s Committee to Review the Structure of Securities Regulation in Canada, “It’s Time” (2003) (“WPC Report”) at 26, 30; Cory & Pilkington *supra* note 7 at 192.

<sup>10</sup> Notice *supra* note 6 at 2.

<sup>11</sup> See Part XXIII.1 (sections 138.1-138.14) of the Act, *supra* note 5; and, generally, Adam C. Pritchard and Janis P. Sarra, “Securities Class Actions Move North: A Doctrinal and Empirical Analysis of Securities Class Actions in Canada” U of Michigan Law & Economics (August 10, 2009) (Olin Working Paper No. 09-009) (“Pritchard & Sarra”). Online: <http://ssrn.com/abstract=1410724>.

<sup>12</sup> Certain judges and policy-makers would agree: see, e.g., Theresa Tedesco, “No contest deals make ‘mockery’ of enforcement,” National Post, (December 20, 2011); and Barbara Shecter, “‘No contest’ settlements to face congressional scrutiny in U.S.,” National Post (December 19, 2011). The authors cite the submission by Michael Watson, former OSC enforcement director, and comments by Judge Jed Rakoff (rejecting the proposed Citibank no-contest settlement agreement negotiated by the SEC) both of whom have spoken out against such a policy: see Michael Watson, “Comment re: OSC Staff Notice 15-704 – Proposed No-Contest Settlements (December 14, 2011). Online: [http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com\\_20111214\\_15-704\\_watsonm.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20111214_15-704_watsonm.pdf); and, *S.E.C. v. Citigroup Global Markets*, No. 11 Civ. 7387 (JSR) (S.D.N.Y. Nov. 28,

**Restitution.** The Notice does not speak to a need for restitution which in our view is the most important issue relating to enforcement from an investor perspective. Restitution is especially significant in light of the potential impairment of securities class actions described above. Although the Commission has the jurisdiction to apply to courts for an order of investor compensation,<sup>13</sup> this jurisdiction is rarely exercised. If the Commission aims to increase the number of settlement agreements and regulatory sanctions, and this aim is to be achieved in part by disabling a valuable tool (namely, a finding of misconduct by regulators) for investor redress through civil litigation, then alternatives for investor compensation must be considered. Perhaps instead of admissions, settlement agreements should require the payment of compensation to investors harmed by the respondent's misconduct.

**Whistleblowing.** Rules which encourage whistleblowing and voluntary information reporting would likely enhance enforcement activity by providing regulators with more information that could facilitate investigations. Such rules would also encourage compliance and deter misconduct by increasing the probability that securities violations will be discovered, which would enhance market integrity. While the Notice mentions whistleblowing, it does not specify when, and in what form, such rules will be introduced.<sup>14</sup> We encourage more specific focus by the Commission on whistleblowing.

**Harmonization of Enforcement Practices.** We believe that the proposed measures will be weakened by the fragmented structure of securities regulation in Canada and the lack of harmonized enforcement practices and priorities among other securities commissions. Given the many organizations involved in capital markets regulation and the multiplicity of channels according to which violations of securities laws can be addressed, we question whether the proposed initiative can do much to enhance enforcement without the participation of other public authorities.

While Staff acknowledge that there are limits to the remedies, protections, and inducements that it can offer under the Notice,<sup>15</sup> these limits are not clearly communicated and will likely affect the overall success of the new measures. In order for these measures to have more impact, we recommend that the Commission work with the CSA to develop nationally-coordinated enforcement policies. We recognize the magnitude of this request but note that absence of universal agreement from provincial and territorial jurisdictions (let alone other bodies that participate in enforcement activities).

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2011). Online: <http://www.nysd.uscourts.gov/cases/show.php?db=special&id=138>.

<sup>13</sup> See s. 128 of the Act, *supra* note 5.

<sup>14</sup> Staff indicate that a whistleblowing program may be introduced in the near future, although the issue presently requires "further study" in light of questions about funding and the possible need for legislative amendments relating to the introduction of such a program: Notice *supra* note 6 at 1.

<sup>15</sup> Notice, *supra* note 6 at 3.

## **CONCLUSION**

Strong enforcement mechanisms can contribute to the strength of our capital markets and as a result can serve to protect investors. For the individual investor, effective enforcement means market participants' compliance with securities laws as well as strong remedies including explicit mechanisms for investor restitution. Although the proposed measures have the potential to advance investors' interests, we are reluctant to endorse them – especially given that the relationship between administrative efficiency and investor protection is somewhat opaque and that restitutionary measures are not included in the reform proposals.

Yours very truly,

The Investor Advisory Panel

Anita Anand, Nancy Averill, Paul Bates, Stan Buell, Lincoln Caylor, Steve Garmaise and Michael Wissell