SIPA
SMALL INVESTOR PROTECTION ASSOCIATION

**A Voice for Small Investors**

November 1, 2011

Office of the Secretary
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**OSC STAFF NOTICE 15-704**
**REQUEST FOR COMMENTS ON PROPOSED ENFORCEMENT INITIATIVES**

http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20111021_15-704_rfc-enforcement-initiatives.htm

The Small Investor Protection Association (SIPA) is pleased to provide comments addressing the OSC's proposed changes to enforcement practices. We commend the OSC for exploring ways to improve investor protection.

Retail Investors are upset with wrist slap penalties and rare jail terms for white collar crimes. According to a 2007 CSA Investor study "Canadians are concerned the "system" takes fraud too lightly. Half disagree that authorities treat fraud as seriously as other crimes, seven-in-ten think people who defraud others tend to get away with it and the same proportion believe those who get caught receive a light sentence at most." . The study found that only 16% of those polled agree that fraudsters 'usually face jail time and/or significant fines' while 12% do not know.

We take this opportunity to remind the OSC that in our submission to the OSC dated February 14, 2010 we stated:
*"SIPA's top priority with regard to investor protection is restitution. The OSC should have its mandate revised, if necessary, so they can provide restitution as other provinces have already done. It should be able to not only order, but also pay the restitution as does the Autorité des marchés financiers in Québec."* When investigations are carried out and rule breaches are found the investigation should be expanded to determine if there are systemic practices and additional victims who may not be aware of these issues. In fact the regulators should contact all clients to alert them to these issues for as long as investors believe they can trust their advisor, it is improbable that they will be in a position to alert the regulators of wrongdoing. Often, initial industry response suggests nothing is wrong and investors are again misled.

We appreciate that concurrent civil litigation could cause respondents to an OSC enforcement proceeding to resist entering into a settlement that requires the target to admit to violations of the securities laws, because respondents are concerned that admissions they make in OSC proceedings (which are public) will be used against them in civil litigation. We also understand that the proposed initiatives would allow more cases to be settled expeditiously. One has to also ask whether implementing these initiatives will effectively stall all efforts to reform the legal system. We certainly hope not.

There is no doubt that enforcement cycle times are excessive. e.g. non-bank ABCP, the mutual fund market timing scandal, Bre-X, Nortel and Livent cases certainly support that statement. The justice system appears broken with clogged courts (and some controversial decisions). So there is some appeal to making selective and judicious compromises to speed things up. However, if market participants don't have to be accountable for their actions and can simply make a problem go away by coughing up money, where's the pain, let alone the deterrence in that? It should be noted that in the U.S., Judge Jed S. Rakoff of the Federal District Court of Manhattan recently suggested that permitting the defendant to neither admit nor deny the misconduct was indefensible. He said "An agency of the United States [the SEC] is saying, in effect, 'Although we claim that these defendants have done terrible things, they refuse to admit it and we do not propose to prove it, but will simply resort to gagging their right to deny it ". We too find the proposal to permit defendants/respondents to neither admit nor deny conduct to be indefensible.

Accordingly, our comments are focused on the **No-contest Settlement Program** initiative. Although recent amendments to the OSC's Rules of Procedure (Rule 12) have eliminated the explicit requirement for admissions in settlement agreements to be presented to a OSC panel for approval, settlement agreements generally include an admission of facts and of non-compliance with Ontario securities law or conduct contrary to the public interest. The proposed initiative would allow cooperative defendants to resolve enforcement matters without admitting facts or to non-compliance with applicable laws/regulations. Such settlements would have to meet the public interest requirements set out in the ***Ontario*** Securities Act and would be limited to respondents not previously subject to enforcement or regulatory activity by the OSC or another agency. While it is necessary to conserve enforcement resources , it is not clear to us whether No-Contest settlements support or degrade the public policy goal of deterrence .This is because OSC staff may impose lesser sanctions than would otherwise be applicable in order to settle cases faster.

Conversely, restitution is the primary goal of victims of financial assault. As a matter of record, the OSC almost never gives to harmed investors the fines and penalties that it extracts from violators of the securities laws. Generally the OSC retains the money, although some may be invested in investor education. Therefore, these enforcement proceedings do not result in direct compensation to injured investors. However, by extracting admissions from defendants, the OSC can

help investors obtain compensation through private litigation, because these admissions can then be used by private litigants to establish the liability of the defendants.

This enforcement initiative raises a number of questions that need to be considered in evaluating whether to adopt a No-Contest Settlement program. These include:

- Should the OSC's investigative and adjudicative powers be separated?
- Does the OSC have adequate enforcement resources?
- What empirical evidence (if any) is there that the availability of no-admission settlements in the United States has sped up enforcement proceedings?
- If the arguments are so persuasive, why isn't this a CSA initiative?
- Could this initiative adversely impact SRO investigations or those of OBSI?
- What oversight will be in place to ensure that sweetheart deals aren't the order of the day? i.e. will extensive publicly available guidelines be available so investors can gauge the magnitude of tradeoffs made by "No contest" settlements?
- What are the possible abuses /misuses by OSC staff in such a system?
- Is the initiative constitutional?
- How will this initiative impact class action proceedings?
- How will this initiative change OSC enforcement staff behaviour and compensation/incentives?
- Is this initiative compatible with civil rights? e.g. right to a trial
- What provision will be made for investor restitution?
- Why should defendants not have to admit culpability? This seems to be contrary to natural justice.
- Does signing a "No Contest" agreement mean that the person(s) need not disclose the result on a Personal Information Form?
- Does signing a "No Contest" agreement mean that the person(s) cannot act as Director(s) of publicly traded firms?
- Will the OSC allow defendants who settle to publicly deny the accusations?- Permitting such denial to be made would allow respondents to engage in public relations campaigns to contend that they had settled only to avoid protracted litigation.
- Does the OSC have clear guidelines as to how fines and penalties are to be deployed? e.g. In the BMO NB FMF Trust case, the OSC collected $3.3 million which to this date remains undeployed. Ditto for the non-bank ABCP fine of $21.7 million levied upon CIBC World Markets. At the time, regulators said they will determine "a fair and appropriate use" for the funds based on "applicable laws, court orders, and the public interest."
- If introduced only in Ontario, could regulatory arbitrage come into play?
- Is there a need to rationalize enforcement priorities across Canada as was recommended by the Wise Persons Committee?

SIPA assume "No Contest" settlements would be used with great discretion. Otherwise, the initiative could subvert the civil litigation alternatives to restitution for victims of Ontario Securities Act breaches.

SIPA note that the OSC staff has been examining the prospect of introducing a new whistle blower program, under which financial compensation and/or protection from retaliation would be provided to persons who provide the OSC with information about misconduct in the marketplace. We agree that such a program would represent a valuable source of information to support enforcement activity. We understand that there are questions as to the funding of such a program and the possible need for legislative amendments but feel that such an initiative would be in the public interest and should be accelerated.

SIPA note that for settlements (whether a traditional settlement or proposed No-Contest Settlement), OSC staff intends to ensure that the settlement agreement, and perhaps a related news release, refer to the credit that was granted to the respondent in exchange for their cooperation. We assume this means full disclosure of the credit details.

We agree the public interest demands timely disclosure of these No Enforcement Action Agreements and No-Contest Settlement Agreements. We also believe there needs to be some oversight and review by the Commission of what OSC staff is doing/proposing to do similar to what now happens with Settlement Agreements. This involves giving at least seven days public notice that a hearing will be held to consider the settlement agreement and setting out the particulars of the matter.

Agreements entered into behind closed doors are reminiscent of Star Chamber proceedings. The current Settlement Agreement process would have to be adapted to provide public notice of the No Enforcement Action Agreement and No-Contest Settlement Agreements and while a full-fledged hearing may not be appropriate, some involvement/oversight by the Commission should be built in. This involvement should not be just a "rubber stamp"

We think it essential that timely public disclosure of what is proposed to be done be given in advance of the implementation of any No-Action Agreement or No-Contest Settlement Agreement and Commission oversight and involvement be built into the respective programs in conjunction with adopting the proposed enforcement initiatives.

SIPA strongly believe in measurement. It remains to be seen whether the initiatives will "contribute to a higher volume of protective orders made in the public interest, at the earliest opportunity, for the benefit of investors and the capital markets". How does OSC staff intend to measure this and report on it? Should the initiatives contain a sunset clause in the event they fail to meet objectives?

The bottom line is that SIPA are constructively critical whether these initiatives will make capital markets safer for small investors by increased deterrence or make it

easier to obtain restitution for investors. It may well be that this practice will lead to faster settlements, but the question we ask is: so what? If the settlement accomplishes little to nothing for retail investors, we fail to see how it improves investor protection.

Further, SIPA believes that independent of this initiative, the OSC should address the clarity of its rules and regulations. A lack of clarity has sometimes given rise to extended, costly and unsuccessful court cases. In particular , we believe a more prescriptive and principled set of rules regarding timely disclosure (utilizing lessons learned from cases like Danier Leather, ATI and Coventree ) , corporate governance ( risk management)/ Director eligibility and issues surrounding entities like Sino-Forest whose businesses are offshore could **prevent** a lot of cases.

Do not hesitate to contact us should there be any questions about our submission.

We consent to the public posting of this Comment letter.

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